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The World Bank's Borrowing Program: Some Questions and Answers

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Introduction

*In the fiscal year ending June 30, 1979, the World Bank entered into new loan commitments aggregating $7,000 million, and disbursed $3,600 million during the year on ongoing projects. Its outstanding and disbursed loans to developing countries stood at $23,000 million, and it had made commitments pending disbursements of another $22,000 million as of June 30, 1979. Its lending program and disbursements on loans are expected to increase further in the 1980s. In order to finance that lending program, the World Bank borrows in a variety of currencies and capital markets throughout the world and from its member governments. In virtually all of the capital markets in which it borrows, the World Bank is the largest single nonresident issuer of debt obligations. The purpose of the Questions and Answers that follow, which are in the form of an informal interview, is to provide information to the financial community and to investors concerning the Bank's borrowing program, its related policies and procedures, and its financial structure.**

* The data and comments herein refer only to the International Bank for Reconstruction and Development (the Bank) and not to its affiliate, the International Development Association (IDA), a separate legal and financial entity whose funds, unlike those of the Bank, are derived primarily from direct grants or replenishments from governments on a three-year cycle, and not from market borrowings. IDA resources are lent at concessionary terms for high priority economic projects in countries that do not meet the Bank's standards for creditworthiness on the financial terms and conditions then prevailing for a Bank loan.

The World Bank's Borrowing Program: Some Questions and Answers

How large is the World Bank's annual borrowing program? What is the Bank's outstanding debt, and what does that debt cost? How much do you expect to borrow in the future?

In the fiscal year ended June 30, 1979, the Bank borrowed almost $5,100 million equivalent, of which $1,300 million refinanced maturing obligations, and $3,800 million represented new funds. It completed that program at a cost of 6.54 percent and with an average maturity of over nine years. Over the last two fiscal years, the Bank borrowed almost $9,000 million equivalent at a cost of about 6.69 percent.

The Bank's outstanding debt of $26,300 million equivalent is constituted in 381 different issues, and is denominated in 16 different currencies. At June 30, 1979, the Bank's outstanding debt cost 7.17 percent. It was composed of US dollars (37 percent); Deutsche mark (27 percent); Swiss francs (17 percent); and yen (13 percent). The remaining 6 percent was denominated in 12 other currencies.

The Bank expects to borrow over $5,000 million equivalent in fiscal 1980; about one-third of its borrowing program will be used to refinance maturing issues, most of which are held by member governments or central banks. As for the future, the amount we borrow depends on how much we lend, and more specifically, on the rate of disbursement from past and future loans. Based on the increased lending capacity that would be permitted by the doubling of the Bank's capital from $40,000 million to $80,000 million equivalent (which is now under consideration by the Bank's member governments), and the needs and absorptive capacity of creditworthy countries, we expect to increase our gross borrowings by about $1,000 million equivalent a year into the mid-1980s.

I might note that since its inception in 1947, and through the 1950s, the Bank raised most of its funds in the United States, the only major market then available. In the late 1960s and 1970s, however, the Bank pressed to develop markets for its securities outside the United States—both with traditional private institutional markets and with governments or central banks.

As a result, in the last decade, Germany, Switzerland, Japan, and some OPEC countries have become important sources of funds for the Bank. I would assume that our future borrowings would be concentrated in these same countries. The amounts we borrow in each country or currency will depend on interest rates, exchange risks, and the availability of medium-term and long-term funds. These matters, in turn, reflect underlying domestic economic policy, perceived inflation rates, domestic savings rates, and, of course, the capacity of particular countries to export capital by opening up their markets to the Bank.

To what extent does the World Bank borrow from governments or central banks, as distinguished from borrowing in the private markets?

There are two major sources for World Bank borrowings. First, placements are made directly by the Bank with its member governments, their monetary agencies, or central banks. This category includes governments or central banks in about 90 countries. Second, we place our obligations with or through investment banking firms, merchant banks, or commercial banks that act both as financial intermediaries with private institutional and individual investors, and as direct purchasers of our obligations. As might be expected, some placements are also made by private financial intermediaries —our underwriters—with governments or central banks, but we have little data on the extent of such placements.

