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718/3/12

SecM81-526

FROM: Vice President and Secretary

June 18, 1981

MAINTENANCE OF VALUE

After consultations among Directors, it has been suggested that the Board may wish to conclude its discussions on the interim arrangements with respect to maintenance of value with a statement expressing the sense of the Board as follows:

"1. The Bank should consider an expansion in the use of the SDR as its unit of account. A staff study will be prepared on the steps which could be taken to this end. This study will be submitted to the Executive Directors for consideration by them prior to July 1, 1982.

2. The Executive Directors will continue to consider the question of the valuation of the Bank's capital with a view to achieving a permanent solution by July 1, 1983. The Executive Directors will attempt to work out this solution on the basis of the various approaches described in the memorandum R81-57 of the President, dated March 20, 1981. It should be noted that during the discussion held on May 7, 1981, a large number of Executive Directors have expressed a preference for a solution based on the use of the SDR as a common standard of value, or based on a choice between the SDR and any one of the constituent currencies in the SDR.

3. In the meantime, the terms described in the President's memorandum of March 28, 1978 (SecM78-251) will apply to all capital subscriptions, including subscriptions under the General Capital Increase. In particular, subscriptions will be accepted at 1.20635 current United States dollars equal to one 1944 gold dollar, subject to the possibility that adjustment may be required when the standard of value issue is settled."

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
President's Council

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

June 16, 1981

Mr. McNamara:

1. Attached is a technical note on the Use of SDR's as the Bank's Unit of Account. This was requested at the Gabon meeting. If you approve, it should be distributed to the Executive Directors as soon as possible.

2. I also attach a draft Board decision on the Maintenance of Value issue, which Mr. Golsong, my associates and I have worked out in discussions at a technical level with the U.S. In its present form it is likely to invite strong objections from the French but I feel that it offers the best possibility of getting the largest measure of agreement in the Board.

06/16

We would like to discuss with you how we should handle this prior to the Board meeting. Mr. Mentre has expressed a very strong preference to me to have the M.O.V. discussion next Thursday rather than next Tuesday. I would recommend that we agree to this since it may help moderate the French position, and it would give us time to get support from the other G-6 members on the draft text.

Moeen A. Qureshi

718/3/11

Board Decision on Maintenance of Value

1. The Bank should consider an expansion in the use of the SDR as its unit of account. A staff study will be prepared on the steps which could be taken to this end. This study will be submitted to the Executive Directors for consideration by them prior to July 1, 1982.

2. The Executive Directors will continue to consider the question of the valuation of the Bank's capital with a view to achieving a permanent solution by July 1, 1983. The Executive Directors will attempt to work out this solution on the basis of the various approaches described in the memorandum R-81-57 of the President, dated March 20, 1981. It should be noted that during the discussion held on May 7, 1981, a large number of Executive Directors have expressed a preference for a solution based on the use of the SDR as a common standard of value, or based on a choice between the SDR and any one of the constituent currencies in the SDR.

3. In the meantime, the terms described in the President's memorandum of March 28, 1978 (SecM78-251) will apply to all capital subscriptions, including subscriptions under the General Capital Increase. In particular, subscriptions will be accepted at 1.20635 current United States dollars equal to one 1944 gold dollar, subject to the possibility that adjustment may be required when the standard of value issue is settled.

REVISED DRAFT
FPA
6/11/81

TECHNICAL NOTE

Use of the SDR as the Bank's Unit of Account

1. In connection with the discussions on valuation of Bank capital, some Executive Directors have asked for a technical note on the major issues the Bank would face were it to adopt the SDR as its unit of account in place of the US dollar. The present note has been prepared as a first response to that request.

2. Adoption of the SDR as the Bank's unit of account is conventionally understood to mean that the Bank's financial statements would be expressed in SDRs. The first section of this note examines the implications of such an arrangement for the Bank's financial reporting. It would also be possible to extend the use of the SDR in Bank operations further by denominating (i.e. determining) the Bank's assets and liabilities in SDRs. The issues that this would raise are taken up in the second section. A third section examines the implications of using the SDR more extensively in the planning, programming, budgeting and other operations of the Bank. The note concludes with a brief comment on the timing and likely costs of a shift to the SDR.

3. Financial Reporting. The Bank's Articles of Agreement require that audited financial statements be published annually, but

no unit of account is stipulated. The Joint Audit Committee considered in 1973, 1974 and 1975 whether the Bank's financial statements should be expressed in SDRs but recommended continuation of the practice of expressing them in dollars principally because of the implications of such a change in the capital markets in which the Bank borrows. 1/ The same subject was taken up more recently with the Bank's underwriters in the major capital markets where the Bank borrows. While some thought it would make little difference whether the financials were expressed in dollars or SDRs, underwriters in two major capital markets concluded that using SDR financials would make it more difficult to sell the Bank's bonds and to broaden the market for them. Producing audited statements in SDRs would require changes in the Bank's existing financial systems which are designed to translate receipts and expenditures in various currencies into the US dollar.

4. Another consideration is that, because of requirements in some markets and the expectations of investors in others, the Bank's prospectuses contain audited statements of income for a period of five fiscal years. Since it would be impractical to construct audited SDR-based accounts retroactively for the Bank for past years, a prolonged transition period (i.e., five years) would be required in

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1/ See for instance Report of the Joint Audit Committee, R75-195 dated October 3, 1975, paragraph 18.

which it would be necessary for the Bank to maintain its accounts and to have them audited in dollars as well as SDRs. This would result in increased internal costs and external auditing fees.

5. An alternative approach would be to continue the practice of expressing the audited financial statements in dollars and, in addition, to publish a balance sheet and the results of the Bank's operations in the Annual Report in SDRs. These additional financial statements, which would not be audited, would show the SDR equivalents of the amounts shown in the audited financial statements. This approach could be implemented very promptly and at low cost, but would of course represent a rather limited use of the SDR as a unit of account.

6. Denomination of Bank Assets and Liabilities. The Bank's operations involve certain assets and liabilities which by their very nature are currency-specific. The bulk of Bank borrowings, for example, will continue to be denominated in national currencies because that is the type of claim which is attractive to most long-term investors. It is entirely possible that in the future the Bank will undertake individual borrowings denominated in SDRs, but such borrowings are unlikely to be significant as a share of the

total borrowing program in the near term. 1/

7. The Bank's Articles of Agreement require that it not incur an exchange risk on borrowed funds. In conformity with this requirement, the Bank matches its borrowing obligations in any one currency with assets in the same currency, primarily by holding or lending the proceeds of its borrowings in the same currencies in which they were borrowed. Since the Bank's borrowings are expected to be mainly in national currencies for the foreseeable future, the only way in which the Bank can lend in SDRs--if by "lending in SDRs" one means fixing or determining the borrower's repayment obligation in SDRs--is by ensuring that loans made in SDRs are matched at all times with appropriate amounts of borrowings in the basket of currencies that make up the SDR. This requirement would impose major constraints on the management of the borrowing program, and thus effectively limit the scope for lending in SDRs.

8. The phrase "lending in SDRs" is, however, sometimes used in a different sense, namely, the fixing of commitments in SDRs. This means that the borrowing country is entitled to draw down currencies equivalent in value to so many SDRs Were this to be done, the borrowers' repayment obligation would continue to be determined as in

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1/ Since the Bank has been designated as an "other holder" of SDRs, it could also borrow SDRs themselves from governments or other holders. No such transactions have as yet been undertaken.

the present system--that is, based on changes in the relative value of all currencies in the Currency Pooling System--because of the prohibition on incurring of exchange risk. 1/

9. The Bank could also acquire SDR-denominated claims as part of its liquid assets--without incurring an exchange risk--if these claims were purchased with the proceeds of borrowings denominated in SDRs or with the constituent currencies that make up the SDR basket. A market in such claims is now beginning to develop, but it is not yet of a size or degree of liquidity to permit the Bank to invest a significant proportion of its liquid assets in this form.

10. The question of whether the Bank's capital should be expressed in SDRs is simply another way of posing the familiar issue of valuation of capital. This issue is not discussed further in the present note.

11. Even this cursory review of some of the Bank's major assets and liabilities should suffice to demonstrate that each element of the balance sheet raises particular questions which would need to be carefully addressed. Future IBRD loan commitments (and hence over time the volume of loans committed but not yet disbursed) could be denominated in SDRs relatively easily in the sense discussed in

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1/ Beginning with the Sixth Replenishment, IDA makes commitments in terms of SDRs, and also fixes borrowers' repayment obligations in SDRs.

paragraph 8. 1/ On the other hand, most IBRD borrowings could not be so denominated at the present time without jeopardizing the Bank's ability to market its bonds among its traditional long-term investors. The Bank's statutory prohibition against taking exchange risk on borrowed funds will mean that most of its investments and the borrowers' repayment obligations will continue to be denominated in national currencies for the foreseeable future.

12. Management of Bank Operations. A shift from the dollar to the SDR as the unit of account would pose rather complex issues in managing operations since it would entail more than a simple transformation of some of the Bank's operational data from the dollar to the SDR. The Bank's internal operations as well as its dialogue with borrowers and co-financiers currently employ the dollar as the established numeraire. Adoption of the SDR as the unit of account will present a number of issues for the internal consistency and efficiency of the Bank's operational planning, programming, monitoring, appraisal, supervision and evaluation processes. For example, if the major financial dimensions of the Bank's project cycle were to be expressed in SDRs, this would have implications for the

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1/ Another liability, the amount recorded as Due to IDA, is currently expressed in U.S. dollars. Since the Bank's net income is actually a composite of earnings in several currencies, a case could be made for expressing future transfers in terms of SDRs in order to reduce the Bank's exposure to exchange risk on this particular item.

integration of project-, sector- and macro-economic analyses and for general communication with borrowers in appraisal and supervision work unless parallel systems of accounting in dollar and SDRs were to be employed. Likewise, administrative expenses are at present mainly incurred in terms of dollars. Careful consideration would need to be given to the problems that would be created by expressing budget plans and monitoring systems in SDRs. In this area, as in several others, it will be necessary to carefully assess possible changes in the Bank's management of its operations that might accompany adoption of the SDR before deciding on the optimal scope of the changes and the pace at which they might be implemented.

13. Timing and Costs. The time required for a conversion to the SDR as the Bank's unit of account will depend on how some of the issues raised in this note are resolved. It seems reasonable to expect, however, that a conversion would be implemented in stages. Similar caution needs to be expressed regarding cost estimates for making the conversion. Our experience with the financial requirements for the Currency Pooling System as well as for the IDA6 credits indicates that complete conversion to SDR transaction accounting and reporting for the Bank will require a significant amount of time and expense; less extensive conversion would of course be less costly. It will only be possible to make an estimate of the likely costs as the scope of the task to be undertaken becomes clearer.

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FORM NO. 75
(9–78)

THE WORLD BANK

ROUTING SLIP	DATE: May 13, 1981

NAME	ROOM NO.
Members of the Finance Committee	
05/13	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		URGENT

REMARKS:

The attached will be discussed at a meeting of the Finance Committee tomorrow in Mr. McNamara's office at 9am.

FROM:	ROOM NO.:	EXTENSION:
Joe Wood	D-1326	75837

718/3/10

DRAFT

May 13, 1981

MEMORANDUM TO THE EXECUTIVE DIRECTORS

SUBJECT: Valuation of the Bank's Capital--Interim Procedures

The purpose of this note is to set forth the basis on which subscriptions ~~to~~ the General Capital Increase could proceed in the event there is no final action ~~agreement~~ on the valuation question before the end of the fiscal year. In considering interim procedures, three issues need to be addressed: (i) on what basis should the Bank accept subscriptions to the GCI; (ii) what if anything should be done about settlement of MOV obligations; and (iii) how long should the interim procedures remain in effect.

