THE WORLD BANK

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SUMMARY AND CONCLUSIONS

The principal financial strengths of the World Bank are based on several factors which are derived from the following:

(i) Conservative financial policies;

(ii) Conservative liquidity policy (no losses on Loans);

(iii) Excellent loan loss experience;

(iv) Conservative project management policies;

(v) The breadth of markets for its securities;

(vi) Central bank and member government debt purchasing support; and

(vii) Quality of overall management.

Some facts:

1. The World Bank had subscribed capital at March 31, 1980 of $36.8 billion, 10% of which has been paid in, while the remainder is callable and can be employed only to meet the World Bank's obligations to holders of its securities.

2. The World Bank is prohibited from holding outstanding loans that exceed the total of its subscribed capital, surplus and reserves. That places a binding ceiling on Bank loans and means that its lending operations are not a function of how much it can borrow, but rather of its capital and reserve base. This requirement establishes a 1:1 ratio whereby every dollar disbursed on loans from the World Bank is covered by a dollar of capital and reserves.

3. Borrowings outstanding at March 31, 1980 totalled $26.5 billion. About 95.9% of this amount is backed by callable subscription of countries whose own public credit ranking is triple-A.

4. Of the total outstanding debt, about 27% is owed to member governments, central banks, or governmental agencies. Their willingness to rollover or renew their holdings of maturing debt and self-interest in assuring the Bank's access to their markets has generated a position unmatched by any bank, finance company, or other financial institution.

5. The Bank has a policy of maintaining a liquid position of at least 40% of its next three years planned borrowing requirements. This policy allows the Bank to meet all of its requirements without the need to borrow funds for prolonged periods. The Bank has the flexibility to avoid adverse conditions in capital markets, and the ability to adjust its lending program to changes in the level of borrowing costs.

6. To date, the World Bank has had no loan losses or write-offs. While it has experienced minor delays in payment of loan service charges, it has never suffered a default. This fine record has been maintained, in fact, because of the Bank's policy of not participating in debt rescheduling.

7. The World Bank has generated a profit every year since 1948, which is a significant achievement scarcely paralleled by other financial institutions. Moreover, the World Bank's trend of continuous profitability is a good indication of the fact that resources are being used productively. The net income for the fiscal year ending June 30, 1980 is estimated to be around $570 million.

8. The World Bank maintains a highly disciplined and finely tuned approach toward project financing. While the World Bank has lent funds to a diversity of borrowers for many different types of projects, each proposed financing is carefully scrutinized and carried out over an extended period of time. As a matter of policy, loans are only granted on a basis of sound financial and economic criteria; the project must produce an acceptable rate of return, i.e. generally 15% or more, and in each case, the prospect for repayment must be apparent. All phases of a project's development are consistently, frequently, and stringently monitored by the World Bank's staff. The Bank has proven to be a tougher, harder lender than many commercial institutions.

9. World Bank loans are not made in support of military or political objectives or for the purpose of facilitating exports of any particular industrialized country.

10. The World Bank's bondholders have a similarity of interests with its shareholders (member countries) because of the guarantee which, in effect, flows from the shareholders to the bondholders.

The following sections on the World Bank endeavour to explain more fully and explore the above considerations.

WORLD BANK

I. WORLD BANK, AN INTERNATIONAL INSTITUTION

A) WORLD BANK AND WORLD BANK GROUP

The WORLD BANK, formally known as the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, is an international organization, founded in 1945, owned and controlled by 134 governments which constitute its membership (or shareholders). The World Bank Group consists of three institutions: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation (IFC). The IDA and IFC are referred to as affiliates of the IBRD. The use of the term World Bank refers to the IBRD alone.

At the outset, it is important to stress that IBRD, which is legally and financially separate and distinct from IDA and IFC, is the sole member of the World Bank Group which borrows funds in the public debt markets.

B) MEMBERSHIP ELIGIBILITY

To be eligible for the World Bank membership, a country must have joined the International Monetary Fund (IMF) which involves agreement to observe accepted rules of international financial conduct. World Bank subscriptions are based on the economic and financial strengths of members and linked to the members' financial participation or quota in the IMF.