In the first category, at June 30, 1979, the equivalent of $8,000 million—about 30 percent of our outstanding debt—had been placed directly by the Bank with "official" sources at an average life of 3¾ years. One has to bear in mind, however, that most of this "official" debt, although of a nominal, relatively short-term maturity, has been consistently refinanced at maturity. The fact is that we expect these somewhat shorter-term funds from our member governments to remain as permanent resources, albeit with periodic interest rate adjustments. One of the largest sources of "official" funds is the Bank's two-year issue that is offered to central banks and official institutions. These have been offered twice a year for over 20 years. In the 1950s, the issues were for $50 million each; in recent years, the offerings have been for $350 million and are typically oversubscribed. Currently, $1,350 million is outstanding on this particular series.

In addition, the Deutsche Bundesbank, a consistent lender to the Bank since the late 1950s, holds $1,300 million equivalent of

World Bank Deutsche mark obligations with a fixed maturity of five years. The Bank of Japan, a lender since 1970, holds approximately $1,600 million equivalent of World Bank yen obligations, having a final maturity of 6½ years. We have also made direct placements (in addition to their holdings of our two-year bonds) with the Saudi Arabian Monetary Agency ($1,400 million equivalent), the Central Bank of Libya ($400 million equivalent), the monetary authorities of Venezuela ($500 million equivalent), Iran ($350 million), Nigeria ($240 million), Yugoslavia ($140 million), and lesser amounts in Australia, Italy, Switzerland, Oman, Abu Dhabi, and Trinidad and Tobago. These "official" borrowings provide a base for our borrowing program in that they allow the Bank to finance a reasonable portion of its lending to developing countries from borrowings from our member countries. For some of these obligations, particularly the two-year US dollar issues, bond prices are quoted daily in public financial media, and there is a reasonably active secondary market. We are currently developing methods to provide some market liquidity for future private placements with our member governments.

In the second category—the private investment market—the Bank had placed outstanding debt as of June 30, 1979 of some $18,000 million equivalent at an average life of seven years. These obligations were underwritten by the investment banking community or placed directly with individual and institutional investors in the private market. Some of these obligations are held by a few institutional investors. In most cases, however, there is an active trading market in listed or unlisted markets throughout the world. In the United States alone, secondary market trading in outstanding World Bank issues exceeds $4,000 million yearly. Such obligations, as one might expect, are quite widely held throughout the world by banks, insurance companies, pension funds, retirement systems, public institutions, individuals, trustees, and a wide variety of financial intermediaries and institutional and individual investors. The maturity of our publicly held debt ranges from five years to 25 years. The table that follows shows our outstanding debt, by sources of funds. It does not, however, adjust for debt sold through, say, syndicates composed solely of US or German underwriters that may be placed, in part, outside the "country of origin" of the issue.

The World Bank conducts annually about 40 different borrowing operations, most of which are in four or five different currencies. The reason for diversification of currency, maturity, country of issue, and source of funds is simply to give the Bank flexibility in its borrowing program. The diversification permits us to forego borrowing in any particular market during periods of weak domestic savings rates, excessively high interest rates, or balance of payments

BORROWINGS BY PRINCIPAL SOURCE

Country	*Percentage*	*Amount (US$ millions)*
Germany	25.41	6,678.9
United States	21.68	5,696.8
Switzerland	15.53	4,082.1
OPEC members	15.38	4,043.0
Japan	13.49	3,544.2
Others	8.51	2,235.5
Total	100.00	26,280.5

constraints that might restrict our access to a particular market for a period of time. In short, we do not wish to be in a position of relying on one or any particular market for the resources needed to support our lending program.

How does the Bank decide which currencies to borrow, and what consideration does it give to matters relating to potential exchange risk?

Basically, amongst the currencies available to us, we seek the longest maturities at the lowest interest rates in those currencies that are projected to be at the lowest long-term overall cost, i.e., after considering the potential exchange rate risk. Although the exchange risk is passed on to World Bank borrowers and is not assumed by the Bank (the Bank relends the currencies it borrows), we make decisions in choosing amongst currencies to borrow as if the Bank did, in fact, take the exchange risk. Currency risks cannot be avoided. Indeed, even a dollar borrowing by a fully dollar-based institution (which we are not) involves a "risk" because of the potential opportunity loss from foregoing borrowing another currency that might devalue against the dollar and thereby reduce the real repayment obligation.