SECTION 1: Basis of Subscription

The Bank is currently accepting subscriptions on the basis of one 1944 gold dollar being equal to $1.20635 current dollars, that is, $120,635 per share, subject to adjustment when the valuation question is settled. To extend this practice would be consistent with my memorandum of March 28, 1978 on the valuation of the Bank's capital (SecM78-251) and with the Notes to the Financial Statements. Such an approach would be also permissible under the GCI resolution.

Alternatively, the Bank could give member countries the option of subscribing either on the basis of $120,635 per share or SDR100,000 per share. This would be consistent with the spirit in which the GCI resolution and the Report of the Executive Directors were prepared; namely, that every effort should be made to avoid the appearance of pre-judging the outcome on the valuation issue. It ~~would~~ does, however, raise ~~certain~~ two technical issues ~~connected with a dual-pricing system~~ that would need to be ~~considered further.~~ handled promptly: ~~For example,~~ would members be permitted to change the basis of their subscriptions from time to time as the relative values of $120.635 and SDR100,000 change~~?~~; and ~~Would~~ would the option be extended to future subscriptions ~~subscriptions~~ to the Selective Capital Increase~~, continue to be accepted at $120,635 per share even though this (currently) represents a greater obligation than SDR100,000? None of these issues appears insuperable, although their resolution could take some time.~~

Because the SDR is currently quite close in value to $1.20635, and because subscriptions would be subject to adjustment once the valuation issue is settled, the two approaches would not differ substantially in terms of their impact on the Bank's financial position. The statutory limit on lending, the coverage of IBRD debt by callable capital and the amount of paid-in capital made available for use in Bank operations would be approximately the same in either case. The important point to bear in mind in considering financial implications is that a prompt beginning to GCI subscriptions is much more important to the Bank's financial position than the relatively minor differences in the basis for valuation.

If adopted for an interim period,

The dual-pricing approach need not raise questions about whether or not the Bank retains a common standard of value. ~~In the interim period, the Bank's standard of value would remain the 1944 dollar. In the view of the General Counsel, valuing the 1944 dollar for purposes of subscription to the GCI on the basis of either $1.20635 or one SDR, at the option of the member, would be consistent with the Articles of Agreement since the amounts subscribed would be adjusted when the successor to the 1944 dollar is determined.~~ In the event members were given such a choice, members' obligations in the event of a call and their rights within the Bank would presumably be based upon the number of shares they subscribe, irrespective of whether they choose $120,635 or SDR100,000 as the provisional basis for their subscriptions.

SECTION 2: Settlement of MOV Obligations

~~Except for a few cases,~~ the Bank has not established and settled maintenance of value obligations arising under Article II, Section 9 (and referred to in Note B to the Financial Statements) since April 1, 1978.[1/] The reason these obligations have not been established is, of course, that no decision has yet been reached on the standard of value. Under interim arrangements that would continue to be the case and would be the basis for continuing to state these obligations in the financial statements on a "notional" basis.

The alternative would be to establish these obligations on a provisional basis and to provide for settlement in terms of the provisional standard. As it

1/ Maintenance of value was not settled with most countries for several years before 1978 because of the breakdown of the par value system of exchange rates in the early 1970s.

happens, the value of the SDR has been quite close to $1.20635 in recent weeks, so that if an appropriate date within this period were chosen as the basis for establishing MOV obligations, the ambiguity about the standard of value would have virtually no impact on members' obligations. If, for example, obligations were provisionally established on the basis of exchange rates prevailing on April 28, 1981, (when an SDR was worth $1.20596) each member's MOV obligation could be calculated without having to pre-judge the question of whether the obligation is based upon $120,635 or SDR100,000 per share. Settlement of the obligations thus established could be arranged over a sufficiently long period to minimize the impact on members.

The financial implications of settlement would obviously depend upon the schedule of payments made by the Bank to countries with credit balances (approximately $100 million) and made to the Bank by countries with debit balances (approximately $450 million). Members with debit balances have the right un der the Articles to withhold consent to release ~~of~~ for lending operations the additional paid-in capital which would be received in settlement of MOV obligations. Were members with debit balances to avail themselves of this right and were the Bank to settle credit balances promptly and in cash, there could be a cash outflow of up to about $100 million. This would effect reported net income only indirectly through a reduction in the volume of cost-free resources deployed in Bank operations.

SECTION 3: <u>Duration of Interim Procedures</u>

In order to assure member countries that the terms for subscription would not be altered while legislation authorizing subscription to the GCI is being processed, the Executive Directors could agree that the interim arrangements should remain in force until June 30, 1983, the final date by which individual members are expected to begin their GCI subscription. At that time, the valuation issue would once again be addressed with a view to achieving a definitive solution as promptly as possible.

A resolution of the valuation question after authorizing legislation has been passed but before subscriptions are completed could require some members to amend their legislation. A longer period, perhaps extending through the GCI subscription period, would deal with this risk, but would be contrary to other objectives. In particular, it would prolong the period of uncertainty and give a degree of permanence to the interim arrangements which some members could find objectionable. On the other hand, a shorter period--say one year--could mean that the issue would come up again before circumstances were propitious for its resolution and could possibly encourage some members to delay the start to subscriptions in the hope that they could thereby avoid uncertainty as to their obligation.

SECTION 4: Conclusions

A procedure presently exists for accepting subscriptions on the basis of one 1944 dollar equals $1.20635 current dollars. Continuing this procedure could reasonably be considered as a simple extension of the status quo. It would require no new actions of the Executive Directors, except to decide the duration of the procedures.

be adopted by the Board in lieu)

A dual-pricing option could ~~require some additional actions to ad-~~

the procedure presented in March.

~~dress the technical issue raised by the option, [although resolving this issue would not necessarily be difficult]. A decision to settle existing maintenance of value obligations now would of course, represent a new action by the Board.~~

718/3/9

Salient Points of the Discussion of the Executive Directors on May 7, 1981, on Valuation of IBRD Capital Subscriptions: Possible Courses of Action

Wood: - Prompt resolution of the issue is most important.

Dawson:
- SDR is the only alternative of the four presented that does not meet our concerns.
- Concerns of all branches of the U.S. Government are:
  1. Need for certainty with respect to U.S. dollar obligations to IBRD, both for appropriating paid-in capital and for callable capital, which is treated as a program limitation. Impossible to envision acceptance of the SDR, as it would imply an open-ended U.S. dollar obligation. Would be rejected by Congress and run counter to the new Administration's efforts to get U.S. budget under control.
  2. Need for certainty in our voting rights. Voting shares in the Bank reflect a variety of economic factors such as trade, GNP shares, IDA contribution, etc; and we do not consider it appropriate that these voting rights be automatically adjusted solely on account of exchange rate changes.
- Any resolution needs to meet the 2 points above. The U.S. dollar option clearly would do so, as would the five currency plus SDR option, provided that this did not include a mechanism for automatic adjustment in voting shares in response to exchange rate changes.
- The new Administration is new to MOV. No need to push for a precipitous resolution. May be useful to consider a temporary resolution which would allow time to reflect further.

McNamara: - Can you accept the basket and SDR option with or without an amendment of the articles?

Dawson: - Either way.

Looijen:
- It is not acceptable to maintain the status quo for the time being, not for the Bank, not for the bondholders, not for the shareholders And not acceptable for our borrowing countries because of the uncertainty about the ceiling for Bank loans.
- Responsibility for the problem is with EDs themselves; should have settled it 3-5 years ago. If the outcome is politically unacceptable, the Board of Governors can reverse our decision. So, put it on the June 4, 1981 agenda and let's vote.
- Main reason we haven't yet approved a solution is the U.S. Administration, because Congress could get upset. But, the U.S. Congress has always accepted MOV on the 1944 gold dollar and SDR for IMF. Would grossly underestimate American common sense if we supposed that the U.S. Congress would retaliate by withholding its approval for the GCI if we interpret the term "1944 gold dollar" in exactly the same way as the IMF has. U.S. proposes to spread its GCI payments over 6 years, so we will have to deal with the U.S. Congress for many more years.

Looijen (Continued)

- Options 3 and 4 can't be considered as they are not applicable to existing capital.
- Option 2 could apply to existing capital, but it has been our intention all along not to link the Bank's capital to one currency only. If that had been the intent, the original articles would not have used the phrase "of the weight and fineness in effect on July 1, 1944."
- For the past 8 years have felt we need a different system for MOV. This is now less necessary as the U.S. dollar is closer to the SDR, but we still need amendment.
- Resolve matter before McNamara leaves.

Ray:

- No hesitation on SDR, option 1:
  1. SDR is the natural successor to the 1944 gold dollar and accepted in international circles.
  2. Legal opinion in IBRD accepts the SDR.
  3. SDR is a basket and less likely to fluctuate on money markets.
  4. Bank's capital should not be valued in one member's currency but rather in an international unit such as the SDR.
- Is a political issue. Group like this can only operate on consensus. Prefers differences not be brought to a head now as not in the interests of the Bank and the developing countries.
- Suggests delinking GCI subscriptions from valuation issue, without prejudice to final resolution of latter.
- Management should be able to devise interim measure to break the present impasse.

Poulsen:

- SDR is the most desirable and logical, and no arguments make it less so. The Nordic countries want strong standard of value and a relationship between subscriptions and voting power. Do not abandon common standard of value.
- Nordic countries not the only ones -- overwhelming majority in favor of SDR. Consensus is important, but it means give and take. Such flexibility was not shown by all countries on April 15. We might be better off recognizing that a compromise pleasing all of us might not be possible. Also, we must recognize that this is a real problem and not push it under the carpet for the future.
- We have consensus, broadly, and only 1 member does not agree. There is fear that a decision of an overwhelming majority of the Board not accepted by 1 member could have adverse effects on that one member's participation in the Bank. It is hard to believe a country that is the foremost guardian of democracy would retaliate against the full democratic preferences of this group.
- Put Looijen's proposal on the Board agenda for a vote June 4 or as soon thereafter as possible, if no consensus can be arrived at.

Kurth:

- SDR is only option that would meet our requirements. It is the best for the IBRD and members.

Kurth (Continued)

- Instructions he received from his authorities say nothing new. Their imaginations seem to be exhausted. There is a considerable degree of frustration and annoyance with the fact that all attempts to work with the main shareholder have been in vain. Still don't understand why accepting SDR solution is such an insurmountable problem for the U.S.
- Repeats criteria his country sees as basic principles:
  1. A solution should not require a change in the Bank's articles.
  2. In the interests of the IBRD, supports common standard of value.
  3. Feel strongly that there should be a clear relationship between rights and obligations, a firm and permanent link between contributions and voting rights.
  4. Equal treatment of all members. There are serious problems in giving privileges to one member, even if one with a major currency. But, would even be worried about German mark being in group of privileged currencies.
  5. Prefer a solution applicable to the existing capital stock.
- Status Quo: Can't see how it could work, but it is okay to investigate it and see what the political, legal and financial ramifications are.
- Coming meeting in Gabon is a great opportunity for a high level mixing of our countries to discuss this informally.
- Not prepared for a roll call vote today. Still, we have to settle this matter soon, but let's not force it for June 4. Agrees with the substance of Mr. Looijen's proposal, but not with the procedure suggested.

Anson:

- It would be distinctly imprudent to force a vote.
- GCI resolution recognized that we might not reach consensus by October 1; as the status quo is, in effect, a U.S. dollar standard, it should not go too long, not more than one year, or it might run the risk of perpetuating the present system.
- Options: There is no consensus for the U.S. dollar option, but we'd okay it as last resort. Same reservations as Kurth and others re multiple currencies; however, given the situation, feels we should retain it as an alternative and consider an amendment if necessary.
- MOV: MOV has been suspended for long time, and it seems unreasonable to create retrospective obligations. Suggests cancel past obligations as of a certain date. For the future, paragraph 15 of Golsong's legal memo refers to adjustment at reasonable intervals; we could instead allow members to reduce their voting power as another option to maintain link between obligations and rights.

