

## 2 The Capital Structure of the MDBs

### *Conceptual Architecture of the Equity Base*

The conceptual architecture common to the equity (i.e. ownership) capital construction of all the MDBs was established with the formation of the IBRD – i.e. the core of the World Bank. From the outset the IBRD was designed to be an institution which would be owned, and whose capital would be provided, by governments and not by private sources. Also, in the aftermath of the Second World War, it was designed to incorporate as much inclusiveness in its ownership as possible. In the event, that did not happen until 1990 when, after the collapse of the Berlin Wall, the countries of the former East Bloc joined or rejoined the institution. Its initial authorised capitalisation of US\$10 billion (of which US\$9.1 billion was subscribed) consisted of: (a) 20% *paid-in capital* and (b) 80% in the form of *callable* or *guarantee* capital. Of the one-fifth paid-in capital component, 2% was to be provided in convertible form, i.e. in gold or US dollars, and 18% was to be paid in the domestic currencies of member countries. The Bank's Articles of Agreements required it to limit its outstanding loans to the total amount of its subscribed capital (i.e. both paid-in and callable) i.e. a 1:1 loans to capital ratio.<sup>1</sup>

This capital structure was designed with several objectives in mind:

- Every member country – no matter how poor – should be able to participate in providing its share of equity capital without having to bear an unaffordable fiscal burden, by providing only a minuscule fraction (2% originally) of its capital payment in *usable* form;
- Countries which were temporarily poor and experiencing balance-of-payments difficulties were permitted under this arrangement to contribute the larger part of their paid-in capital (the 18% domestic currency portion) in a way which would gradually become usable later. This was the

---

<sup>1</sup> Thus, compared to most market-based financial institutions whose loan assets often exceed their stockholders' equity by a considerable multiple (averaging between 10-15 times) the Bank might be deemed to be very conservatively geared in terms of its total capital base. But the more comparable capital base would of course be the usable and available (i.e. paid-in and convertible) cash capital provided by those shareholders regarded as creditworthy in international capital markets.

case with most European countries and Japan immediately after the Second World War whose currencies only became fully convertible after the 1960s. The domestic currency capital contributions of a large number of *developing* country members with inconvertible currencies are now usable although often on a restricted basis under certain specified conditions (e.g. such as use for certain types of local expenditures in that country). In some cases these inconvertible currencies are now even lent out by the IBRD and other MDBs as occurs with Indian rupees provided they are used for procurement from India. When currencies on loan are not fully convertible, and therefore not openly available on foreign exchanges, borrowers and MDBs have to make special arrangements to ensure the availability of these currencies for repayment.

- A high level of *cash* gearing was induced by emphasising the mobilisation of loanable capital from private market sources. Such market-capital would of course be underpinned by the collective guarantees of the world's governments. Framing the capital structure in this manner, the architects of the IBRD envisaged that the Bank would make extensive use of the guarantee powers which were highlighted in its Articles.<sup>2</sup> Persuaded that it should not become a purely government funded agency vulnerable to the political willingness and ability of its member states to finance its operations, the original architects of the Bank designed its capital structure to encourage it to mobilise resources from international capital markets for financing its lending operations rather than relying on the use of its government-provided capital to finance lending.

It took some time for the World Bank to get off the ground and for capital markets to accept without qualms the underlying risk on the securities it issued. By the time the next MDB was established in 1959 (i.e. the IDB), however, this capital structure had proven its durability and was replicated for every MDB that has been set up since. All the multilateral development banks therefore have their financial edifices constructed on a figment of confidence, originally incorporated in the financial architecture of their progenitor. MDB balance sheets – i.e. the size of their asset and liability structures – have since been highly geared by permitting them to borrow and lend substantial

---

<sup>2</sup> As events transpired of course the World Bank did not even begin to use its guarantee powers in any serious fashion until the late 1980s. Even now it uses them very sparingly while the other MDBs have not yet begun to use their guarantee powers at all. In September 1994, the President of the Bank issued an instruction to all staff requiring that henceforth guarantees were to become a mainstream instrument, alongside loans, in the Bank's regular operations.

amounts against a relatively small amount of *paid-in* (cash) capital. This point is explored in greater detail later in this chapter.

### *Callable Capital*

The figment of confidence underlying the capital structure of the MDBs is embedded in the notion of *callable capital*. This feature assures the creditors of these institutions that each dollar lent is fully backed by a dollar of shareholders' equity, given the 1:1 limitation on the loan assets to capital ratio. Allowing for the cash equity and *reserves*<sup>3</sup> components of MDB liabilities, that assurance enables the borrowings undertaken by the MDBs to be fully covered by total net worth. However, only a small fraction of the *equity dollar* in MDBs is paid up-front in cash. The bulk is subscribed in the form of a guarantee provided by shareholder governments which could be *called* in the event that repayments from MDB borrowers' and available liquidity are insufficient to cover the MDB's own obligations to its creditors.

