World Bank General Capital Increase

This largest capital increase in the Bank's history will permit growth of about 10 percent a year in the Bank's lending program

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On February 19, 1988, the Executive Directors of the World Bank approved a resolution to be sent to the Governors authorizing a General Capital Increase (GCI) of 620,000 shares valued at $74.8 billion. This is the third General Capital Increase in the Bank's history (see box on history) and by far the largest. It will provide the basis for the Bank to implement the planned, and urgently needed, expansion in lending to support borrowing countries' growth and adjustment programs. Approval of the General Capital Increase raises the legal limit on the Bank's total amount outstanding of loans and guarantees that is specified in the Bank's Articles; it signals to financial markets the strong support of the Bank's shareholders, enabling the Bank to borrow the resources needed in the markets at the best possible terms; and, above all, it endorses the role of the Bank in the development process.

The additional shares are to be made available for purchase by the Bank's 151 member governments in proportion to each country's current share allocation. A second resolution provides for an additional 14,000 shares, valued at $1.7 billion, which are to be held on reserve to accommodate initial subscriptions by new members in the future. The two resolutions will increase the authorized capital stock of the Bank to $171.4 billion, or by more than 80 percent.

To become effective, the capital increase had to be approved by Governors representing at least 75 percent of the total voting power. This condition was met on April 27, 1988, by which time 133 Governors, representing about 77 percent of the total voting power, had given their approval. This will enable members to subscribe the additional shares allocated to them.

Gearing ratio

Any market-based operation must maintain an appropriate relationship between its capital base and its assets, and the World Bank is no exception. The Bank's Articles of Agreement state that "The total amount outstanding of guarantees, participations in loans, and direct loans made by the Bank shall not be increased at any time, if by such increase the total would exceed one hundred percent of the unimpaired subscribed capital, reserves, and surplus of the Bank." This means that the Bank's outstanding and disbursed loans must not exceed its capital, reserves, and retained earnings—a very conservative requirement.

In recent years, two of the constraints that were implied by this provision came to require urgent attention as the lending program expanded and world economic conditions changed: (1) increasing the Bank's sustainable level of lending, and (2) keeping outstanding loans below the ceiling specified in the Articles, despite increases in the dollar values of loans caused by exchange-rate changes.

Sustainable level of lending. The quoted provision in the Bank's Articles refers to outstanding disbursed loans and not to commitments— yet it is commitments which are the basic planning tool used by the Bank's Management and Executive Board in formulating annual operating programs. Since the time lag between commitments and disbursements may be as much as seven years, it is necessary to take account of the impact commitments will have on outstanding, disbursed loans over the longer term. The tool developed for this purpose is the concept of the sustainable level of lending. The sustainable level of lending is defined as the maximum level of annual loan commitments that, under certain assumptions (for example, about the rates of loan disbursements, repayments, reserve accumulation), can be sustained indefinitely in nominal terms without increasing the amount of loans and guarantees outstanding beyond the authorized limit. When annual commitments approach this level, a review of the Bank's capital needs is triggered. Sustained growth beyond the sustainable level of lending can only proceed if member governments agree on an increase in the Bank's capital. (Annual lending can exceed the sustainable level of lending temporarily while a decision on capital is being implemented, but lending may not grow to the point where disruptive adjustments would become necessary if there were no capital increase.)

In December 1987, the sustainable lending level was estimated at $13.6 billion. Lending had reached $14.2 billion in fiscal year 1987 (ending June 30, 1987) and new commitments of about $15.5 billion are planned for FY1988. While these commitment levels are consistent with the sustainable level of lending policy, the planned level of new commitments for FY1989 of $17 billion is clearly more than marginally beyond the sustainable level. Without a general capital increase, therefore, planned commitments for FY1989 would have had to be reduced.

Exchange-rate effects. The Bank's capital is denominated in US dollars, while its outstanding loans are in many currencies,

especially yen, deutsche marks, and Swiss francs. As the dollar declined against these major currencies, the value of the outstanding loans in dollars rose, while capital remained unchanged. Thus, the Bank's headroom, that is, the difference between the statutory lending limit and the value of outstanding loans, declined, reaching a low point of $6.7 billion on December 31, 1987 (see box on headroom). If there were no further dollar depreciation, this would be adequate for more than a year's operations, but no one can rule out further exchange-rate movements. While there are a number of measures the Bank can take to protect its headroom, the most attractive and least costly is expeditious action on a GCI followed by subscriptions.