McLeod:

- Favors SDR.
- No vote June 4. Too divisive. Agrees with substance of Looijen's memo however.
- If failure to reach a conclusion on the use of SDR, we should turn to interim solutions, including the status quo. He would not want SDR to be discarded as the solution, however; in fact, he would like to see the SDR associated with the status quo as an alternative .
- Put MOV aside until satisfactory solution found to standard of value.

Razafindrabe:
- Wants SDR as common standard. Endorses Ray's views.
- Need much more reflection to reach a general consensus. Not in favor of a vote. Discuss informally in Gabon and again formally before end of fiscal year.
- Wants from staff further clarification on the implications of the status quo.

Drake:
- SDR is the only solution that meets all criteria described by Kurth. Although American dollar also would preserve capital, it would not be equal treatment of all members.
- However, we can't ignore budgetary problems, and especially those where the uncertainty of the SDR could be used against further cooperation with the IBRD. Avoid action today which would harden the situation further; we can live with the status quo a little longer. But, push for a solution or an interim solution here and in Gabon.
- Hopes Board can agree on using SDR for callable capital, but suggests allowing conversion of SDRs to national currency on the paid-in capital. Wouldn't lead to a significant discrepancy in voting rights, and it would eliminate the need for MOV. This would also give the U.S. firm figures for GCI. Even if dollar devalued in future, the U.S. could meet part of its callable capital. In the unlikely event all callable capital were ever needed, it would be doomsday and a problem beyond one country.

Morioka:
- Valuation issues must be settled urgently to implement GCI successfully and to help Bank maintain and expand lending program.
- As long as the basic principle of SDR is maintained, his government is willing to be flexible.
- Agrees with Looijen and shares his frustration, but does not agree with the date for a vote. It is necessary to reach consensus on the basis of a solution that:
  1. Avoids an amendment to the articles.
  2. Conforms with IMF.
  3. Maintains relative obligations and relative rights.
  4. Strengthens the Bank's financial base.

Parent:
- SDR is the only satisfactory solution. Agrees with Drake's suggestion for flexible implementation.
- Opposed to option 2 which would suppress MOV and keep the status quo.
- Option 3 should continue to be examined.
- The French position requires:
  1. Protection of the Bank's capital as in the articles which have been accepted by ALL member countries. As Looijen said, the 1944 gold dollar is tied to the value of gold.
  2. Equality of treatment among subscribers.
- Authorities asked her to express slight disappointment at the Bank Document. Would have expected some clear statement based on the above principles; instead the Bank document was presented as neutral and in fact leads the Bank to accept the status quo and the privileged treatment of one member.

Parent (Continued)
- Re interim ideas: Putting the SDR and the U.S. dollar on the same standard would only stabilize inequality so that we'd never be able to get back to equality. Favors an SDR-based compromise.
- Looijen's idea is premature.
- Wants copy of the U.S. statement, particularly to check reference to option 3 with and without an amendment of the articles. Expects her government will want to look very carefully at that.
- Also, she is still requesting detailed information on what is going on in this area in the other international institutions such as IMF, Common Fund, IDB, ADB and others. Wants clear explanation in detail on both actions taken and proposals.

McNamara:
- Dawson statement to be circulated. Qureshi to prepare note on second Parent request.

Ragazzi:
- Prefers SDR option.
- Shares principles of Kurth; especially essential to continue correspondence of votes and obligations. Is concerned with the leniency of the U.S. on this fundamental principle of democracy. To achieve this equality, need a common standard of value. Without precise relationships, we'd get to UN type discussions.
- Also, IBRD is international, and SDR would be a clear affirmation of this; not one currency is predominant and many countries share.
- SDR was recognized in the past. Has heard no objection to SDR in principle except the technical difficulties of the U.S. Drake suggested a solution to the problem of the U.S. Is it possible to have a precise definition of how it would be done? If the only uncertainty for the U.S. is callable capital, he has great difficulty understanding the U.S. problem because a real risk would come only from an exceptionally serious problem for everyone quite apart from MOV.
- Has it been made clear enough to U.S. Administration and Congress that paid-in portion would not have problem of uncertainty?
- Once SDR is approved, we can compromise on the mechanics of MOV.
- Postponement of the solution can hurt, but feels IBRD can't fulfill its obligations without the support of its major shareholder. Wishes U.S. central role as founder of IBRD would again manifest itself on this issue with a proposal or acceptance of positive solutions that meet the needs of the institution and the consensus of most of the other shareholders.

Muns:
- SDR is preferable, based on conditions similar to those mentioned by Drake. Also, use of the SDR puts IBRD in line with reform of the international monetary system, as carried in 2nd Amendment to IMF Articles. Inconsistent to have different solution for IBRD and IMF.
- Supports Ragazzi's points.
- Supports approach to MOV that is predictable and flexible and can be discharged within reasonable time, like 5 years.
- Necessary to settle valuation issue, but not at the expense of GCI moving ahead. So, as others said, support continuation of arrangement similar to present one, after examination of implications and desirable adaptations based on a staff paper soon.

Chen:

- SDR is the only equitable approach. Equality is important; no country should put itself in a special position.
- Standard of Value and Maintenance of Value are distinct but interrelated. The background document shows how important it is to have a standard of value. Wants correspondence between voting rights and capital subscriptions, and the basic element making this possible is a standard of value. The best unit for this is the SDR.
- The U.S. dollar no longer enjoys the position it once had. The SDR is increasingly the new reserve currency. As a basket, it's more stable; that's why it is accepted by most countries.

El-Naggar:

- SDR is the only natural successor to the 1944 gold dollar. The 1944 gold dollar satisfied conditions when it was chosen, and the only alternative now satisfying the same conditions is the SDR. Any doubt was quelled April 1, 1978, with the 2nd IMF amendment.
- Hopes that in the near future the U.S. Government will see its way to come to an understanding of the position of practically all member governments -- and realize that by not taking a vote, governments have been deferring to the special importance of the U.S. Government. He noted that the U.S. representative pointed out uncertainty with respect to the magnitude of the obligation which the U.S. Congress will be reluctant to enter into. Drake and Ragazzi went a long way to show a solution; combined with the Philippines formula, ideas for a solution go even further.
- Options 3 and 4 are obviously inappropriate as they fail to meet the test of a strong standard of value implicit in 1944 gold dollars. Also, they fail to meet correspondence between the rights and obligations of members, and cannot apply to existing capital stock, and seem to require amendment of the articles.
- Option 2, the U.S. dollar, has two basic defects:
  1. Runs counter to the basic international nature of the Bank. The 1944 gold dollar was not the currency of one country; it was a common standard. It would be inappropriate to use the U.S. dollar.
  2. It violates the basic principle of equality among all member countries. It would be very difficult for member countries to accept a solution that accommodates the problems of only 1 member and also puts all other members in an inferior position.
- Don't need to act now. Give more time to U.S. to evolve its position and recognize that the solution as accepted for IMF is okay for IBRD too.
- However, if we give time to the U.S., we must deal with the practical problem of the GCI. Asks management to do a paper within 1 to 3 weeks, at most, describing an interim arrangement for GCI without prejudice to valuation of Bank capital. Probably would be based on the status quo. However, just how interim will be a big issue. We will have to set a time limit.

Khelil:

- SDR has overwhelming advantages:
  1. Would obviate need to amend articles.
  2. Would enable IBRD to keep pace with international monetary system.
  3. Would be dangerous for the Bank to depend on 1 currency; basket is stronger hedge against financial instability.
- Also, it meets the objectives necessary for a successor to the 1944 gold dollar:
  1. Solution that can be implemented feasibly and economically and for the long range future.
  2. Preserves commitment authority and financial strength.
  3. Close relationship between rights and obligations.
  4. Strong common standards of value.
  5. Maintains our close cooperation with other international institutions.
- We must achieve a solution to address our collective concerns and can't look only at one member's views.
- Management should explore the further possibility of consensus.
- As El-Naggar said, a document on an interim program could be done before the Gabon meeting.

Garcia-Parra:

- Prefers SDR. Ray and Anson said the most.
- We are deferring to the U.S. and clearly can expect from the U.S. a proposed solution we can adopt by consensus.

Sola:

- As SDR and U.S. dollars are now so close, we can proceed on the GCI on an interim basis without much immediate problem.

Zain:

- Supports SDR. Believes in strong standard of value and correspondence between rights and obligations.
- Supports consensus, but we must go forward. He does not detect many different views at this time; in fact, except for the U.S., there is a clear majority which is more than consensus. Can't have "consensus" unless we vote, it appears, and we may have to come to that yet.
- U.S. must take the initiative to finding a solution. It should examine the options and look carefully at the real situation in callable capital, paid-in capital and even consider a decrease in voting power. The U.S. representative said the U.S. needs certainty in dollar obligations and in voting rights -- but maybe he'll have to realize he can't have both.
- We must make some decision soon, even if only an interim arrangement.

Kivanc:

- SDR is the most suitable option, with the Philippines formula.
- Supports Razafindrabe, El-Naggar and McLeod and hopes we will reach a compromise consensus.

MaKonnen: - SDR preference. Issue should be handled in manner to ensure timely completion of GCI.

McNamara: - Summarizes:

1. Clear the Board does not wish to decide now.
2. Informal meeting will be held in Gabon.
3. Some want to add maintenance of the status quo as a fifth option. Management to prepare something prior to Gabon.
4. Must choose among the five options before the end of the final year. Management to try to bring issue back to Board after Gabon.

Looijen: - 19 of 21 are in favor of SDR. It is ironic that those who are not in favor are those who provided the Bretton Woods text on valuation.
- Withdraws his request for a vote on June 4.

El-Naggar: - Agrees summing up should show that 19 of 21 strongly favor SDR.
- Stated that his understanding of an interim alternative is not as a fifth option for a permanent solution of the valuation question but as a practical solution to immediate problem of GCI subscriptions, that substance apart from interim solution will be on the basis of the four alternatives.

McNamara: - Several EDs suggested maintaining status quo -- management will describe implications of this so Board can decide what to do.

May 8, 1981
Gail O'Gorman/Monica Gruder:sr

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

718/3/8

OFFICE MEMORANDUM

TO: Mr. Moeen A. Qureshi, SVPFI

DATE: May 8, 1981

FROM: H. Golsong, ~~VPG~~

SUBJECT: Valuation of Capital -- Interim Procedures

I am leaving this afternoon for Paris and will be back in the Bank next Thursday, May 14.

I thought it would be useful to set out briefly my views on an interim procedure for valuation of capital. In general, I think it would be most wise and give us most support for the proposal among the Executive Directors if we made the solution as provisional as practical. I would, therefore, stick to Mr. McNamara's memorandum of March 29, 1978 and not give an option for subscriptions under the GCI on the basis of one 1944 dollar equaling one SDR. I would also not have a settlement of maintenance of value. A settlement at this time did not receive strong support in the Board yesterday. Such a settlement would be politically unwise and would look as though we are favoring U.S. interests. Finally, a settlement of MOV on the basis of $1.20635 equaling one 1944 dollar would I think raise serious difficulties with our auditors since our capital is stated in SDRs and since a settlement of MOV on a basis other than the SDR would raise doubts as to notional MOV. At the very least it would involve some important changes in the notes to our financial statements. As you know, these were the result of difficult negotiations in 1978 between the Bank, Price Waterhouse and the United States, and I would not like to see these negotiations reopened at this time. A settlement of MOV on an SDR basis would raise questions of appropriateness since members have been subscribing since 1973 on the basis of $1.20635 equaling one SDR.