We have recently borrowed primarily Swiss francs, Japanese yen, and Deutsche mark. Given the rather low nominal interest rates in the spring of 1979, we believed there were better borrowing opportunities in those currencies after considering their appreciation potential. The fact is, at times we would rather borrow Swiss francs at 4 percent than US dollars at 10 percent. Stated another way, we believed the Bank, as a cooperative institution, might be better

served by having liabilities at 4 percent rather than at 10 percent. A nominal interest rate differential of 6 percent over 15 years, we believed, was greater than the revaluation potential, say, of the Swiss franc against the dollar. Perhaps we will turn out to be wrong. We have made mistakes, and will make them in the future; in 15 years, we will know whether our Swiss franc, yen, and Deutsche mark borrowings were a mistake. But it should be stressed that our decisions are not made either arbitrarily or randomly.

As for the future, as interest rate differentials change amongst currencies, so will our mix of borrowed currencies change also. The problem, of course, can become quite complex. It may be that the projected short-term currency appreciation of a particular currency, say, over one year, might, at least in our analysis, exceed the current long-term interest rate differential between two currencies. In that case, we would consider the *prospective* availability and nominal costs of each and the long-term exchange rate risk before deciding whether to borrow and disburse one currency rather than another.

The World Bank, unlike most commercial banks, has virtually no short-term resources, i.e., deposits or other short-maturity liabilities. Why does the Bank have a policy of maintaining medium-term to long-term maturities on the liability side of its balance sheet?

The lending operations of the World Bank are quite different from those of commercial banks. Much of the Bank's lending is for infrastructure projects. The typical terms involve a repayment obligation, with a four-year grace period and a final maturity of about 17 years. The interest rate is fixed at the time of loan commitment for the entire life of the loan, and disbursements are made over a five-to-seven year period. The average life of the Bank's outstanding and disbursed loans is about 10 years. Since these loan assets are at fixed rates of interest, we do not believe it would be prudent to finance ourselves with short-term resources such as deposits or short-term paper. That could involve, in our view, both an imprudent interest rate risk as well as an excessive maturity intermediation risk. We would not be particularly comfortable in refinancing six-month paper, at a variable cost, 30 times in order to finance a 15-year fixed rate loan. We could, of course, lend at a variable interest rate as in the Eurocredit markets, but, considering the type of loans we make and the purpose for which they are made, we believe that a more stable and certain cost to our borrowers may be both more appropriate and in their interest. Com-

mercial banks, for a variety of reasons, finance their loans in short-term markets, in part because of the variable interest rate applicable to their outstanding loans.

Are the funds that the Bank borrows earmarked to a particular loan or project, or to a particular developing country?

No. The Bank does not disburse funds at the time of commitment of a loan. That is one of the strengths of the Bank. Disbursements are made over a period of time in payment for goods and services pertinent to the project. The Bank reviews the invoices and directly pays the supplier on receipt of appropriate documentation. It is expected that the typical loan for a project will take five to seven years to disburse. The contracts for these goods and services are, for the most part, granted through international competitive bidding that is supervised by the Bank. Our borrowed funds are converted, for the account of our borrowers, to pay for the invoiced goods and services. The borrower from the Bank does not know at the time it enters into a loan agreement with the Bank which currencies will be used to pay for the goods and services it will require. The resources we borrow become part of our liquid holdings for use in our general operations and are not earmarked or designated or restricted in any way to any particular project or loan or borrower. Funds from a variety of sources are invested pending their disbursement on loans (currently about $4,000 million a year on over 750 loans) and payment of the debt-servicing obligations on our outstanding debt. Clearly, there is no way to identify in a 40-currency cash flow from a variety of sources (paid-in capital, retained earnings, loan repayments, interest payments, borrowed funds), which funds are being used to finance any particular project.

How does the Bank select its managers and its underwriters for its public issues throughout the world?