Although not a member of the World Bank, Switzerland has entered into an agreement with the World Bank on June 29, 1951 on the legal status of the World Bank in Switzerland.

C) PRINCIPAL PURPOSE

The principal purpose of the World Bank is to promote economic development of member countries, primarily by providing loans for specific projects and related technical assistance, in the interests of promoting the long-term growth of international trade and improved standards of living. As prescribed under its Articles of Agreement, the World Bank:

(i) must base decisions to lend funds only on economic considerations, including ability to repay;

(ii) must make loans only to governments or must have loans guaranteed by the government of the borrower concerned;

(iii) must lend funds only for productive purposes;

(iv) must stimulate economic growth in the developing countries where it lends funds.

II. MANAGEMENT

A) ADMINISTRATION

The World Bank's administration is composed of the Board of Governors, Executive Directors, and President, along with other officers and staff.

All of the Bank's powers are vested in the Board of Governors, which consists of a governor and an alternate governor appointed by each member of the World Bank, who exercise the voting power to which that member is entitled.

B) EXECUTIVE DIRECTORS AND GOVERNORS

There are, at present, twenty executive directors. Five are appointed, one by each of the five members having the largest number of shares of capital stock (United States, United Kingdom, Federal Republic of Germany, France and Japan), and the remaining fifteen are elected by the governors representing the other members. The Board of Governors has delegated to the Executive Directors authority to exercise all the powers of the World Bank except those reserved for the Governors under the Articles.

C) PRESIDENT

The President is selected by the Executive Directors. Subject to their direction on questions of policy, he is responsible for the conduct of the ordinary business of the World Bank and for the organization, appointment, and dismissal of its officers and staff.

D) STAFF

There is no quota system for staff selection. The World Bank's management, rather than its member governments, is responsible for staff selection, recruited from as wide a range of countries as possible, including non-members of the World Bank. The professional staff of the World Bank currently consists of approximately 2,400 well-trained, culturally diversified and highly disciplined individuals.

III. FINANCIAL CHARACTERISTICS

A) CAPITAL STRUCTURE

Many elements and considerations blend together to make the World Bank a unique financial institution. Those elements include the Bank's structure and policies that give it form and strength. The World Bank's capital structure is comprised of subscribed capital, reserves, and net accumulated earnings. Subscribed capital represents the largest portion of the capital base and is made up of two forms: paid-in and callable.

Paid-in Capital is that portion of total subscribed capital that is actually paid to the World Bank and that is available for use in its general operations. It represents 10% of the World Bank's total subscribed capital, and, in essence, is the equity interest of the member governments, thereby constituting a permanent capital contribution. At March 31, 1980, total paid-in capital amounted to $3,680 million.

Callable Capital constitutes the remaining 90% of the World Bank's total subscribed capital. The World Bank's callable capital may not be used in its operations, for disbursements, or for administrative expenses.

It is solely for the protection of its bondholders and can be used only for that purpose. The World Bank's charter requires that it call, to the extent necessary, callable capital, if it is unable to meet its debt obligations in full out of its other assets.

It is important to note that the existence of callable capital means that the Bank's borrowings, in essence, are guaranteed by its member governments. This provides substantial protection to the holders of World Bank securities and means that they may look beyond the general financial condition of the institution itself to the nature and credit-worthiness of the member governments and that the funds can be used for nø other purpose.

It should also be noted that the World Bank's shareholders (who are its members) have a similarity of interest with its bondholders because of the effective guarantee that flows from the shareholders to the bond-holders. Because of the sizable amount of callable capital at risk to the shareholders, they strive to ensure that conservative operating policies concerning liquidity, borrowing diversification, debt maturity mix, reserve accumulation, income generating capacity, and lending, are maintained to ensure that callable capital need never be called and further-more, to protect the bondholder against unnecessary financial risk. Since its beginning, the World Bank has never had to utilize callable capital. On March 31, 1980, the uncalled portion of total capital subscription amounted to $33,124 million.

B) CAPITAL STRUCTURE REVIEW

Since 1976, the World Bank's capital base has increased, as shown in Table 1 below. Increases in capital subscriptions have occurred each year as a result of the admission of new members or through additional subscriptions made by existing members. During that period, paid-in capital has risen by $600 million and callable capital by $5.3 billion, representing a 19% advance in total subscribed capital.