05/08

cc: Messrs. McNamara
Stern
Hattori
Thahane

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Dawson - Pts of concern
1. Need for certainty of obligation - impossible to accept SDR as it would involve an open unspecified obli
2. inappropriate to adjust voting shares automatically in relation to exch rate changes
US $ obli or a basket would meet the US concern -
Consider a temporary resolution of the issue -

Loeffler - Neth would have difficulty in subj to shares & to decision on MOV -
Wishes vote on 6/4

Ray - Proposes SDR
Don't bring differences to a head now -
Delink MOV from GCI -
Devise an interim measure

Poulsen - Prefers SDR
may not be able to find a compromise pleasing all ED's -
Hard to believe US would retaliate if the majority voted for SDR -
∴ support vote on L's proposal 6/4

(2)

Keith - FRG not yet prepared for a decision - wishes to avoid a forced vote -
Annoyed that attempts to meet US difficulties were in vain -
Wish a solution which
a. Does not require change in Articles
b. Strongly support concept of value
c. Will maintain clear relationship between rights + oblig
d. Provides equal treatment to all states
e. Can be applied to the existing capital
∴ only SDR is the logical choice
Can't see how the Status Quo could be maintained -
Interim provides opportunity for contact at high level by informal contacts
And then should bring back to the Bd but don't decide now on a vote on Z's proposal 614
Anson - GC Resol. made prov for a situation in which MOV decision is not made by 1871 -
Could consider maintenance of Status Quo for a period of time -
Which decision will permit Bk to carry out its functions most effectively -
∴ opposes a forced vote on 614 -

(3)

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As a last resort could consider $

Any decision should cancel obligations of the past -

If consensus cannot be reached, continue status quo for a certain period - reach a satisfactory understanding w/o formalizing it

[illegible] - Prefers SDR
Would not wish a vote on 2 614
Should consider maintaining SQ -
would like SDR associated with SQ

[illegible] - does not wish to vote on an [illegible] -
discuss informally at [illegible] + [illegible] [illegible] and [illegible] wants a [illegible] on SQ & solution to [illegible] GC1

[illegible] - Canada favoring [illegible] with [illegible]
SDR is only solution meeting [illegible]
But [illegible] [illegible] uncertainty -
∴ hopes for SDR [illegible] for [illegible] + [illegible] for [illegible] -
Avoid forcing a vote -
Can live with SQ a little longer
Discuss informally at [illegible] -

[illegible] - attempt to solve by consensus
Prefers SDR
Opposes vote on 614

[illegible] - Wishes decision by consensus
Opposes a solution that gives a privilege

(4)

to 1 state -
∴ prefers SDR
L's proposal premature
Wishes a note on what other institutions
are doing -
Ragazzi - must maintain linkage of rights
& obligations -
Phila formula would clear uncertainty
for 21 S for LA - in position -
Mrno - Prefers SDR
Could support SR
Chen - Prefers SDR
El Naggar - Does not support L's 614 vote
Decide by consensus -
Prefers SDR
Could contemplate with SQ to deal with
the practical problem of sub - the GCI -
∴ wants a note on dealing with sub... -
Khalil - Prefers SDR
Could work out an interim arrangement
Garcia-Parra - Does not support 614 vote on L's proposal
Prefers SDR
But decide by consensus
Sola - Request paper on SQ
Abdo Zain - Prefers SDR
Not desirable to vote
∴ consider SQ

(5)

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Kevane – prefers SDR with Phila formula
Matiramen – prefers SDR

718/3/7

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

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Office of the President

D I S C U S S I O N D R A F T

March 20, 1981

MEMORANDUM TO THE EXECUTIVE DIRECTORS

SUBJECT: Valuation of IBRD Capital Subscriptions: Possible Courses of Action

Section 1: Introduction

1. The purpose of this memorandum is to provide a basis for Executive Directors' discussion of the issues relating to the valuation of IBRD capital subscriptions. The main problem to be resolved is what the Bank should use as the successor to the 1944 gold dollar, the unit in which IBRD capital stock is expressed in the Articles of Agreement. Four possible approaches, each of which involves a different successor unit, are described in the memorandum:

(1) Use of the SDR as a common standard of value for all members' subscriptions.

(2) Use of the current United States dollar as a common standard for all members' subscriptions.

(3) Granting member countries a choice of either the SDR or any one of the constituent currencies in the SDR.

(4) Permitting all member countries to subscribe in their own national currency (i.e., abolishing a common standard of value).

Each of these options is discussed in detail below.

2. The General Counsel has given an opinion that either of the first two options could be implemented using the Directors' powers to interpret the Articles of Agreement, i.e., without an amendment being required. It is also clear that the third and fourth options raise more far-reaching legal questions under the Articles.

3. The remainder of this introduction gives a background to the capital valuation problem and outlines the subsequent discussion in the memorandum.

Background to the Problem

4. The problem of IBRD Capital valuation has two main aspects: the first concerns the standard of value in which members' subscriptions to the Bank should be denominated; the second relates to the maintenance of value (MOV) provisions in the Bank's Articles. Until 1978, the Bank had an unequivocal common standard of value for all shares regardless of the subscribing member or the date on which the shares were subscribed. This common standard was the par value per share established in the Bank's Articles, namely, 100,000 United States dollars "of the weight and fineness in effect on July 1, 1944" (the so-called 1944 gold dollar). 1/ And, while the Articles permit the Bank to issue shares at a subscription price other than par, 2/ the Bank has consistently followed the practice of issuing all shares at par, thereby establishing an identical obligation of $100,000 (in 1944 gold dollars) on every share. This obligation was unaffected by changes in the exchange rates of member countries' national currencies.

5. Standard of Value Problem. Resolving the standard of value issue is necessary for the Bank to be able to state with precision what members' obligations are on existing shares and to fix an unequivocal subscription price for new shares. It was no longer possible to apply literally the provisions of the Articles relating to the standard of value when the changes in the international monetary system resulted in the removal of gold as the basis for determining the par values of national currencies. It became necessary for the Bank to find a successor to the 1944 gold dollar, since the basis for translating these dollars into current United States dollars or into any other currency ceased to exist on April 1, 1978 when the Second Amendment of the IMF Articles took effect. In 1978 the Vice President and General Counsel gave an opinion that the SDR would be a logical successor to the 1944 gold dollar and that it could be substituted for purposes of the Bank's capital subscriptions without an amendment of the Articles. It was acknowledged that the Executive Directors might also decide that the current United States dollar could serve as a

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1/ Article II, Section 2 (a).

2/ Article II, Section 4.

successor.1/

6. Although the choice of a successor to the 1944 gold dollar had not been resolved, subscriptions continued to be received under the 1976 Selective Capital Increase and other capital increases. It was necessary, therefore, to adopt an interim arrangement whereby subscriptions are accepted at a price per share of $120,635 (the current US dollar equivalent of the 1944 dollar at the last official par value of the dollar), subject to adjustment once the valuation issue is settled. For purposes of its financial statements, the Bank has expressed the value of its capital stock on the basis of the SDR.

7. The need to resolve the question of how to value the Bank's capital has become more urgent as the time for the start of subscriptions to the General Capital Increase (GCI) draws near. At the time the GCI was approved, it was expected that the Board of Executive Directors would be able to arrive at a definitive position on the valuation of capital and maintenance of value questions and a procedure for resolving these issues before subscriptions to the GCI began. 2/ The GCI resolution contains provisions for adjusting the number of shares issued under the resolution, depending on how the valuation question is resolved. Several member governments have expressed strong reservations about subscribing to the GCI before a final decision is taken on these issues.

8. Maintenance of Value Problem. The maintenance of value (MOV) provisions in the Bank's Articles require members to maintain the value of that portion of their paid-in capital that is subscribed in their own currency in terms of the subscription price (i.e., 100,000 gold dollars). 3/ These provisions require a member (or the Bank) to make payments of national currency whenever there is a change in the par value of the member's currency, or when in the Bank's opinion, there has been a depreciation in the foreign exchange value of the member's currency. In the early 1970s, when floating exchange rates became common, the Bank began to examine new approaches to the settlement of MOV obligations. Previously, the application of the MOV provisions had been relatively straightforward: generally, a member (or the Bank) made MOV payments only when an explicit decision

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1/ "Valuation of the Bank's Capital" (SecM78-251, dated March 29, 1978).

2/ Report of the Executive Directors to the Board of Governors on the IBRD General Capital Increase, (R79-57/2, dated June 20, 1979), paragraph 7.

3/ Article II, Section 9.

was made to change the par value of the member's currency. 1/ Floating complicated MOV because exchange rates changed frequently and without any corresponding changes in official par values. Discussion of a new method for settling MOV obligations was never brought to a conclusion, because the amendment of the IMF Articles made the Bank's existing standard of value unusable, and without an agreed replacement the MOV provisions of the Articles could not be applied. If the question of the replacement of the 1944 gold dollar can be resolved--and this is clearly the more difficult issue--it should not be difficult to develop a satisfactory technique for settlement of MOV obligations. 2/

9. The Bank is thus faced with the task of determining in the near future: (a) what the standard of value for capital subscriptions should be, i.e., what the successor to the 1944 gold dollar should be; and (b) whether and how the maintenance of value provisions in the Bank's Articles should be applied.

Outline of the Discussion

10. The memorandum begins with a discussion of the fourth option listed above, namely doing away with a standard of value altogether and letting each member subscribe to the Bank in terms of its own national currency. This approach is analyzed first (in Section 2) in order to make clear at the outset the purposes that a standard of value has served in the Bank in the past. The advantages and disadvantages to both the Bank and its members are described. A distinction is made between a strong standard of value, which brings important financial benefits to the Bank, and a common standard of

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1/ The provision in the Articles of Agreement permitting the Bank to require an MOV payment if it finds that a de facto depreciation has taken place, has only been applied in special circumstances.

2/ In its published accounts, the Bank has been accruing "notional MOV" against the SDR since April 1, 1978. As of December 31, 1980, notional MOV payable to the Bank was $468.1 million, and the Bank's own notional MOV obligation was $130.8 million, leaving a net amount due to the Bank of $337.3 million. The positions of individual members with respect to MOV obligations prior to April 1, 1978 vary widely. Some have settled on the basis of the last par values or central rates of their currencies; others have not settled MOV since the early 1970s.

value, which preserves the important principle that countries' rights in the Bank should correspond to the obligations they carry.

11. Section 3 describes how substitution of the SDR for the 1944 gold dollar would affect members' obligations to the Bank. While adoption of the SDR would ensure that the Bank continues to have a standard of value that is both relatively strong and common to all members, this approach would also mean that members' obligations could vary in terms of their own national currencies.

12. Section 4 discusses the option of substituting the current US dollar for the 1944 gold dollar (at an exchange rate of 1.20635). The operation of such a standard of value would be essentially the same as under the SDR. However, the United States would be able to subscribe in its own currency and thereby avoid certain legislative difficulties. It is not possible to predict with confidence whether the Bank would be better or worse off in the future with a US dollar standard rather than the SDR. Adopting a dollar standard rather than the SDR would have reduced the Bank's capital by about $700 million (or 2%), using exchange rates of March 11, 1981. The effects of a dollar standard on the value of the Bank's capital would have been larger in the past, fluctuating from a small increase to a reduction of $3.5 billion.

13. Section 5 describes the multiple currency option. Under this approach, members would be given a choice of the SDR or any of its constituent currencies as the standard of value for their capital subscriptions.

14. Section 6 discusses the options available to the Bank with respect to existing (as opposed to future) capital subscriptions. Section 7 provides a summary.