GCI, Bank borrowings

The Bank depends on market-based borrowings to fund most of its lending operations. Total disbursed and outstanding loans are $89 billion, and the Bank also holds about $21 billion in cash and investments. These assets are financed by capital, reserves, and borrowings. The portion of capital actually paid in amounts to only $5 billion and accumulated reserves are $9 billion. The balance, or about $96 billion, is borrowed funds. The annual borrowing program is about $11 billion and will grow as the lending program expands. This makes the Bank a major borrower in the medium- and long-term capital markets. While the Bank is rated highly for the prudent management of its resources and the quality of its portfolio, its credit standing and its ability to mobilize funds at the best terms available in the market also rests upon the real and perceived support of its members. The large size of the GCI, and the portion of capital to be paid in, demonstrates the continued strong support of the Bank by its members and reinforces the Bank's standing in international financial markets as well as its ability to provide adequate lending to its members.

Operational goals

The support of the Bank's shareholders rests on their belief that the cooperative approach to financial intermediation is a cost-effective way to finance development. This, in turn, depends on broad agreement as to how the role of the Bank should continue to evolve. Consideration of the General Capital Increase therefore started, about three years ago, with a series of discussions on the future role of the Bank. The Bank's Executive Directors considered the Bank's future role in light of experience since the mid-1970s and possible alternative scenarios in the 1980s. While the breadth of the topic was matched by the diversity of the views, the basic themes that attracted broad support have guided operations in recent years and are expected to continue to do so as the lending program expands.

It was generally recognized that the growth prospects of the developing countries were less buoyant than in the preceding decade, and that a major objective should be to restore higher rates of growth. This would require both sound domestic policies, emphasizing the more efficient use of resources, and a sufficient flow of external capital, private and public. The Directors placed great emphasis on maintaining the Bank's flexibility so that it could respond to the many different situations faced by its borrowing member countries.

It was agreed that the Bank's traditional strengths—in project design, in close supervision during project implementation, and in institution-building—will remain essential in the future. Support for the financing of investment is expected to remain the mainstay of Bank operations. Financing for investment has grown from $9.3 billion in FY1982 to $10.6 billion in FY1987, a period of rapid growth in adjustment lending (see box on adjustment lending). In countries that have kept their external debt at manageable levels, most of the Bank's lending is for investment financing, whether for individual projects or for sectoral programs. But even in the highly-indebted countries, the financing of investments remains central. Investment levels have declined and need to be restored if growth is to accelerate. And while policy changes are often vital to restore creditworthiness in these countries, the supply response to improved policies requires new investment.

The Executive Directors also expressed broad support for the Bank's increased attention to borrowing members' economic policy framework, at the macro and sectoral levels; to the incentives for the efficient use of resources; and to the business environment. While issues in these areas are frequently addressed in structural or sectoral adjustment loans, they are also addressed in the Bank's economic work and its investment lending. In a period of constrained resources, both domestic and foreign, improving the efficiency of resource use must be a central theme. In this the Bank supports the growing perception among its members that the role of governments in the productive areas may need to be reconsidered, and that greater reliance on private sector development may improve prospects for accelerated growth.

While accelerated growth will be a major objective of the Bank's expanded lending program, growth is not considered synonymous with development. Two critical areas in which the Bank is expected to play a key role are poverty alleviation and environmental protection. Increased lending will aim at improving the access of the poor to better food, shelter, health care, and schooling, while at the same time enhancing their