The important factors are trust and expertise. We do not choose underwriters on the basis of their "prestige" or for political or social reasons. We are not particularly attracted to underwriters that appear more preoccupied with the order of their name on the prospectus than with understanding the financial structure of the Bank or finding bona fide customers for our securities.

Most of the time, we expect our bankers to *place* our bonds; on a few occasions, they *take* our obligations—the distinction is an

important one. Generally, we do not expect or wish investment banker-underwriters to take or hold our securities. Indeed, we do not expect commercial banks that underwrite our securities to hold them in their portfolio. If we did, we would have made a bank loan or a restricted placement with them, not a public bond or note issue. We are not comfortable with firms that tell us that if the bonds or notes are not sold, they will "put them away" in their own portfolios or in discretionary accounts. We select underwriters that can give us advice, and that feel an obligation to us and to their own customers. We do business with underwriters that advise us when we should *not* come to the market. We do not like issues in which the ultimate customer is not satisfied with the fairness of the price, and we are not comfortable with firms that either do not know the market or seek to be excessively competitive in order to attract our attention or favor. Over the long run, that is no way for an issuer to do business; sooner or later, the confidence that investors have in the issuer's integrity and fairness would surely be inhibited.

There are three parties to every transaction: the issuer, the financial intermediary, and the ultimate buyer. We do not consider it in the best interest of the issuer to be unconcerned with the best interests of the ultimate buyer. Nor do we believe that investment bankers and issuers must be adversaries. It is not in our interest to seek or achieve better terms than we deserve at the expense of our underwriters or the public market. There is no room for game playing, and the managers and underwriters with whom we deal understand that.

What is the Bank's general policy on negotiating the terms and conditions of its bonds and note issues?

World Bank bonds are rated Triple A, or its equivalent, throughout the world. Its securities are priced within the range of securities of strong government obligations and their instrumentalities. There are, however, some variations that are explained by peculiarities inherent to the market in which the securities are offered, but these are usually predictable and well known, reflecting, say, either the absence of a withholding tax or the extent of nonresident demand for a particular currency. We obviously follow the market quite closely—particularly at the time of pricing an issue. So do our underwriters.

There is really only *one* market, and that is the one that is fair to the Bank, the bond buyer, and the underwriters. Indeed, we

have refused transactions and quite favorable ones—because we believed that the managers either incorrectly assessed the market, or were simply taking on too much risk. As indicated before, we are a constant borrower in the market; that is, we will come back when conditions are right, so all parties involved—our investors, our underwriters, and ourselves—must have confidence in each other.

I do not mean to say that we will always accept what is offered. Not at all. We just don't bargain. If the initial offer is more than we wish to pay, we simply refuse the transaction. We are not comfortable doing business with or through bankers that lack expertise as to what we require, what the market requires, or that seek some "negotiating room" for anticipated bargaining sessions. Sometimes, what we require or wish to pay, and what the market demands are quite different. That is no cause for any great trauma. We respect our underwriters and do not seek to bridge that gap through bargaining sessions. We will simply come back some other day, or month, or year and do the transaction at that time.

After many years' experience, it is quite rare for the Bank to enter negotiating sessions and not know within two or three basis points exactly what the market demands and precisely the price that will be offered by our investment bankers. There is no room for surprises on anyone's part. Indeed, over the years, trust and confidence have developed to the point where, with increasing frequency, we advise underwriters that we will accept the price that they offer because we know, and they know, they will offer us the best possible price. I am convinced that our underwriters throughout the world, if anything, are particularly cautious to satisfy themselves that they are offering us terms that are fair. They know, too, that if they were to abuse our confidence in them, we would know of it quite quickly and, of course, could not do business with them again.

In earlier years, I remember telling underwriters that we do not negotiate bond issues, that we would accept only one price and would not come back with a counter offer. Initially, it took some time for some of them to accept the concept of a "one-price" negotiating session, but I think they are now reasonably comfortable with the way we negotiate issues. We do not threaten our managers with price competition from other firms. In turn, they have good reason simply to offer us terms that are fair to us and to the market place. They also know that the subsequent market performance of our issue will provide the best yardstick to measure the accuracy of their market assessment and our satisfaction with their advice and service.

Why hasn't the Bank ever done a dollar Eurobond issue?