Table 1

CAPITAL STRUCTURE REVIEW FOR FY76-79 AND FY80 TO MARCH 31, 1980
(in $ Billions)

	1976	% Total Capital-ization	1977	% Total Capital-ization	1978	% Total Capital-ization	1979	% Total Capital-ization	March 31, 1980	% Total Capital-ization
Debt	$14,647	30.74%	$18,478	35.82%	$22,602	38.88%	$26,280	39.45%	$26,497	39.89%
Equity										
Reserves (Retained Earnings)	2,136	4.48	2,235	4.33	2,483	4.27	2,905	4.36	3,126	4.70
Paid-In Capital	3,086	6.48	3,087	5.99	3,305	5.69	3,743	5.62	3,680	5.54
Total Equity	$ 5,222	10.96	$ 5,322	10.32	$ 5,788	9.96	$ 6,648	9.98	$ 6,806	10.24
Total Debt & Equity	$19,869	41.70	$23,800	46.14	$28,390	48.84	$32,928	49.43	$33,303	50.13
Callable Capital	27,775	58.30	27,782	53.86	29,741	51.16	33,686	50.57	33,124	49.87
Total Capitalization	$47,644	100.00%	$51,582	100.00%	$58,131	100.00%	$66,614	100.00%	$66,427	100.00%

On January 4, 1980, the World Bank's Board of Governors adopted two resolutions authorizing an increase in the World Bank's capital by $40 billion. From that increase, it is expected that $3 billion will be applied towards the paid-in capital portion of total subscribed capital and the remainder will be applied towards callable capital, i.e. $37 billion. Pro forma, this additional capital will raise paid-in capital to about $6.7 billion and callable capital to about $70.7 billion, thus nearly doubling total subscribed capital. This additional capital should significantly enhance the protection afforded to holders of World Bank securities and will increase greatly the World Bank's lending capacity.

C) LIQUIDITY

The World Bank maintains a sizable liquid position of marketable, short-term assets at a level that can adequately meet its requirements without the need to borrow new funds over prolonged periods. This policy gives the World Bank the flexibility to avoid adverse conditions in capital markets and the ability to adjust its lending program to changes in the level of its borrowings.

The World Bank has systematically built up its liquidity position by borrowing substantially in excess of existing requirements at times when funds have been obtainable at reasonable costs and terms of maturity. The borrowing program has been formulated to maintain liquid assets at 40% of net cash requirements for the succeeding three years. The World Bank's net cash requirements in turn, are largely a function of its past and projected lending program. The Table 2 below is a review of the World Bank's liquidity position during the period of 1976 to 1980.

Table 2

LIQUIDITY REVIEW FY76-79 AND FY80 TO MARCH 31, 1980

	June 30				March
	1976	1977	1978	1979	1979
Liquid Assets/Debt	41.9%	42.7%	39.2%	37.1%	31.8
Liquid Assets/Debt Due in 1 Year	447.9%	570.4%	510.0%	386.9%	274.8
Percentage Growth in Liquid Assets	18.6%	28.5%	12.3%	10.1%	(7.1
[illegible] illions)	$6,136	$7,885	$8,857	$9,750	$9,05

Finally, it should be noted that if, because of an expectation of prolonged instability in world capital markets, the World Bank's liquidity appeared likely to decline to an unacceptable level, the World Bank's lending program could be reduced. If instability in the world capital markets were to continue for long periods, estimates are that the Bank could delay borrowing for one to two years without impairing its lending program. That capacity was partially exhibited by the World Bank when it did not borrow at all in United States markets in 1969, 1973, 1974 and since August 1977. It can be concluded that the World Bank's liquidity policy is solidly based on three sound financial elements: FLEXIBILITY, STRENGTH, and DIVERSITY.

D) BORROWING PROGRAM

Borrowings provide the funds necessary for the continued growth of the World Bank's lending operations and supplement the other principal World Bank resources which are its paid-in capital, accumulated earnings and loan repayments. The aggregate gross borrowings for the five fiscal years 1976-80 was $21,755 million, compared with $10,198 million in the preceding five years. The higher rate of borrowing in the capital markets supported the growth in the World Bank's financial requirements that resulted from the rapid expansion in its lending operations during the period.