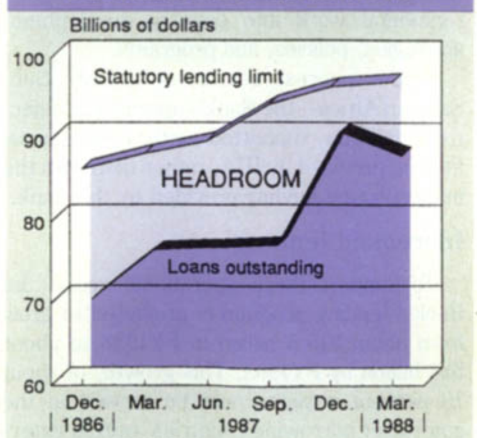
"Headroom" in lending

Headroom is defined as the difference between the statutory lending limit in the World Bank's Articles and the amount outstanding of loans and guarantees. Changes in headroom are determined by: (1) loan disbursements; (2) loan repayments; (3) new capital subscriptions; (4) additions to reserves; and (5) exchange-rate changes. Loan repayments, new capital subscriptions, and additions to reserves increase headroom; loan disbursements decrease it. Exchange-rate changes can affect headroom in either direction. Because the Bank's capital is denominated in US dollars, while loans are denominated in a mixture of currencies, a depreciation of the US dollar against the other currencies used reduces the headroom, and an appreciation increases the headroom.

With the decline of the US dollar against other major currencies, the Bank's headroom declined by $10.4 billion in the course of 1987. The decline would have been even sharper had measures not been taken to increase subscriptions of available authorized capital and to use all subscribed capital as the base for the Bank's lending authority. These measures increased headroom by about $8 billion in 1987. In early 1988, the US dollar strengthened slightly against the other major currencies and, consequently, the Bank's headroom increased to $11.7 billion by February 29, 1987.

In view of the exchange-rate volatility of 1987, the importance of early approval of the GCI, followed by early subscriptions of the authorized capital, is clear.

Lending headroom, December 1986–March 1988



Source: World Bank.

Adjustment lending

Structural Adjustment Loans and Sector Adjustment Loans are intended to help countries with deeply-rooted balance-of-payments difficulties to reform policies either at the economy-wide or sectoral levels. Unlike traditional World Bank loans, these loans do not fund specific projects but provide foreign exchange to help meet the transitional costs of restructuring and policy reform. Such loans often are an integral part of financing packages associated with debt restructuring programs, and serve as a catalyst for other inflows of foreign capital. Since economic restructuring normally takes several years, adjustment loans are designed to span five or more years, involving up to five separate loans. Both structural adjustment and policy-oriented sector lending have increased in volume and importance in recent years. The first adjustment loan was made in FY1979. By June 1987, 73 loans totaling $13.4 billion had been approved in support of policy reforms in 32 countries.

IBRD adjustment lending, FY 1980-87

	FY 1980	FY 1982	FY 1984	FY 1986	FY 1987	Cumulative FY1980-87
Number of adjustment loans	2	6	11	12	15	72
Amount (in millions of dollars)	250	991	2,247	2,540	3,485	13,324
Percent of total lending	3.3	9.6	18.8	19.3	24.6	14.0

Source: World Bank

productive potential through activities that create employment and income, including improvements in infrastructure. The Bank will also work more closely with the private sector and nongovernmental organizations in this area.

For the environment, the protection of renewable resources will be the focus of attention. Additional emphasis is being placed on the need to manage human and natural resources better, so that countries can achieve sustainable development. The core of efforts in the area of natural resource management will be the integration of environmental work into country development strategies, policies, and programs.

In the poorest countries—notably Sub-Saharan Africa—the Bank's operational objectives will be supported with concessional funding provided by IDA, rather than with the market-based funding provided by the Bank.

Increased lending

To support these operational goals, the Bank's lending program is projected to grow from about $15.5 billion in FY1988 to about $24 billion by FY1993. This growth, of about 10 percent a year, must be viewed in the context of borrowing countries' overall external financing needs. The net borrowing requirements of IBRD borrowers will depend on a number of factors, including international economic conditions and the policies governments adopt. Over the period 1986–88, the growth of commitments has resulted in the Bank's net lending (i.e., gross disbursements minus repayments) averaging about $5 billion a year, representing about a quarter of all net lending to IBRD borrowers.