First, in a very real sense, the Bank does borrow in the "Euro" markets. Our public issues and private placements are sold throughout the world to nonresidents of the country of issue. We just do not use international *syndicates*. We have not done so for several reasons, though, of course, we have great respect for the integrity and expertise of the participants in that market. Indeed, we use many of them as underwriters or bankers for our borrowing operations, and we maintain excellent relationships with them.

Our problem with dollar-denominated Eurobond issues sold through an international syndicate is rather straightforward. We do not like issues that are not priced at the market. We do not feel at ease pricing issues in which there are variable discounts from the issue price given to some customers and not to others. We are not sure that it serves the interest of the issuer, the underwriters, or the public if the bonds are not placed, but rather, are held in the syndicate for a time, or until the "cost of carry" is too burdensome. There also seems to be some lack of mutual openness between the issuers and managers, between the managers and the underwriters, between the underwriters and the selling group, and between the customers and their underwriter bankers. Or, so I am told. We find it difficult to evaluate a market in which the financial intermediaries, depending on market conditions, ask for amounts manyfold in excess of what they can place, and where lead managers are pressured by both issuers and customers to offer unrealistic terms.

Perhaps these matters should not trouble us, but considering the fact that our US dollar issues trade about $4,000 million a year in the US secondary market, we are somewhat concerned that a substantial portion of, let us say, an "inadequately" priced issue might be sold quite quickly into that up-to-now very efficient US domestic secondary market. Perhaps if issues were priced at market, and more discipline maintained within syndicates, then it might be an attractive vehicle for us. But until that develops, I am afraid the market poses too many risks for us. I suppose I am naive. Indeed, I know, for example, there is rebating of commissions in our other currency issues, but, in these, at least pricing "mistakes" cannot be unwound in another market.

Finally, if I might be permitted a personal comment, I must confess to some concern when a major preoccupation—alas, it's almost all-consuming—of many investment banking firms appears to be their place on the tombstone advertisement. But, despite everything I have said, I suspect that some day, not too distant, we

will choose a fine manager—I mean managing group—and enter the market.

Why does the Bank, for rather prolonged periods, stay out of certain markets? Why, for instance, has the Bank not borrowed in the United States for over two years?

Choices have to be made. We have not borrowed recently in the United States because we believed there were alternative sources of funds that were likely to be less costly. I have described the process in an earlier answer. We did not wish to borrow US dollars at 10 percent in the context of other alternatives. From time to time, of course, we may not be able to borrow in a particular market simply because the market is closed—either because of inadequate capital formation or savings rates or, more often, because temporary balance of payments difficulties limit our access to capital. For the most part, the concentration of our borrowings in particular countries or currencies, and conversely, an absence from other markets, sometimes for prolonged periods, can be attributed to balance of payment surpluses or deficits. As one might appreciate, developed economies with surpluses in their balance of payments usually have a whole set of attractive economic conditions that make borrowing less costly. Typically, they have a fairly low inflation rate that normally entails a low interest rate structure. The external demand for their currencies is strong as nonresident investors seek a real rate of return for their investments. The country usually enjoys an adequate level of reserves that reflects their export potential. Countries in surplus also usually have a consumer sector with a high propensity to save or are blessed with raw materials, or commodities, or finished goods in demand by the rest of the world. Conversely, when countries have balance of payments problems and high inflation rates and interest rates, they are not likely markets for external borrowers or investors.

However, as governments take steps to correct such conditions, the worldwide balance of money and goods and services begins to shift, and the imbalances are redressed. We do our best to follow these shifts and tap the resources that are available from time to time in countries that can afford to export capital. The process necessarily involves projecting when and where the shifts will occur, as well as choosing amongst current alternative sources of funds at any given time. The most difficult problem is to assess a relatively favorable nominal interest rate against the short-term and long-term exchange rate risk *and* to assess the consequences of waiting.

But as I mentioned earlier, that assessment must be made. It often involves an assessment of the social, political, and psychological environment envisioned for the future and our access to a particular market, as much as a straightforward break-even analysis of projected interest and exchange rates.

How does the Bank monitor the various capital markets, and what is the procedure within the Bank for consideration and approval of borrowing operations?