The World Bank sells its securities (a) through placement directly with governments, government agencies and central banks, and (b) in the public markets in which securities are offered to investors through the medium of investment banking firms, merchant banks, or commercial banks.

In fiscal year 1980, the World Bank sold 36 debt issues totalling an equivalent of $3,644 million in the public markets throughout the world, which was more than two-thirds of all its borrowings in the period. Also during the fiscal year 1980, governments and central banks purchased World Bank debt issues equivalent to $1,672 million, which was equal to about 30% of total debt issues sold by the World Bank. A break-down of Bank debtholders among government and all other categories during FY78 to December 31, 1979 is shown below in Table 3.

Table 3

BREAKDOWN OF BANK DEBT OWNERS
(in $ Millions)

Dec. 31, 1979	U.S. Dollar	%	Other Currencies	%	Total	%
Central Bank or Government Accounts	$3,644.9	38.2%	$$4,089.5	21.6%	$$7,734.4	27.2%
Other Holders	5,887.8	61.8	14,836.7	78.4	20,724.5	72.8
Total Outstanding Debt	$9,532.7	100.0%	$18,926.2	100.0%	$28,458.9	100.0%
June 30, 1979						
Central Bank or Government Accounts	$3,678.0	37.8%	$ 4,077.6	24.6%	$ 7,755.6	29.5%
Other Holders	6,055.1	62.2	12,469.9	75.4	18,525.0	70.5
Total Outstanding Debt	$9,733.1	100.0%	$16,547.5	100.0%	$26,280.6	100.0%
June 30, 1978						
Central Banks or Government Accounts	$3,676.1	37.3%	$ 3,678.2	28.8%	$ 7,354.3	32.5%
Other Holders	6,171.7	62.7	9,076.5	71.2	15,248.2	67.5
	[illegible]	100.0%	$12,754.7	100.0%	$22,602.5	100.0%

The World Bank's securities are held by investors in 98 countries in Africa, Asia, Australia, Europe, the Middle East and North and South America. Thus, the Bank has developed the flexibility to select the markets that will allow optimum borrowing conditions and has lessened its dependence on any other specific market. Currently, the Bank's securities are denominated in 18 different currencies. As shown in Table 4 below, the US dollar historically has been the currency of choice for World Bank borrowings. However, the Deutsche Mark, Japanese Yen and Swiss Franc have grown in importance as borrowing currencies in recent years.

Table 4

OUTSTANDING BORROWINGS
BY CURRENCY OF BORROWING

Amount Expressed in Millions of U.S. Dollar Equivalents

Currency	June 30, 1976	1977	1978	1979	March 31, 1980
United States dollars	$ 7,151.1	$ 9,172.9	$ 9,847.8	$ 9,733.0	$ 9,319.9
Austrian shillings	–	–	–	–	72.0
Belgian francs	70.9	75.4	80.0	85.3	74.3
Canadian dollars	153.8	129.4	110.2	93.9	58.2
Deutsche mark	3,198.8	4,493.5	5,687.8	7,061.1	7,636.2
French francs	30.6	28.8	23.5	29.5	25.8
Italian lire	71.4	50.9	52.6	51.6	44.3
Japanese yen	1,495.0	1,652.9	2,919.1	3,515.7	3,549.9
Kuwait dinars	390.6	373.2	352.6	310.5	276.9
Lebanese pounds	30.5	24.4	–	–	–
Libyan dinars	101.3	101.3	101.3	101.3	101.3
Netherlands guilders	313.3	335.2	403.1	426.0	391.1
Pounds sterling	27.6	8.9	9.0	9.8	9.7
Saudi Arabian riyals	141.6	141.6	145.1	148.2	150.1
Swedish kronor	33.7	33.5	31.7	31.5	28.5
Swiss francs	1,237.0	1,655.1	2,635.2	4,485.3	4,566.2
United Arab Emirates dirhams	76.0	77.0	77.4	79.0	80.3
Venezuelan bolivares	123.5	123.5	121.1	118.8	109.4
Totals	$14,646.7	$18,477.5	$22,602.5	$26,280.5	$26,497.1
Weighted Average Effective Interest Rates	7.41%	7.40%	7.24%	7.06%	7.19%