The Bank can make an important contribution to restoring growth and development momentum, but this contribution can never be more than a modest share of what is needed to sustain growth over the medium term. Therefore, the Bank must continue to complement its own direct lending by promoting other resource flows, including direct investment, private commercial lending, and financing from export credit agencies. The Bank will increase its efforts to help the heavily-indebted countries design and implement adjustment programs which can serve as the foundation for debt restructuring and financing packages to help restore growth and reduce the debt burden over the medium term.

The estimates of growth in the Bank's own direct commitments for the next few years are based on the current loans in the pipeline of Bank operations, and are built up country-by-country in the context of the continuing operational and policy dialogue with the Bank's borrowers. Prospects for Bank lending beyond the next three years are for continued real growth, based on a recovery of the investment programs of most borrowers and a continuing need for fast-disbursing lending in support of adjustment. These estimates of lending requirements provided the starting point for determining the desired lending capacity of the Bank and hence the size of the GCI. But because the Bank's capital requirements also depend on various other factors, such as the proposed enlargement of its role in mobilizing lending from other sources; lending to its private sector affiliate, the International Finance Corporation; the share of fast-disbursing loans in its portfolio; repayment terms for future IBRD loans; the behavior of exchange rates; and the availability of other sources of capital, it is difficult to specify precisely for how long the lending capacity provided by the General Capital Increase will suffice. Nevertheless, the GCI is broadly expected to allow the Bank to implement its planned annual lending program for the next five to six years.

Assuming there is no change in the share of adjustment lending in total lending (about 25 percent) or in the Bank's repayment terms, the planned increase in commitments will result in increased net disbursements with a considerable lag: net flows from IBRD to its borrowers are projected at about $14 billion in 1989–91 before rising to over $17 billion in 1992–94. In real terms, this corresponds to a 10 percent reduction in net lending in 1989–91, followed by a six percent increase in 1992–94, compared with 1986–88. In part, the lag is a consequence of the substantial build-up in projected repayments. The projected volume of net Bank lending, even with the GCI, underlines the important role which other official and commercial lenders will need to play.

Other issues

The bulk of the Bank's capital is callable capital, and only the remainder is paid in. In formulating their proposal for the paid-in portion of the 1988 GCI, the Executive Directors were guided by two main considerations. First, these cost-free resources would strengthen the Bank's financial position and its risk-bearing capacity, thereby moderating pressure on the Bank's loan charges. Second, the size of the paid-in component (about $2.2 billion) reassures financial markets that shareholders' support for the Bank and its programs is reflected through actual budgetary allocations, and not only by contingent liabilities which are not expected to materialize. The Executive Directors agreed that 3 percent of the subscription price should be paid at the time of subscription, with 0.3 percent of the subscription price payable in US dollars and the other 2.7 percent payable in the national currency of the subscribing member. The remaining 97 percent will be callable capital, to be used only when needed by the Bank to meet its obligations to its creditors.

In the interest of expeditious action, the Executive Directors agreed to keep the structure of the GCI simple, but to take up certain other related matters after the negotiations were completed:

The Bank's repayment terms. In 1977, the Bank changed the repayment terms on its lending from an annuity basis (i.e., equal payments of principal and interest combined) to equal payments of principal plus interest. At the same time, the policies on grace and amortization periods were shifted from a project to a country basis, and the averages for various country groups were constrained. This was done to permit a higher level of commitments with a given capital base. In view of the growing indebtedness of some of the low-income countries that borrow from the Bank, and the severe and extended payment difficulties of the middle-income countries, the Directors agreed to consider whether some changes in repayment terms, within the context of the existing policies on grace and maturity periods, might be feasible. Since a permanent change in repayment terms, except for a temporary increase in grace periods, would reduce the sustainable lending level which could be supported by the GCI, it will be necessary to strike a balance between improvements in repayment profiles and preservation of the Bank's capacity to sustain growth in new commitments for a longer period.

Voting power of smaller countries. Under the Bank's Articles of Agreement, each member has 250 basic votes plus one additional vote for each share of capital stock held. Under this structure, a pro-rata increase in all members' shareholdings reduces the relative voting power of smaller shareholders, since the 250 basic votes not derived from subscription of shares do not increase in proportion to increases in subscription votes.