Section 2: Abolition of a Standard of Value

15. The initial standard of value (i.e., the 1944 gold dollar) has served two main purposes in the Bank: protection of the Bank's financial strength; and preservation of a correspondence between relative subscriptions and relative voting power. 1/

Effect on Bank Financial Strength

16. Historically, the standard of value has helped preserve the real value of IBRD capital by linking subscriptions to a unit (effectively gold) that was strong relative to the national currencies of members subscribing to the Bank and the currencies in which Bank operations were conducted. It is estimated that the Bank's subscribed capital would have been about $8.4 billion (or 21%) lower at the end of FY80 if members' subscriptions had originally been denominated in their own currencies rather than in a common standard of value. 2/ Similarly, if exchange rate movements in the future continue as they have in recent years, 3/ abolition of a standard of value altogether could result in future reductions in subscribed capital of $11 billion over the next 4-6 years, compared to what would be the case if the SDR were substituted for the 1944 dollar. Both the Bank's bondholders and its borrowing member countries benefit from the stronger capital base provided by a strong standard of value, but in somewhat different ways.

17. Bondholders: One of the main protections for holders of World Bank bonds is the callable capital guarantee provided by the shareholder governments. The value of the callable capital is expressed in terms of the unit in which the capital subscriptions are denominated (i.e., the subscription price per share). If this unit is

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1/ Under the Bank's Articles, relative shareholdings also determine member's relative claims on the Bank's earnings and assets (in a liquidation).

2/ The calculations underlying this estimate use the 1944 gold dollar as the standard of value until April 1, 1978 and the SDR thereafter. All calculations use June 30, 1980 as their terminal date. Use of different terminal dates could have an impact on the results.

3/ Specifically, as they did between 1974 and 1979.

strong relative to the currencies in which IBRD borrowings are made, the risk to the IBRD and its bondholders of a depreciation in the value of the callable capital vis-a-vis outstanding borrowings will be minimized. If the subscription price is expressed in terms of a weak unit of value, then bondholders face the prospect of an erosion over time in the value of the callable capital guarantees.

18. Without a standard of value, the exposure of the bondholders to a depreciation in the callable capital can be determined by comparing two currency baskets: the basket in which borrowings have been made and a subscribed capital basket made up of the currencies of all members. The basket of borrowings has consistently appreciated vis-a-vis the subscribed capital basket because most borrowing has taken place in a few strong currencies, whereas the capital is made up of the subscriptions of a much wider number of currencies, many of which have depreciated substantially over time. If, on the other hand, a standard of value is retained, the relevant comparison is between the effects of exchange rate changes on the basket of borrowings and their effects on the standard of value. For example, if the standard were the US dollar the value of the callable capital would move against the Bank's debt in the same way that the dollar does, i.e., as though all subscriptions were made in dollars. If the SDR were the standard, the relevant comparison would be between the basket of borrowed currencies and the SDR basket.

19. The importance of a strong standard of value to bondholders is reduced to the extent that bondholders look for protection mainly to the callable capital of the more creditworthy countries, whose currencies tend to be somewhat stronger on average than the total subscribed capital basket. 1/

20. Lending Authority. The Bank also benefits from the effects of a strong standard of value on commitment authority. The Bank's Articles of Agreement put a statutory ceiling on outstanding loans equal to the total of subscribed capital and reserves. The absence of the 1944 dollar as a standard of value since the Bank's inception would have resulted in a ceiling about \$8.4 billion lower at the end

1/ Because of its effects on paid-in capital, a strong standard of value also produces a marginal strengthening of the Bank's net income and equity, which provides some additional benefit to bondholders. This effect is marginal, however, because the currency composition of paid-in capital that is released for use in the Bank's operations (which is all that affects the Bank's income) is considerably stronger than the basket of subscribed capital generally.

of FY80 than with a SDR standard of value.

21. In recent years, most of this hypothetical $8 billion loss of commitment authority would have occurred because of depreciation of the subscriptions of countries which are currently borrowers from the Bank. While there has been some depreciation of the currencies of certain Part I countries, this has been offset by appreciation in the currencies of other Part I countries. A strong standard of value has not, however, imposed a major cost on the borrowing countries because (a) the major part of subscriptions to the Bank are in the form of a contingent liability that does not, and is never expected to, impose a real cost on member countries; and (b) many of the Part II countries have not released the national currency portion of their paid-in capital for use in the Bank's operations.

Subscriptions and Voting Power

22. The second purpose a standard of value achieves in the Bank is that, since it is common to all members, it ensures that there will be a correspondence between members' relative obligations (i.e., capital subscriptions) and their relative rights (i.e., voting power). The framers of the Bank's Articles saw this as an important principle and established the Bank as a share capital institution with each share having similar rights and obligations. Differences among countries in economic and financial strength have been taken into account in the number of shares allocated to members through periodic selective capital increases, and differences in voting power have matched differences in share allocations. 1/

23. The existence of a single, common standard of value ensures that this parallel distribution of votes and obligations remains unchanged over time regardless of what happens to exchange rates. That is, the proportions of total subscribed capital obligations held by various members will remain as they were at the time shares were allocated, and they will continue to correspond to the proportions of shares and votes (subscription votes, that is) held by the same members. Without a common standard, exchange rate movements would cause the distribution of capital obligations to diverge both from what it was at the time shares were originally allocated and also from the distribution of shares and votes. This process, which is illustrated in the table below, would result in members having

1/ This contribution-weighted voting is tempered in the Bank by the membership votes (or "membership shares" in the case of GCI).

different obligations per share and thus in a mismatch between relative obligations and relative rights.

Hypothetical Impact of Exchange Rate Movements on Relative Subscriptions and Voting Power with and without a Common Standard of Value

With Common Standard of Value

	Initial Position					Position after Exchange Rate Changes				
	Exchange Rates a/	Subscriptions SDR	Subscriptions National Currency	% Total b/	Voting Power c/ (%)	Exchange Rates a/	Subscriptions SDR	Subscriptions National Currency	% Total b/	Voting Power c/ (%)
Country A	2.00	1,000	2,000	41.7	41.7	1.80	1,000	1,800	41.7	41.7
Country B	1.00	600	600	25.0	25.0	1.25	600	750	25.0	25.0
Country C	.75	300	225	12.5	12.5	.70	300	210	12.5	12.5
Country D	5.00	300	1,500	12.5	12.5	4.00	300	1,200	12.5	12.5
Country E	10.00	200	2,000	8.3	8.3	25.00	200	5,000	8.3	8.3
		2,400		100.0	100.0		2,400		100.0	100.0

Without Common Standard of Value

	Initial Position					Position after Exchange Rate Changes				
	Exchange Rates a/	Subscriptions National Currency	Subscriptions SDR d/	% Total b/	Voting Power (%)	Exchange Rates a/	Subscriptions National Currency	Subscriptions SDR d/	% Total b/	Voting Power c/ (%)
Country A	2.00	2,000	1,000	41.7	41.7	1.80	2,000	1,000	46.9	41.7
Country B	1.00	600	600	25.0	25.0	1.25	600	480	20.3	25.0
Country C	.75	225	300	12.5	12.5	.70	225	321	13.6	12.5
Country D	5.00	1,500	300	12.5	12.5	4.00	1,500	375	15.8	12.5
Country E	10.00	2,000	200	8.3	8.3	25.00	2,000	80	3.4	8.3
			2,400	100.0	100.0			2,367	100.0	100.0

a/ National currency units per SDR.
b/ Percent of total in SDR.
c/ Excluding effect of membership votes.
d/ Used as a numeraire only.

24. Disparities between votes and obligations could become large over time in the case of the Bank. This could happen because the main portion of IBRD capital obligations remains outstanding (i.e., uncalled) indefinitely, rather than being paid-in within a relatively short period of time after agreement is reached on relative burdens and relative voting power, as is the case in institutions like UNDP or IDA.

25. These considerations suggest that a common standard of value offers advantages to the Bank's shareholders. If such a standard is also a strong currency unit, it will protect the Bank's commitment authority and other aspects of its financial strength. It is these considerations which constitute the case for continuing with a standard of value system; that is, adopting a single, strong successor to the 1944 gold dollar.

26. The case against adopting a common standard of value is partly based upon the legislative and administrative inconvenience that is imposed on members by acceptance of an obligation denominated in something other than their national currency. While they acknowledge that, absent a common standard of value, exchange rate changes will alter relative obligations, those opposing a common standard of value also believe that this change is similar to other changes in relative burden-sharing ability and should not by itself force a realignment of voting power--at least not automatically. They believe that share allocations take account of many factors, and feel that these allocations, and the relative voting power associated with the allocations, should not be changed except after careful review and renegotiation based upon the same broad range of factors. They would, in other words, tolerate discrepancies between relative subscriptions and relative voting power that arise because of exchange rate changes. These discrepancies could be taken into account--as one factor, but not the only one--in determining the allocation of new shares. They would not, however, tamper with the allocation of existing shares solely because exchange rate changes had altered relative obligations. This point, however, can be used either to argue in favor of a common standard of value or to argue against it. As noted above, the Bank has in the past operated on the principle that because relative voting power should not changed except by negotiation, relative obligations should also not change except by negotiation. Adherence to a common standard of value has prevented exchange rate changes from altering relative obligations and hence creating a situation where relative voting power would need to change.

27. There can be differences of view about the importance of keeping relative votes in line with relative obligations. Those who attach major importance to maintaining a fixed relationship between obligations and voting power over time may prefer the substitution of

the SDR or the current US dollar for the 1944 gold dollar, options that are described in the next two sections. The multiple currency option, which might be viewed as a compromise between a common standard of value and no standard at all, is discussed in Section 5.

Section 3: Substitution of the SDR

28. Substitution of the SDR for the 1944 gold dollar as the Bank's common standard of value, would leave the provisions of the Articles relating to the par value of the capital stock and MOV on paid-in capital unchanged. If the SDR were substituted for the 1944 gold dollar, the par value of a share of IBRD capital stock would become SDR100,000, and members' obligations with respect to both paid-in capital and callable capital would be defined in terms of SDR. In the General Capital Increase, for example, member countries would be required to pay in 3/4% of the subscription price per share of SDR100,000 (i.e., SDR750) in gold or dollars and 6-3/4% in their own national currency, i.e., the national currency equivalent of SDR6,750 at the exchange rate prevailing on the date payment is received. In addition, members would be expected to recognize a contingent liability of SDR92,500 per share. If a call was ever made on the GCI shares, each member would be expected to pay up to the equivalent of SDR92,500 per share, depending on the amount of the call. From time to time, the member (or the Bank) would also be required to make payments of national currency in order to maintain the value of the 6-3/4% portion of paid-in capital at its SDR value of SDR6,750 per share.

29. The preceeding section discussed the benefits to the Bank's bondholders, borrowers and the shareholders themselves that would arise from use of a strong and common standard of value for capital subscriptions. These benefits would, however, involve what may be perceived as a cost to the shareholders, namely, acceptance of an obligation expressed in something other than their own national currency. This cost has two components: (a) the administrative and legislative problems created by MOV on paid-in capital; and (b) the policy and other problems associated with a contingent liability whose value in the member's own currency changes with day-to-day movements in exchange rates.

30. Paid-in Capital. Several different problems are potentially created for members by the maintenance of value obligation. The first concerns the number and size of MOV transactions that could result under a system of floating exchange rates. Technically speaking, MOV obligations could arise on a daily basis for many members, stemming from daily movements of exchange rates. These obligations could also fluctuate in value, sometimes flowing from the member to the Bank (when the member's currency depreciates against the SDR) and sometimes from the Bank to the member (when the member's currency appreciates against the SDR). Fortunately, the Bank has very wide latitude in arrangements for settlement (i.e., payment) of MOV obligations, subject only to considerations of equity among members and prudence in

financial policy. MOV obligations might be accrued for 12 months at a time, for example, and then settled anytime within the subsequent five years.