The Treasurer's Department of the Bank examines the major and ancillary capital markets in which it might borrow by keeping informed of the interest rate structure, monetary policy, balance of payments developments, etc. It maintains almost daily contacts by telephone or telex with the Bank's principal underwriters in several countries. In short, the Bank has a rather continuous flow of financial information relating to alternative market prospects. Underwriters and bankers make offers or proposals to the Bank. The Bank itself seeks out borrowing opportunities. The time frame to conclude an operation from its initiation to its conclusion may vary from as short a period as a week to as long as two months, depending on the complexity of the operation and the lead time needed for advance notice before entering a particular market.

About 40 operations in various currencies are executed each year. The initiation, documentation, and negotiation are handled by four or five Bank staff members. The Bank's President, Robert McNamara, and its Vice President, Finance, Moeen Qureshi, are often intimately involved in detailed evaluation of each recommended operation. There is no such thing as a routine operation. The President of the Bank forwards and recommends each operation to the Bank's Board of Executive Directors which must specifically approve each borrowing operation before it is done. Indeed, at the beginning of each fiscal year, the Board of Executive Directors of the Bank considers and reviews the recommendation of the Bank's President as to the size of the annual borrowing program. At Board meetings considering each proposed borrowing, pointed and detailed questions are usually put by the Bank's Directors (who represent the Bank's member governments) concerning the proposed operation, including such matters as underwriters' fees, investment of proceeds of the issue, implicit currency risks versus nominal interest rates, sinking fund premiums, timing of the operation, alternative borrowing proposals, prospects for interest rates,

maturity structure of the Bank's outstanding debt, and related issues. The President of the Bank chairs these meetings and recommends the approval of the operation to the Board.

How is the World Bank's lending rate—that is, the rate that it charges developing countries for loans it makes to them—linked to its borrowing costs?

The Bank seeks to achieve an income target consistent with a prudent accumulation of earnings and reserves. To that end, it makes new loans at a fixed interest rate that includes a positive spread over its recent and projected borrowing costs.

The Bank's liquidity (its short-term cash assets) now approximate $10,000 million equivalent. Why does the Bank hold such a large amount of liquid assets? Where does it come from? What currencies are held?

The Bank's liquidity is designed to permit the Bank to maintain flexibility in its borrowing program. To some extent, it allows the Bank to meet future demands and to continue its projected loan commitment program without tapping capital markets. Thus, if interest rates are very high for the maturities that are sought, or if capital is not available, the Bank has the flexibility to stay out of the market. This flexibility enables the Bank to decide where, how much, at what cost, and on what terms to maturity it will borrow, rather than put itself at the risk of adverse capital market conditions or have to cut immediately its lending program. The World Bank's liquidity currently represents about 38 percent of the World Bank's outstanding debt and is currently equal to about 50 percent of its cumulative gross borrowing program for the next three fiscal years.

The currency composition of these short-term assets is $7,200 million in US dollars and $2,600 million equivalent in other currencies—primarily Canadian dollars, Deutsche mark, French francs, Italian lire, Japanese yen, Netherlands guilders, and Pounds sterling. These short-term assets are fully invested, liquid, convertible, and marketable. They are readily available to meet the Bank's cash requirements, i.e., the servicing of the Bank's debt and the disbursements on loans, that represent the principal demand on the Bank's resources. The investments are limited to obligations of

governments or their agencies and to deposits or other unconditional obligations of commercial banks and other financial intermediaries.

The World Bank does not speculate in currencies. It takes no currency risk in managing its liquid assets. The liquid assets are derived from our overall cash flow and are exactly matched by corresponding liabilities in that currency. Thus, the Bank borrows, say, Deutsche mark, invests the proceeds in Deutsche mark, lends Deutsche mark, and is repaid interest and principal in Deutsche mark from its borrowers, which are then used to extinguish the Bank's liabilities in Deutsche mark. No conversion of Deutsche mark for the account of the Bank is permitted at any stage in the process.