In the 1979 GCI, this problem was addressed by allocating to each member 250 additional shares to be subscribed with no paid-in portion (so-called "membership shares"). This, unfortunately, turned out to create substantial contingent liabilities in the form of callable capital for the small countries. For the smallest, the use of this approach in the 1988 GCI would have meant that almost all of the country's GNP would potentially be required to meet its callable capital obligation. It was, therefore, agreed not to allocate "membership shares" under the 1988 GCI and to establish an ad hoc committee of Executive Directors to consider alternative steps to protect the voting power of small members from dilution whenever there is a general capital increase.

Two other matters also will be dealt with after the GCI. First, some members are concerned that their shareholdings in the Bank do not accurately reflect their relative positions in the world economy. The Executive Directors plan to review the criteria for share allocations in the Bank before the completion of the Ninth General Review of Quotas of the International Monetary Fund.

Second, there has been a widely held concern to find ways of avoiding the headroom problem in the future. Since the Bank's headroom would be less affected by exchange-rate changes if its capital were valued in a basket of currencies, such as the SDR, many Directors wanted to look again at the issue of how the Bank's capital unit of value should be interpreted. This issue had been debated for many years after the demise of the gold dollar (the unit mentioned in the Bank's Articles). In 1986 a decision was reached to interpret the gold dollar in terms of current US dollars ($1.20635 for one gold dollar). Nonetheless, the Executive Directors decided to establish an ad hoc committee to review this issue once again.

Conclusion

The 1988 GCI has strongly reaffirmed the importance the Bank's member governments attach to cooperative international support of development and the expanded role they expect the Bank to play in meeting the evolving requirements of its borrowers. The increased resources that the Bank will be able to mobilize with the GCI, and the expansion of its lending and other activities that this makes possible, also represent a major commitment by the international community to support the efforts of developing countries to achieve sustainable growth in their economies and to substantially alleviate poverty. ■

History of capital increases

The International Bank for Reconstruction and Development, more commonly known as the World Bank, was established in 1945, with an authorized capital stock of $10 billion consisting of 100,000 shares, with each share having a par value of $100,000 in terms of US dollars of the weight and fineness in effect on July 1, 1944. Today, the value is $120,635 per share in current dollars. As a result of ten capital increases approved from 1959 to 1984, the authorized capital stock has grown to 786,500 shares, with an aggregate value of $94.9 billion.

There are two kinds of increases in authorized capital—general and special capital increases. The primary purpose of general capital increases is to support growth in Bank lending. There have been only two previous general capital increases. The first, in 1959, doubled the original authorized capital to $20 billion; the second, in 1979, increased the Bank's capital by 97.5 percent, from $41 billion to $81 billion. Shares authorized under these GCIs were allocated to members on a pro rata basis.

Special capital increases are largely designed to provide shares selectively to certain members, so as to adjust their relative shareholdings in the Bank in line with their changing positions in the world economy. These increases have often followed changes in relative positions reflected in the IMF's periodic review of quotas. Occasionally, increases in authorized capital have also been used to provide shares for new members.

An important aspect of general capital increases is the portion of the price of shares paid in at the time of subscription. The Bank's Articles divide capital into an 80 percent portion—the callable capital—which may not be used in the Bank's operations and is subject to call only to pay the Bank's creditors, and a paid-in portion. The latter, which may be used to finance operations, is in turn divided as follows: 2 percent is payable in gold or United States dollars and 18 percent is payable in the currency of the subscribing member. These latter portions were paid under initial capital subscriptions. Subsequent capital increases required members to pay a lower percentage of this portion of capital to meet the requirements of Bank operations.

In the context of the 1959 General Capital Increase, it was decided that the Bank should borrow the resources it would need for lending in the capital markets. There was no paid-in portion. All of the newly authorized shares were designated as callable capital, in order to increase the Bank's guaranteed resources as a basis for expanded borrowing in the capital markets. In the 1979 GCI, part of the price of shares was paid in at subscription. The purpose was to provide some equity to blend with borrowed funds, to reduce the average cost of loanable resources, and to demonstrate the shareholders' support for the growth of the Bank's operations. The paid-in portion was set at 7.5 percent of the price of shares, 0.75 percent to be paid in US dollars, and 6.75 percent to be paid in the currency of the subscribing member.

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