31. A potentially more serious problem with respect to paid-in capital obligations expressed in terms of the SDR is that members would not know at the time a capital increase was agreed how much national currency would be required to purchase a share of IBRD capital stock. The amount required would depend on what happened to the member's exchange rate vis-a-vis the SDR between the time the increase was agreed and the time the shares were actually subscribed. The legislative process of appropriating amounts for IBRD capital subscriptions would thus be more complicated than if the subscription were expressed in national currency. Moreover, even after subscription was made, some members might need to take legislative action from time to time in order to maintain the funds paid-in in national currency at their initial value. 1/

32. While flexibility in the timing of settlement of MOV could reduce these administrative and legislative problems, a more complete solution may lie in the use of a provision of the Articles that permits the member country to be relieved entirely of the need to make MOV payments. This approach, which has become known as the "Philippines Formula" after the country to which it was first applied, is made possible by the fact that MOV applies only to the national currency portion of the subscription that is actually held by the Bank. If a member exchanges this national currency with a currency acceptable to the Bank, then there is by definition no further MOV requirement (unless, of course, the transaction is reversed). In earlier years, the Bank permitted the Philippines and several other countries to exchange their national currencies for US dollars as a means of obtaining the release, for lending purposes, of otherwise unusable subscriptions.

33. This approach could be applied under an SDR (or any other)

1/ It may be worth noting in this context that none of these problems are unique to an SDR standard. The same problems existed previously when the 1944 gold dollar was the Bank's standard of value, but they arose less frequently - because exchange rates changed less frequently - and they were normally encountered only as part of an explicit decision by the member government to change its currency's official par value. And, except for the United States, they would also exist if the current US dollar were adopted as the Bank's standard of value.

standard of value by permitting countries to exchange their own national currency for the SDR basket of currencies 1/, (or the currency or basket of currencies comprising the standard of value). The value of the national currency portion of their subscription would automatically remain constant in terms of the standard of value regardless of what happened to the exchange rates of the currencies they had exchanged with the Bank.

34. Callable Capital. As noted in the preceding section, expressing IBRD capital subscriptions in terms of SDR would provide important financial benefits to the Bank because of its effect on the long-term value of the callable capital guarantees. The cost to shareholders of providing callable capital in SDR rather than national currency is not financial - because there is no expectation of a call ever being made - but administrative. If expressed in SDR, subscriptions to the Bank would carry a contingent liability that varies in terms of the member's own currency. While this results in only minor inconvenience for some members, others, as a matter of law or policy, may be extremely reluctant in an environment of floating exchange rates to accept an IBRD callable capital obligation expressed in something other than their own currency. Difficulties tend to be greater for those countries with more extensive legislative procedures applying to their Bank subscriptions.

35. A number of options have been explored for alleviating the difficulties associated with a contingent liability that varies in terms of national currency. It might be possible to work out procedures under which a member could temporarily set limits on its national currency liability, with the arrangements to be reviewed periodically.

1/ Since the IBRD has been designated by the IMF as an "other holder" of SDRs, governments could also provide SDRs themselves, though there would have to be satisfactory arrangements for assuring the Bank's ability to exchange SDRs for national currencies in connection with loan disbursements.

Section 4: Substitution of the US Dollar

36. The financial and administrative implications of a current dollar standard of value with the Bank and the member countries would be essentially the same as an SDR standard, with the important exception of the United States. Under this approach, references to the 1944 gold dollar in the Bank's Articles would be read as referring to 1.20635 current US dollars. The par value per share would thus become $120,635 and members' subscribed capital obligations would be defined in terms of the current dollar. Taking the example of the General Capital Increase, GCI subscriptions and share allocations would be established in terms of a subscription price per share of $120,635 rather than SDR100,000. The paid-in portion of each share would be $9,047.62, or 7-1/2%, and $111,587.38, or 92-1/2% would remain uncalled.

37. For all members other than the United States, the administrative and legislative requirements of a subscription to the Bank would be the same as under the SDR standard of value. That is, members would have variable national currency obligations with respect to both paid-in capital and callable capital. As compared to an SDR standard, the size and frequency of such variations might be greater for some members. However, for those countries that maintain the value of their national currency in terms of the US dollar, such variations might be less and perhaps more within their control.

38. For the United States, this option would have the same effect in terms of administrative and legislative requirements as abolition of a standard of value, that is, its subscription to the Bank would be fixed in terms of its own national currency. This would simplify procedures related to its subscription by firmly establishing the value of its obligations in its national currency at the time of agreement to capital increases.

39. Until July 1, 1974, the current dollar value of the SDR was also $1.20635, and adoption of either the SDR or the current dollar as the Bank's standard of value would have produced the same aggregate value for the Bank's capital stock. Since that time, however, the value of the SDR has varied relative to the dollar. As of March 11, 1981, adoption of the current dollar rather than the SDR would result in reduction in IBRD capital (and commitment authority) by about $700 million. How the dollar will vary relative to the SDR over the long term is a matter for speculation. In the past, the dollar, like the SDR, would have given a much stronger basis for capital stock than subscriptions in each member's national currency. It seems likely that it will continue to do so in the future.

Section 5: Multiple Currency Standard

40. The last option would be to seek to retain the advantages of a strong standard of value, but to give members a choice of currencies in which they can subscribe. This approach would be consistent with a view that in economic terms the successor to gold has not been the SDR but rather a multiple reserve currency system in which any or all of several national currencies act as international standards of value. Under this option, which is modelled on the arrangements agreed in the UNCTAD Common Fund, all members would gain slightly greater flexibility in subscribing to Bank capital stock.

41. One way to apply this scheme would be to permit subscriptions to be made in SDR or in any of the component currencies of the SDR. at exchange rates on a given date. Using the rates in effect on the date of effectiveness of the General Capital Increase resolution, for example, the terms and conditions for GCI subscriptions might be amended to state that the purchase price of a share would be SDR100,000 or any of:

US$132,108
DM226,631
FF531,140
Y313,757,000
L59,122

Each member would be permitted to choose any of these currency units in which to denominate its subscription under the GCI. Countries whose currencies are included in the SDR basket might perhaps be restricted to a choice of either their own currency or the SDR.

42. If a member country chooses the SDR, its obligations with respect to paid-in and callable capital would be just as described in Section 3. On the other hand, if it chooses one of the other currencies, its obligations would be expressed in terms of that currency alone. For example, suppose that a country chose to subscribe in DM. It would be required to pay in a total of DM16,997 per share (7-1/2% of the total subscription price per share), of which one-tenth (i.e., 3/4% of the subscription price) would be in gold or dollars and nine-tenths would be in the member's own currency (i.e., the equivalent of DM15,298 or 6-3/4% of the subscription price). Maintenance of value obligations would apply with respect to DM, not SDR. That is, the member (or the Bank) would have an obligation to make MOV payments so as to maintain the national currency portion of the paid-in capital at DM15,298 per share. The callable capital obligation would, of course, also be expressed in DM. In the event of

a call, the member would be expected to pay up to the equivalent of DM209,633 at rates prevailing on the date the call is made.

43. As noted in the Introduction, this option raises far-reaching legal questions under the Articles. Several other questions would appear to be important in considering the merits of this alternative: (1) What would its likely impact on Bank finances be, compared to the other options? (2) How would it affect member countries' subscribed capital obligations? (3) What would happen to the relationship between relative burdens and relative rights?

44. Bank finances. The potential impact of the multiple currency option on the Bank's finances cannot be determined without speculating about the choices member countries are likely to make and the behavior of exchange rates in the future. The SDR component countries (i.e., those whose currencies are in the SDR) may well choose to subscribe in their own currency, and this will change the behavior of their collective portion of capital subscriptions in response to exchange rate movements from what it would be with a pure SDR standard. The following table compares the proportions of these currencies in the SDR and the GCI. As the table indicates, the respective shares in the GCI and SDR are close enough so that one would not expect major differences in the SDR value of this group of countries' subscriptions under either option.

	% Share of Currency in:	
	GCI	SDR a/
US dollar	49.7	44.0
British pound	16.6	12.8
French franc	11.2	12.1
Deutsche mark	11.3	17.7
Japanese yen	11.2	13.4
	100.0	100.0

a/ At exchange rates of March 11, 1981.

45. Effect on Members' Obligations. The five member countries whose currencies make up the SDR basket would: (a) be able to know at the time a capital increase is agreed what their ultimate national currency obligation would be; (b) be relieved of the need to make maintenance of value payments with respect to paid-in capital; and (c) have a fully-determined callable capital obligation in terms of their own currency.

46. Other member countries would be in essentially the same position as under the SDR option. It seems probable that many of the "non-SDR" countries would choose to take advantage of the "hedging" potential of an SDR-denominated subscription and thus choose the SDR as their standard of value, although some might attempt to identify the potentially weakest currency in the SDR basket and subscribe in it. Some might gain a degree of flexibility and simplicity by being able to denominate their Bank subscription in the currency (e.g., the US dollar) against which they maintain their exchange rates.

47. Votes and subscriptions. At the time of a review of capital subscriptions, calculations relating to relative shareholdings and the allocation of new subscriptions among members would need to be done in terms of a common unit, most likely the SDR. Once this allocation of shares were agreed, members could choose which of six different currency units (the SDR plus its five component currencies) they wished to subscribe, at some agreed set of exchange rates. 1/ At the outset, therefore, all shares could entail the same financial burden for members, whether measured in SDRs, dollars, francs or any other currency. However, once different subscription currencies were established, the cost per share for the various classes of shares would begin to diverge from each other as exchange rates changed. By the time of a subsequent review of capital subscriptions, the divergences from the original equal burden per share could be substantial. 2/ These exchange rate movements would affect not only the relationship between, e.g., the UK and the United States, but also all countries that had selected the pound and the dollar as their standard of value. There could be six groups of countries, each having a different cost per share. The following table gives an illustration of the type of change that could take place in the GCI. The table assumes that the five SDR countries all choose their own currency as the standard of value and that all other countries choose the SDR.

1/ If all members were to choose as of a certain date, and the exchange rates of that date were used to determine equivalent subscription prices in the five currencies, there would be less risk that exchange rate movements might affect members' choice of a standard of value.

2/ The movement in exchange rates since January 4, 1980 (the date of effectiveness of the GCI) would have produced a differential of about SDR37,000 per share between the highest and lowest value per share (see table below).

Illustration of Effects of Multiple Currency Standard of Value (SOV) on Relative Subscriptions and Voting Power in the GCI

	Initial Position					After Exchange Rate Changes		
		Price per Share		Total Subscription				
Country	Exchange Rates[a/]	In SOV	In SDR	In SOV(m)[b/]	% Total	Exchange Rates[a/]	SDR Price per Share	% of Total Subscr.[c/]
US	1.32108	132,108	100,000	$8779.5	21.95	1.22700	107,668	23.16
UK	.59122	59,122	100,000	£1314.2	7.34	.555218	106,484	7.66
France	5.31140	531,140	100,000	FF7977.2	4.96	6.11660	86,836	4.22
Germany	2.26631	226,631	100,000	DM3412.4	4.97	2.59142	87,454	4.26
Japan	313.757	313,757[d/]	100,000	¥ 470.5[d/]	4.95	254.603	123,234	5.98
Others	1.000	100,000	100,000	SDR16902.8	55.83	1.0000	100,000	54.72
Total					100.00			100.00

a/ Number of currency units per SDR. Initial rates are as of January 4, 1980, the date of effectiveness of the GCI resolution. Subsequent changes use rates as of March 11, 1981.
b/ The amount of the GCI has been set at SDR30,278.3 million ($40 million divided by 1.32108) and the number of shares has been scaled down to 302,783.
c/ Measured in terms of a common numeraire (i.e., the SDR).
d/ Yen figures are in thousands.