A partial breakdown of outstanding Bank obligations held by investors on June 30 of the last two years and December 31, 1979 (see Table 5 below) indicates that a large amount of the Bank's debt is concentrated in three countries (United States, Germany and Japan) that subscribe to about 35% of the World Bank's total subscribing capital. As a result, those countries have a special interest in the assurance of the World Bank's financial integrity and in maintaining its credit quality, because their governments' financial institutions and citizenry have invested so heavily in its securities.

Table 5

SUMMARY CLASSIFICATION OF OUTSTANDING
BORROWINGS BY PRINCIPAL SOURCE
(in $ billions)

	% of Total			Total			Member's % of Subscribed Capital		
	Dec. 31, 1979	June 30, 1979	June 30, 1978	Dec. 31, 1979	June 30, 1979	June 30, 1978	Dec. 31, 1979	June 30, 1979	June 30, 1978
United States	19.43%	21.68%	25.72%	$ 5.5	$ 5.7	$ 5.8	23.9%	23.9%	23.7%
Germany	[illegible]	[illegible]	24.33	7.9	6.7	5.5	6.1	6.1	[illegible]
Switzerland*	16.49	15.53	10.60	4.7	4.1	2.4	*	*	*
Japan	13.44	13.49	13.03	3.8	3.6	2.9	4.7	4.7	4.7
OPEC**	8.38	15.38	16.65	4.1	4.0	3.8	5.9	5.9	6.2
Other	14.46	8.51	9.67	2.4	2.2	2.2	59.4	59.4	53.9
Total	100.00%	100.00%	100.00%	$28.4	$26.3	$22.6	100.00%	100.00%	100.00%

Notes:

*Switzerland is not a member country.
**Includes OPEC Countries, Bahrain, Qatar, Oman, and Trinidad and Tobago of which:

Saudi Arabia	5.61%	5.81%	6.39%	$ 1.6	$ 1.5	$ 1.4	1.7%	1.7%	1.7%
Kuwait	1.85	2.04	2.50	0.6	0.5	0.6	0.2	0.2	0.2
Venezuela	1.78	2.05	2.41	0.5	0.5	0.5	0.7	0.7	0.7

An historical review of the Bank's maturity structure of outstanding borrowings is shown in Table 6. As may be noted, since 1976 the World Bank has depended heavily on debt maturing in five or more years and this reflects the trend toward longer maturities in its loan

Table 6

MATURITY STRUCTURE OF BORROWINGS OUTSTANDING
(In $ billions)

	June 30								March 31,	
	1976	% Total	1977	% Total	1978	% Total	1979	% Total	% Total	1980
1 year	$ 1.4	9.5%	$ 1.4	7.6%	$ 1.7	7.5%	$ 2.5	9.5%	10.2%	$ 2.7
2-5 years	5.2	35.4	6.8	36.8	9.3	41.2	10.2	38.8	41.1	10.9
6-10 years	5.5	37.4	7.3	39.5	7.8	34.5	9.3	35.4	29.5	7.8
11 or more years	2.6	17.7	3.0	16.2	3.8	16.8	4.3	16.3	19.2	5.1
Total	$14.7	100.0%	$18.5	100.0%	$22.6	100.0%	$26.3	100.0%	100.0%	$26.5

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

During the last five fiscal years, World Bank gross borrowings have averaged $4.2 billion a year, having risen from $1.9 billion in 1974 to $5.3 billion in fiscal 1980. Despite that rise, Bank borrowing costs have remained fairly low during that period because of the Bank's ability to attract funds in a variety of international capital markets, and because of its superior debt management. A breakdown of historical borrowing costs is shown below in Table 7.

