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cc: Mr. Rotberg

World Bank in move to borrow at flexible rates

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THE WORLD BANK is to ask its board within the next few weeks for authorisation to borrow on international capital markets at variable interest rates.

This would mark a radical change in the bank's approach to the markets where it has borrowed only at fixed rates.

Implicit in the proposed change is the possibility that developing countries which borrow from the bank may also face regular adjustments in the interest rates they are charged.

A plan to introduce variable rate borrowing has been under study by the bank's staff for almost a year – it was first disclosed by Mr Eugene Rotberg, the bank's Treasurer, last October.

It stems from the volatility of interest rates and the bank's very heavy borrowing requirement, but even though authorisation to introduce the change is being sought, bank officials stressed that the changes could be less radical in practice than it first appears.

The bank is seeking the flexibility to borrow at variable rates if necessary. The change would not mean that the bank would immediately acquire a high profile in the floating rate note market.

One instrument which might have more appeal is the retractable issue, a fixed rate bond where the coupon changes periodically, say every three years. The bank has not yet used this type of security, which was developed by other borrowers in the international market.

Any decision to use variable rate borrowing would also depend on the market situation. Despite volatile interest rates, the bank has managed to raise more than its original $8bn target so far this fiscal year, which ends on June 30.

Its interest costs have risen sharply, partly because this year has seen a higher proportion of borrowing in expensive currencies such as U.S. dollars. Whereas the average rate of interest paid by the bank in 1980/81 was 9 per cent, this year's average rate is about 11 per cent.

The higher cost is placing a squeeze on the bank, whose loans to developing countries bear interest at a rate fixed from the outset. It is thus effectivly having to fund old loans at a rate of 7 to 8 per cent with money costing 11 per cent.

This is one major reason why the bank may have to move towards a more flexible lending rate, despite opposition from developing country borrowers. The average life of its borrowings has shrunk to about seven years, compared with loan operations

World Bank officials also say the bank's borrowing requirements have increased because of the shortfall of contributions to the International Development Association (IDA) its soft loan affiliate. This has meant that some projects originally allocated IDA funding have had to be financed by the bank itself.