Section 6: Existing Capital Subscriptions

48. The range of possible solutions to the valuation of existing capital subscriptions is much more limited than for future subscriptions. First of all, even with an amendment of the Articles, abolition of a common standard altogether with respect to existing capital would entail legal and financial problems because of the Bank's creditors. Similarly, there would be problems in implementing the multiple currency option retrospectively, since the existing shares were all subscribed at an issue price of 100,000 1944 gold dollars.

49. The SDR or current dollar options, on the other hand, could be implemented for existing subscriptions in the same way as they would apply to future capital increases (including the GCI). Indeed, the General Counsel's 1978 opinion dealt primarily with the question of what members should understand by the term "US dollars of the weight and fineness in effect July 1, 1944" as it applies to their existing capital. Adoption of the SDR or the dollar as the Bank's standard of value would have the effect of re-expressing members' obligations with respect to shares already subscribed in terms of one of these units rather than 1944 dollars.

50. If the current dollar were adopted as the standard of value for existing subscriptions rather than the SDR, the Bank's capital subscriptions and commitment authority could be greater or less than the levels shown in the IBRD financial statements (which use SDR 100,000 as the value of a share of capital stock). As of March 11, 1981, this reduction would have been about $700 million.

Section 7: Summary

51. A strong common standard of value helps the Bank and its shareholders by preserving commitment authority and financial strength and by maintaining a close relationship between members' rights and their obligations. Providing the stronger financial base for the Bank requires, of course, that members with depreciating currencies contribute additional resources.

52. Substitution of the SDR for the 1944 gold dollar would mean that commitment authority would be maintained in terms of a strong standard and the correspondence between votes and subscriptions would be preserved. Substitution of the current US dollar would have similar effects, and in addition for the United States would simplify procedures related to IBRD capital subscriptions. A multiple currency standard based on the SDR currencies would introduce a degree of flexibility for some members and extend the advantages of a current dollar standard to the other four SDR currency countries. The multiple currency standard would correspondingly weaken the link between votes and obligations over time.

Robert S. McNamara

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

718/3/6

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President

DATE: May 4, 1981

FROM: Anthony IJ. A. Looijen, Executive Director

SUBJECT: Valuation of IBRD Capital

In their report to the Governors of the Bank dated May 4, 1976, on the "Increase in Authorized Capital Stock and Special Increases in Subscriptions to the Capital Stock", the Executive Directors brought the following to the attention of the Governors of the Bank:

"12. It will be noted that in accordance with the provisions of Article II, Section 2(a) of the Bank's Articles of Agreement, both the proposed increase in the authorized capital and the proposed special increases in subscriptions are expressed in terms of 1944 dollars.

13. The valuation of the Bank's capital and subscriptions in terms of 1944 dollars is based on the par value system established by the Articles of Agreement of the International Monetary Fund. Since the original Fund Articles of Agreement were drawn up, several developments significantly affecting that system have taken place, culminating in proposed amendments of the Fund Articles currently being considered by the Fund Board of Governors. These amendments, if approved, would, inter alia, result in the formal abandonment of par values and the par value system, subject to reinstitution under certain conditions and with a qualified majority.

14. In the light of the foregoing developments, it is appropriate to examine the effects of these amendments on the Bank's capital, the subscriptions of members and their rights and obligations with respect thereto. Such an examination, which will be put on the agenda of the Executive Directors for a future meeting, relates, however, equally to the existing capital and the proposed additions thereto. The Executive Directors are, therefore, of the opinion that the proposed increase in capital and increases in members' subscriptions need not await resolution of this question."

The first draft memorandum on this issue was sent to the Executive Directors on June 8, 1976 (document SecM76/423), and since then several discussions in the Board and in the Joint Audit Committee have taken place. Most recently a Seminar was held on April 15, 1981, during which your discussion draft memorandum dated March 20, 1981, (document R81-57) was discussed for the first time.

This Seminar has made it clear that no consensus on this issue seems possible in spite of repeated pressure in the Board and the Joint Audit Committee during the last five years and in spite of prolonged efforts of a Working Group in which the six largest Part I shareholders participated.

I agree with those who find it unacceptable that an important international institution, such as the World Bank, does not know the value of its own capital, the value of its shares and the rights and obligations deriving therefrom, and I therefore propose that the Executive Directors, after their discussion on May 7, 1981, decide on short notice on this issue.

To this effect I attach:

1) A Draft Decision of the Executive Directors regarding the interpretation of Sections 2(a) and 9 of Article II of the Articles of Agreement.

2) A Draft Resolution on Implementation of Maintenance of Value

In accordance with Section 3(a), second sentence, of the IBRD Rules of Procedure, I request that these proposals be included on the Agenda for the meeting of the Board of June 4, 1981, to be decided upon by voting, if no consensus proves possible.

Attachments

cc: Mr. Timothy T. Thahane for
distribution to all Executive Directors
and Alternates

DRAFT

Decision of the Executive Directors regarding the interpretation of Sections 2(a) and 9 of Article II of the Articles of Agreement

1. The Executive Directors, acting pursuant to the powers vested in them by Article IX of the Articles of Agreement, have considered the question of the meaning to be given to the term "United States dollar of the weight and fineness in effect on July 1, 1944" (the 1944 US dollar) in Section 2(a) of Article II of the Articles of Agreement in the light of the Second Amendment to the Articles of Agreement of the International Monetary Fund (the Fund).

2. The Executive Directors have noted that the gold content of the United States dollar on July 1, 1944 was established by the Bank's Articles of Agreement as the unit of value in which the size of the authorized capital stock of the Bank and the share of each member in the capital stock is expressed and, as a consequence, as the common denominator and standard of value for determining in terms of the relevant currency the obligation of each member to make payments to the Bank on account of the paid-in and callable portions of its subscription, as well as the mutual obligations of each member and the Bank to maintain the value of the portion of that member's subscription paid in its own currency. They also noted that the value of the Bank's subscribed capital, in terms of currencies of members, is an essential element in determining the limit imposed by Section 3 of Article III of the Articles of Agreement on the Bank's disbursed and outstanding loans and its outstanding guarantees (the lending limit).

3. Section 2(a) of Article II of the Bank's Articles was drafted in the context of the monetary system established at Bretton Woods which gave

a central place to gold. Under the Fund's Articles par values for members' currencies were to be expressed in terms of gold or in terms of the 1944 US dollar. The Executive Directors have noted that upon the coming into effect on April 1, 1978, of the Second Amendment to the Articles of Agreement of the Fund (i) the function of gold as the common denominator of the par value system was eliminated, (ii) the official price of gold was abolished, (iii) par values of members' currencies in terms of gold ceased to exist and, if at some future time the Fund permits the re-establishment of par values, gold will not be the common denominator and (iv) consequently there is no longer any official basis for relating the value of any member's currency to the gold content of the United States dollar in effect on July 1, 1944.

4. The Executive Directors consider it essential for a continued proper application of the Bank's Articles of Agreement to determine the unit of value which will perform the function assigned by the Bank's Articles to the 1944 US dollar.

5. The Executive Directors have noted that the special drawing right of the Fund was defined, under Article XXI, Section 2 of the Fund's Articles of Agreement as they stood immediately prior to the Second Amendment, in terms of the same gold content as the 1944 US dollar, and that when an alternative method of valuation of the special drawing right was adopted by the Fund in June 1974, the "basket" of members' currencies on which such valuation was based was composed and calculated so as to produce an initial value of the SDR, namely $1.20635 on the basis of the dollar's 1973 par value.

6. In the light of the foregoing, the Executive Directors have come to the conclusion that, since the coming into effect of the Second Amendment to the Fund's Articles the special drawing right of the Fund constitutes the unit of value for members' currencies which will most effectively and

fairly fulfill the purposes for which governments represented at the Bretton Woods Conference adopted the 1944 US dollar as the denominator of the Bank's capital.

7. For these reasons the Executive Directors decide that with effect from April 1, 1978, Section 2(a) of Article II of the Bank's Articles of Agreement shall be interpreted to mean that the capital stock of the Bank and its shares therein are defined in terms of the special drawing right of the International Monetary Fund, as determined from time to time by the Fund, on the basis of one such special drawing right for one United States dollar of the weight and fineness in effect on July 1, 1944.

8. The Executive Directors further decide that, as from the same date, the mutual obligations of each member and the Bank to maintain the value of holdings of the member's currency under, and within the limits of, Section 9 of Article II of the Articles of Agreement will be measured by the value of that currency in terms of the special drawing right at any given time and that any payments by or to the Bank resulting from such valuation of Bank's holdings of the member currency will be made at such times as the Bank shall determine in accordance with rules uniformly applicable to all members.

DRAFT

RESOLUTION

Implementation of Maintenance of Value

Whereas the Executive Directors have decided on .... 1981 that with effect from April 1, 1981, the mutual obligations of each member and the Bank to maintain the value of holdings of the member's currency under, and within the limits of, Section 9 of Article II of the Articles of Agreement will be measured by the value of that currency in terms of the special drawing right at any given time and that any payments by or to the Bank resulting from such valuation of Bank's holdings of the member currency will be made at such times as the Bank shall determine in accordance with rules uniformly applicable to all members:

It is hereby resolved:

1. Each member and the Bank shall determine their respective maintenance of value obligations in respect of the currency of such member derived from the portion of its subscription, paid in its own currency under Section 7(ii) of Article II or the applicable Board of Governors Resolution authorizing such subscription, and held by the Bank in cash or substitution notes as of the end of each fiscal year, and make payment of such obligations within eighteen months thereafter.

2. Notwithstanding the previous paragraph, if the obligations so determined in respect of any currency are equivalent to less than five percent of the holdings to which they apply, the amount of such obligations shall be carried on the books of the Bank, but no payment shall be made on account thereof until such obligations constitute as of the end of any fiscal year the equivalent of more than that percentage.

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WORLD BANK / INTERNATIONAL FINANCE CORPORATION

718/3/5

RSM

OFFICE MEMORANDUM

TO: Members of the Finance Committee

DATE: May 6, 1981

FROM: Moeen A. Qureshi MAQ

SUBJECT: Maintenance of Value

05/06

Attached is a draft note on Maintenance of Value which has been prepared by Mr. Wood's Department. The paper is in line with our earlier discussions. However it no longer reflects my own recommendations which I will present orally during the Finance Committee meeting this afternoon.

MAQureshi:gmb

DRAFT
PVApplegarth:eok
May 6, 1981

Mr. Robert S. McNamara

Moeen A. Qureshi, Senior Vice President, Finance

Subject: Maintenance of Value

1. Over the past two weeks, we have had extensive discussions with the United States' and with the Executive Directors seeking a solution to the MOV problem. Directors have also consulted extensively among themselves.

2. Our present thinking is that only two of the options being considered have a chance of being accepted as the basis of a consensus; 1/ the two are the dollar and the five currency scheme. However, both are opposed by one or more major shareholders. The Japanese oppose the five currency scheme because they do not want an amendment; the French strongly oppose the dollar as a matter of principle; other countries share these misgivings.

1/ While it will not be accepted by consensus, the possibility that the SDR will be adopted by majority vote cannot be entirely ruled out. Mr. Looijen may circulate a resolution calling for a vote on the SDR, and the Scandinavians have indicated they may vote in favor of such a resolution. However, several countries have indicated that voting would put them in a very difficult position; the British and the Japanese, in particular, have indicated they would be reluctant to vote against the U.S. and might abstain. In a vote, a majority of votes cast, excluding abstentions, would be determinative.