Table 7

HISTORICAL BORROWING COSTS

	1976	1977	1978	1979	March 31, 1980
Average Cost of:					
Borrowing drawn down in period	8.17%	7.46%	6.73%	6.22%	7.92%
Borrowings outstanding during period	7.32%	7.53%	7.45%	7.21%	7.23%
Total borrowings and other funds available during period	5.43%	5.96%	6.09%	5.98%	5.97%
Average interest rate on:					
Loans approved in period	8.53%	8.44%	7.57%	7.54%	8.06%
Disbursed and outstanding loans—end of period	6.69%	6.90%	7.10%	7.27%	7.37%

E) LENDING PROGRAM

General Policies

Rules included in the Bank's charter have generated general conformity to specific lending principles. Each loan is made to either a member government or must be guaranteed directly by the government in whose territories the project being financed is located. Since the World Bank must lend for productive purposes, it must justify each loan on an economic basis. The prospects of repayment are carefully evaluated for each loan. World Bank studies of a country's economic structure and an assessment of its ability to generate sufficient foreign edchange to meet debt service obligations are completed before making a loan. Loans are not made in support of military or political objectives or for the purpose of facilitating exports of any particular industrialized country.

Before granting a loan, the World Bank must be thorough in its economic analysis of a country's credit. Areas that are examined and forecast include present and estimated future per capita income, population growth, savings rate, the foreign exchange position, sources of borrowings, tax base, terms of trade, external debt requirements, reliance on commodities, exports, sensitivity to commodity prices, flexibility in curtailing imports, tariff structure, etc.

The lending policies and procedures of the Bank have several advantages. Since all loans to developing countries are made to a government or under government guarantees, evaluation of the credit quality of each borrower gives an intimate knowledge of the country's administration, trade patterns, and balance of payments. These studies facilitate the identification, appraisal, and supervision of new projects. The continual security of existing loans is monitored as a result of the groundwork accomplished in each study.

An extensive knowledge of a member country also is derived from the broad spectrum of projects that are financed by the Bank. In addition to the traditional areas of power, telecommunications, water and sewerage facilities, transportation, agriculture and industry, the Bank has also justified and quantified the benefits and costs of lending to education, rural and urban development, and population control projects. In each case, the productive capabilities to be derived from loans associated with all these areas are evaluated.

Co-Financing

The World Bank has financed development projects in association with other lenders. The arrangement and degree of the Bank's role in such financings are dependent on the co-lender's experience, the borrower's desires, and the type of co-financing. The Bank conducts co-financing with member governments, their agencies, multilateral financial institutions, and private institutions (commercial banks, insurance companies, etc.).

Financing may be with official sources of aid by means of: (1) a joint scheme in which the financing of certain items is shared between the Bank and the co-lender in agreed proportions or (2) a parallel scheme in which the co-lender finances different goods and services or parts of a project; by means of export credits linked to the procurement of certain goods or services from a particular country; or direct financing provided by private lending institutions outside the country of the borrower.

Disbursements and Monitoring

The Bank controls loan disbursements. It ascertains that loan proceeds are spent efficiently and economically. Loan proceeds are disbursed only on receipt of documentation that the goods and services being paid for are covered by the loan agreement - typically after international competitive bidding - and are of the agreed quality. Disbursements are typically made directly to suppliers of equipment for the project to ensure that funds are used for authorized purposes. The international competitive bidding is required and supervised by the Bank. The Bank staff follows the execution of construction of a project closely and is in a position to recognize problem areas before they result in default. Borrowers submit reports on the progress of each project. The Bank staff periodically visits projects to examine and review physical construction or operations, accounts, deployment of purchased equipment, and construction management.

Major Loans

From its establishment to March 31, 1980, the World Bank had approved loans in the aggregate amount of $55.9 billion to finance projects in 99 countries.

A breakdown by sector of the World Bank total loans approved through March 31, 1980 was as follows:

Purpose	Total Loans to March 31, 1980	
Agriculture and rural development	$11,308.0	20%
Education	2,056.4	4
Energy	611.5	1
Industrial development and finance	5,927.4	11
Industry	4,744.0	8
Non-project	2,466.1	4
Population and nutrition	191.8	-
Power	11,175.3	20
Technical assistance	41.6	-
Telecommunications	1,241.8	2
Tourism	363.6	1
Transportation	12,195.0	22
Urban development	1,073.4	2
Water supply and sewerage	2,566.2	5
TOTALS	$55,962.1	100%

Loan Loss Experience

The World Bank has never experienced any loan losses or loan write-offs. Any delay in payment of principal or interest is due to technical reasons, such as the timeliness of currency conversion, rather than a credit delinquency. The World Bank has a policy of not participating in debt rescheduling and its financial achievement has been maintained, in part, because of this policy.