In the last five years, the Bank has shown a positive return on its liquid assets, as compared with its marginal cost of borrowing. There are four reasons why the Bank has been able to earn a positive return on its liquid assets over its marginal borrowing costs. First, for rather frequent periods in the last five years, short-term yields have been higher than the cost of medium-term and long-term borrowing. Second, the overall size of the Bank's liquidity permits us to forego borrowing in very high-cost markets, thus, in effect, allowing us to hold currencies previously borrowed, sometimes at relatively high interest rates, without the necessity of having to refinance in that currency. Third, the liquidity is quite actively and, I believe, rather well managed so as to secure the highest financial rate of return in a particular currency. It is not passively invested and held to maturity. Fourth, the Bank, within limits, can maintain the currency composition of its liquid cash portfolio in those currencies that have a high financial short-term rate of return. But it should be emphasized that the main purpose of liquidity is to give us flexibility as to when, where, and how much we borrow to meet our obligations to our borrowers and to the holders of our debt. The fact that it may also be profitable is an incidental by-product.

What are the protections offered to a World Bank bondholder?

It is difficult to set forth in a concise manner the mix of factors that accounts for the Bank's standing in world capital markets. But there are several important points relating to the way it conducts its business and to the more formal protections offered to bondholders.

The Bank has never suffered a loss on its loans to developing countries. It has a firm policy against debt rescheduling; countries have consistently met their financial obligations to the Bank. It does not lend to countries that are not deemed creditworthy for a loan; substantial time and effort are spent evaluating the foreign exchange requirements and the future prospects of our prospective borrowers. It lends for projects of high economic priority after careful appraisal of the economic and financial returns of the project. The Bank does not write "blank checks." That is why it takes five to seven years to disburse fully a loan. It supervises the project during its implementation and evaluates its productivity thereafter on a regular basis.

The Bank is profitable. Its profits are increasing. The return on its assets is now about 7.8 percent, and the cost of total funds (debt plus equity) is less than 6 percent. During fiscal year 1979, it earned $407 million net profit, compared with $238 million in fiscal year 1978. In the fiscal year beginning July 1, 1979, profits are expected to increase further. The Bank maintains a positive interest rate spread on its new loans over its marginal cost of borrowing. In addition, it has a good base of $6,600 million of equity ($3,700 million paid-in capital from member governments received over the last 30 years and $2,900 million of reserves), which facilitates its capacity to add to its reserves without having the full cost of the Bank's operations borne by the lending rate charged developing countries.

Its debt is relatively long term, consistent with its lending, and as noted earlier, sources of borrowing are diversified by currency, country, and maturity.

The Bank's liquidity is almost equal to 70 percent of its debt due to the public over the next 10 years, and it now constitutes about half of its entire outstanding public debt, even inclusive of debt maturing in 20 years. As a result, the Bank can be reasonably selective in determining when and how much to borrow during periods of difficult markets.

The Bank's capital consists not only of the paid-in portion (which is used in its operations, and facilitates the earning capacity of the Bank), but also includes "callable" capital, which is available *only* to meet the Bank's obligations to its bondholders. Unlike the Bank's paid-in capital, the callable capital may never be called for use in the Bank's operations—either for lending or to meet administrative expenses. That capital has never been called. We do not expect that it would ever need to be called, given our liquidity, earnings capacity, diversity of borrowings, and experience with our outstanding loans. At June 30, 1979, the Bank's callable capital from its member governments amounted to $33,700 million, which,

in effect, provides a guarantee for its bondholders. And it is for the protection of bondholders that the callable capital was designed. Currently, the Bank's member governments are considering a further increase of $40,000 million equivalent in capital—the great part of which would be callable—but which must be subscribed if the Bank is to continue to expand its lending program.

In that connection, the World Bank's outstanding and disbursed loans, under its Articles of Agreement, may not exceed its capital (callable and paid-in) and reserves. That 1:1 ratio is quite conservative as it limits the Bank's outstanding and disbursed loans to the capital commitment of its member governments plus the Bank's accumulated retained earnings. As such, the "callable" capital provides a ceiling on how much the Bank can *lend;* the Bank then finances the loans it makes, for the most part, by borrowings in the markets, which, in turn, are backed by the callable capital of the Bank's member governments.

These factors together make for a quite strong financial institution and account for the World Bank's standing in the marketplace.

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