3. If as I suspect it is not possible to reach a consensus, I suggest that you sum up the meeting with a proposal to maintain the status quo for the duration of the GCI subscription period. Two questions need to be addressed in defining precisely what the status quo is. First, the Bank is presently accepting subscriptions on an interim basis at the rate of one 1944 dollar equals $1.20635 current dollars, subject to adjustment when the valuation issue is settled. This is consistent with your March 28, 1978 memorandum to the Board (copy attached). However, we are bound to be asked whether under the status quo the Bank will also accept subscriptions at a rate of one 1944 dollar equals one SDR. The 1978 memorandum indicated "we should begin to move towards substituting the SDR as the unit of value in which to define the capital stock of the Bank," and, for a time, the Bank notified some shareholders that it would permit subscriptions at the SDR rate. No member exercised this option because until recently subscriptions at the SDR rate would have been substantially more expensive that subscriptions in dollars. 1/

1/ In 1980, Vietnam indicated it was prepared to adjust its subscription to the SDR in connection with a change in its currency. The Bank took no position on this point, and suggested that Vietnam substitute its new currency for the old currency without adjusting (i.e., maintaining the value) on the total amount.

While the Bank has ceased notifying members that they have the option to subscribe at the SDR rate, there is some ambiquity as to whether the Bank would accept a SDR subscription if it was tendered. This issue is now relevant since subscribing in SDR's would be cheaper than subscribing in dollars. The issue is further complicated by the history of the GCI report and resolution. In the first Board draft of the GCI report, language was included indicating that members could subscribe at a price of 100,000 SDR per share. This language was deleted at the request of the United States, but with the concurrence of several other Directors, including Mr. Looijen, who were advised that deletion of the language would not prejudice the right of members to subscribe in SDR's.

4. Because good cases can be made both for and against accepting subscriptions in SDR terms as well as in relation to $1.20635, the draft summary statement below includes alternatives. The longer version contemplates SDR subscription, the other does not. On balance, and despite the fact that the United States is likely to object, I believe subscriptions on the SDR basis should be permitted. SDR subscriptions by other countries do not threaten a vital interest of the United States, and giving other shareholders this point will certaily facilitate their agreement to continue the status quo.

5. A second issue which will arise is what to do about settlement of "notional" MOV obligations. Germany is likely to insist that existing maintenance of value obligations be settled. As a precondition to their agreement to continuation of the status quo. They are under pressure from the German equivalent of the GAO to enforce their "right" to settlement of MOV. Such settlement would represent a departure from the 1978 paper, which indicated that the Bank was not establishing or settling maintenance of value obligations. It will also raise an issue for some countries, most notably the United Kingdom, whose currencies have depreciated since the early 1970's when MOV obligations were last settled. There is merit to clearing up these obligations. Subject to our being able to reach a satisfactory accommodation with the British, 1/ we believe your summation should also include a proposal that countries make arrangements with the Bank within the next six months to settle their existing MOV obligations against the dollar. (i.e., $1.20635).

6. In short, our recommended fall back position in the absence of a consensus is to permit shareholders to subscribe, subject to adjustment, in dollars or the SDR, for the duration of the GCI subscription period. ~~(Once a member chooses, its choice would be binding for all its additional subscriptions during the GCI period.)~~ Members should make arrangements with the Bank within the next six months for settlement of existing obligations.

1/ We have told them they can reduce the budgetary implications of settlement be depositing notes and releasing the currency over time.

7. A possible summation statement would be as follows:

"Gentlemen, from the diversity of comments received today, it is clear that we will not be able to achieve a consensus on a final solution now or in the near future. However, several shareholders have indicated they need to know how we intend to proceed, so that they can begin to subscribe to the GCI. Therefore, in the absence of a consensus on a final solution, I think that the only viable option is to proceed on the basis of the status quo for subscriptions to the GCI. That is, the Bank should continue to accept subscriptions at a rate of one 1944 dollar to $1.20635 current dollars, subject to adjustment when the valution issue is settled. [The Bank should also accept subscriptions at a rate of one 1944 dollar to one SDR, also subject to adjustment.] [Each member will have the choice of subscribing in dollars or SDR's, however, once it chooses, its choice should apply to all its subscriptions under the GCI.] I also note with understanding the concern expressed by some members that settlement of maintenance of value obligations on existing subscriptions be brought current. With the fluctuations in exchange rates over the past several years large divergences have been created in obligations among shareholders, and in the obligations between the Bank and shareholders. There is value in cleaning up these obligations. Therefore, I would propose that maintenance of value obligations on existing subscriptions be calculated against $1.20635, the last par value of the dollar, as of some date in the near future, for example, June 30, 1981, and that members make arrangements with the Bank within the following six months for settlement of these obligations. Actual payments and release of the currencies for the use in Bank operations could be made over a longer period."

Attachment

cc: Messrs. Golsong, Scott, Wood

PVApplegarth:eok

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

718/3/4

CONFIDENTIAL

TO: Mr. Robert S. McNamara

DATE: May 6, 1981

FROM: H. Golsong, NFG

SUBJECT: Maintenance of Value

In order to avoid any misunderstanding with regard to my personal position as to the possible recommendation permitting shareholders to subscribe, at their option, in dollars or SDRs for the duration of the G.C.I. subscription period (Mr. Applegarth's draft of May 6, para. 6), I would like to repeat that I am opposed to the introduction of the SDR in the subscription formula under the G.C.I. labeled "status quo" formula. The reasons for this opposition are as follows:

1. The inclusion of the SDR is inconsistent with the description of the "status quo" as described in your memorandum to the Executive Directors of March 28, 1978 (SecM78-251). This memorandum contains the following two paragraphs:

> "5. In view of the uncertainties regarding exchange rates and the proposed amendments to the Fund's Articles of Agreement, the Bank (except in a few cases where provisional settlements were made) has not, for several years, established and settled the maintenance of value obligations arising under Article II, Section 9 (see note B of the notes to Financial Statements) and has accepted subscriptions and payments based on the 1944 gold dollar being equal to 1.20635 U.S. dollars."

05/07

> "6. In view of the fact that the Second Amendment to the Fund's Articles of Agreement shortly will become effective, and taking account of the General Counsel's opinion, I believe we should begin to move towards substituting the SDR as the unit of value in which to define the capital stock of the Bank. However, some member governments may feel that a substitution of a new unit of value, insofar as it would give rise to any new obligations with respect to maintenance of value and capital stock subscriptions and payments, should be made only by amendment of the Articles. There are many other issues that may be raised, such as the desirability of retaining the principle of maintenance of value and the appropriateness of substituting a different unit of value other than the SDR, i.e. the dollar. Some time will be required by the Board to resolve these issues. During this period we will continue the practices referred to in paragraph 5."

I attach particular importance to the last sentence of paragraph 6 which refers to the practices described in paragraph 5 of your memorandum, which in turn refers to subscription in payments based on the 1944 dollar equals US$ 1.20635. There is no reference to the SDR.

2. The option SDR/US dollar was given to our members at the initiative of the then General Counsel, Mr. Broches, and was discontinued after his retirement at the end of March 1979. It is to be noted that no member used the SDR option At the time it was offered the dollar was quoted at approx. $1.30 per SDR and therefore the SDR option was useless to members.

3. If therefore we would at this stage introduce an SDR oprtion in addition to the formula of one 1944 US dollar equals $1.20635, we could hardly present this recommendation as a recommendation based on the "status quo".

4. There would be a number of open questions which we would have to address in case it were decided to introduce the SDR option. Would the introduction of the SDR option, in addition to $1.20635, mean that we did not have a common standard of value? On which basicould a call for the 90% capital be computed if the interim arrangements remain in effect? Would such a call be based on the SDR following Mr. Broches' opinion or on the SDR or dollar, whichever resulted in a smaller potential liability for members? Would such an arrangement not introduce an additional uncertainty as to the exact amount to be paid in on our capital stock under the G.C.I. and thus disturb our position on the capital market?

5. Finally, the United States has always strongly opposed the SDR option and considered it a violation of their understanding with you which was embodied in your memorandum of March 28, 1978. I attach Mr. Fried's memorandum of April 1979 requesting the deletion of the paragraph in the G.C.I. resolution which specifically provided for this option. As you remember, this paragraph was deleted, although several Directors, including Mr. Looijen, agreed to the deletion because they thought the option would be available even without specific mention in the Resolution.

Attachment

HGolsong:csh

Capital increase
bk. pl.

APRIL 1979

TO: Mr. Robert S. McNamara

FROM: Ed Fried

SUBJECT: IBRD General Capital Increase

I should like to add my suggestions for changes in the draft Executive Directors Report and Board of Governors Resolution to those of Messrs. Looijen and Ryrie.

I am suggesting changes in paragraphs 6 and 7 of the Report and paragraphs 1 and 4(g) with the objective of making absolutely clear in those documents that there has been no resolution of the unit of value and maintenance of value issues and that the status quo will be preserved until such resolution occurs. This is consistent with your memorandum of March 28, 1978, on the valuation of the Bank's capital and the Notes to the 1978 Financial Statements of the Bank.

In particular, I have suggested deletions in paragraph 7 of the Report and paragraph 4(g) of the Resolution which would allow member countries the option of making payment for their shares on the basis of one share of capital stock being equivalent to 100,000 Special Drawing Rights. I see no basis for sanctioning this departure from the status quo and no advantage for the Bank's financial position in this procedure. I should emphasize that I believe that the maintenance of the status quo until resolution of the unit of value and maintenance of value issues neither favors nor discriminates against any member country.

I have previously expressed my view that the substitution of a new standard of value which would change members' obligations relating to their subscriptions to Bank capital stock in a manner which cannot be said to have been initially intended by the members, would constitute a revision of the Articles of Agreement, and, therefore, needs to be undertaken by amendment of the Articles and not by their interpretation. The changes which I have suggested in paragraph 7 of the Report and paragraphs1 and 4(g) of the Resolution reflect this view.

I am prepared to discuss all aspects of unit of value and maintenance of value issues with the objective of finding a solution which protects the financial integrity of the Bank and which is equitable for all members.

Attached are versions of paragraphs 6 and 7 of the Report and paragraphs 1 and 4(g) of the Resolution which incorporate my suggested changes.

Attachments

Para. 6

In order to translate the overall increase of $40 billion into a specific number of shares to be subscribed by each member, it is necessary to determine a subscription price per share. The IBRD Articles of Agreement express the Bank's capital in terms of 1944 dollars. The 1944 dollar ceased to have a par value in terms of gold on April 1, 1978, the effective date of the Second Amendment of the IMF Articles of Agreement which abolished par values. The implications of this change on the valuation of Bank capital stock are still being examined. Since April 1, 1978, the Bank has expressed the value of its capital stock on the basis of the SDR for purposes of its financial statements. The Bank has continued to accept capital subscriptions at $1.20635 current U.S. dollars to one 1944 dollar, the value of the 1944 dollar at the last par value of the U.S. dollar, subject to the possibility that adjustment may be required by resolution of the standard of value issue.

Para. 7

No decision has been made on this issue. Until such time as the Bank members decide by amendment of the Articles on a different valuation for Bank capital subscriptions, the Bank would continue to accept subscriptions at the price of $120,635 per share, subject to possible adjustment as provided above. On the basis of one share being valued at $120,635, the proposed $40 billion increase translates into an increase of 331,500 shares.

Board of Governors Resolution

Para. 1

The authorized capital stock of the Bank shall be increased by 331,500 shares of capital stock having a par value of $100,000 each in terms of 1944 dollars; provided, however, that if as a result of a modification by Bank members of the standard of value for Bank capital stock the increase in authorized capital is in excess of $40,000,000,000 calculated as of the time of such modification and on the basis of that value, the number of shares authorized by this Resolution shall be reduced so that such value shall be equivalent (to the nearest number of shares) to $40,000,000,000.

Para. 4(g)

any payment required to be made on account of subscriptions pursuant to this Resolution shall be made on the basis of one share of capital stock being equivalent to $120,635, subject to such adjustment as may be required by a subsequent modification in the valuation of Bank capital subscriptions.