IV. FINANCIAL POLICIES REVIEWS

A) LENDING LIMITATIONS

When examining a development bank's capital structure, it is important to consider the limitations imposed on lending.

As prescribed under the World Bank's Articles of Agreements, the total amount of disbursed and outstanding loans held by it may not exceed the total of subscribed capital, surplus, and reserves. This 1:1 ratio, by most financial standards, would be considered to be an extremely prudent prescription. A binding ceiling, therefore, is placed on the level of Bank loans which makes the lending operations a function of the Bank's capital base rather than a function of how much it can borrow.

For example, if the Bank were to borrow $10 billion a year, it could not under its Articles of Agreement lend and disburse those funds, since the founders of the Bank made a conscious decision to restrict the Bank's lending operations not to how much it could borrow but rather in relation to capital and reserves - and on a one-to-one basis. Therefore, it remains for the Bank to actually finance the loans through borrowings in the marketplace which in turn are backed by the Bank's callable capital.

B) RESERVES

An important element to consider in the evaluation of a development bank's credit is its reserve policy. The existence of substantial reserves to cover losses on a bank's own loans or to be available to meet a bank's debt service obligation can provide security, which is important for debt holders.

Most of the Bank's net income is allocated to the Bank's reserves which currently total $2,709 million. This is a book reserve, and the funds allocated to it are employed in the lending operations of the Bank. Thus this reserve account in effect is the Bank's retained earnings. The World Bank has no advance experience in loan losses as there have never been any.

Since 1975, the Bank's reserves (including unallocated net income) have grown from $2.2 billion to $3.1 billion on March 31, 1980.

C) DEBT RESCHEDULING

The World Bank does not participate in debt rescheduling. That means that although countries engage in debt rescheduling, the World Bank insists that its loans be serviced in accordance with the terms of the original loan agreement. Because of its relationship with its borrowers, the Bank receives repayment on its loans even when a nation may default on, or reschedule, commercial loans. The maintenance of that policy by the Bank provides the investor in its securities with an additional level of security that goes beyond the bounds of its readily available financial resources. The Bank has never suffered a loss on any of its loans.

There are substantial pragmatic reasons why borrowers do not default on World Bank loans. In the event of a default, no further disbursement would be made on that loan or any other loan outstanding in the country. And no new loans would be committed until the default had been cured. Borrowers know the World Bank's policies in this respect, and given the substantial amount of our undisbursed loans, they would be extremely reluctant to take steps to jeopardize the transfer of future resources.

A default to the World Bank also has serious consequences which would affect the credit of the country involved, both with other countries and with commercial suppliers of resources.

D) PROFITABILITY

Although the World Bank is a "supra national" institution organized to promote world development and not its own profit, reviewing its trends in profitability is nonetheless important.

The idea of profitability involves a rigorously tough standard. It is a measure of the productive ability of the resources under the control of the Bank's management. Continuous profitability is one of the ways in which the Bank can expand its operations on a sustained long term basis. In addition, ongoing profitability is an indicator that resources are being used productively, which provides a base of profits from which retained earnings can be added to the capital base.

Table 8

PROFITABILITY AND DEBT SERVICE REVIEW 1975-79

(As of June 30)

	1976	1977	1978	1979	Estimate 1980
Net Income (In $ Millions)	$220	$209	$238	$407	$571
% Change of Net Income	(20.0%)	(5.0%)	13.9%	71.0%	40.3%
Return on Average Paid-in Capital	7.1	6.8	7.5	11.5	15.2
Cost of Outstanding Debt	7.3	7.5	7.5	7.2	7.3
Average Cost of Total Funds	5.4	6.0	6.1	6.0	6.0
Average Interest Rate on Disbursed and Outstanding Loans	6.7	6.9	7.1	7.3	7.4