MDB managements and their shareholders (particularly those OECD countries whose budgets are likely to bear the brunt of the burden of any calls) have laboured over the years to ensure the application of high standards of financial soundness and performance on the part of these institutions. This emphasis has been placed so as to maximise MDB reliance on *internally generated* capital resources (i.e. retained earnings and reserves) and to minimise, to a level of insignificance, any risk that callable capital might actually be required to be paid-in.

Until the mid-1980s, confidence in the financial strength and backing of the MDBs was rarely, if ever, questioned in global capital markets. But, since the debt crisis which engulfed a large number of developing countries in the 1980s, their financial standing and performance has come under increasing scrutiny in financial markets. Yet, despite a discernible deterioration in the intrinsic quality of their portfolios during the 1980s, all the MDBs have managed to maintain the highest ratings for their debt issues in international capital markets, enabling them to continue borrowing at extremely fine spreads. Indeed MDBs are now borrowing at even finer spreads over prime government issues in major world markets than they were before. Their credit ratings thus appear to rely less on the financial performance and

---

<sup>3</sup> These reserves, relative to the paid-in cash capital, are now quite sizeable in the case of all the MDBs except the AfDB and EBRD. These reserves are essentially a paid-in capital substitute. They belong to the share-holders as retained earnings which have not been distributed as dividends. The only difference is that they do not have attached to them a callable capital guarantee as paid-in capital does.

standing of the MDBs themselves<sup>4</sup> and much more on the *callable capital* guarantee.

It has always been recognised (albeit quietly) within the MDBs, and in the markets that provide them with funds, that the *quality* of the capital provided by all member governments in the form of domestic currency payments and in callable form was not uniform or equal. But this realisation was more specifically explicated in the 1980s when markets noted bluntly that the callable capital obligations of many of the MDBs' poorer member countries could not be counted upon to support the full safety of MDB borrowings. They signalled clearly that the callable capital of a severely-indebted, low-income country (SILIC) – whose currency was not readily convertible, subject to high devaluation and exchange risk, and whose international reserves were supported mainly by aid flows – could not be given the same weight as the callable capital of an OECD country or of a newly industrialised country.

### *Usable Capital*

Hence the notion of *usable capital* – which markets had always been conscious of but, until the 1980s, not too concerned about – was refined through the 1980s as the more relevant dimension against which comfortable levels of borrowing and lending ought to be gauged. In other words, it was regarded as imprudent by markets (in terms of heightening the risk of calls on guarantee capital being made) for MDB managements and shareholders to extend MDB balance sheets to the limits of 100% of *subscribed capital* as their Articles clearly permit. Prudence dictated instead that MDB borrowing and lending should be more appropriately gauged against limits of *readily usable capital*; with capital increases being negotiated and concluded before borrowings or outstanding loans approached the limits of usable capital. Obviously, considerable differences of opinion exist as to what proportion of callable capital is *readily usable*. Financial analysts and rating agencies vary widely in the definitions of usable capital which they employ. Most judgements are arbitrarily based on including in usable capital only that portion which is provided by the following shareholders: (a) countries which are members of the OECD or which enjoy the higher investment grade ratings on their own debt instruments in international capital markets; (b) some Arab members of OPEC which have enjoyed large, sustainable current

---

4 In terms of strict financial analysis it would be difficult to make the case that their relative strength and standing had not deteriorated since the 1970s with the MDBs now being affected by protracted arrears and non-payment risks of a sort that simply had not occurred or even been contemplated until 1984.

account surpluses and have accumulated large holdings of international reserves relative to their import needs; and (c) some newly industrialised developing countries (NICs) which generate large current account surpluses, have large reserves and can easily access international capital markets for funds on a voluntary basis (e.g. Hong Kong, Korea, Singapore and Taiwan).

From time to time, with the legislatures of certain countries being unwilling to appropriate funds for MDB hard and soft loan windows (even after they have been authorised), questions have been raised about whether the callable guarantee provided by certain OECD countries should be counted in *usable capital*. With the complex, unwieldy parliamentary procedures which some of these countries have, it is conceivable that they might find it difficult to meet calls quickly in the event of an unforeseen financial calamity befalling the MDBs. These worries range from the intellectually interesting to the extremely unlikely. But they do emphasise the need to codify clear rules and criteria, in the case of each MDB, to define unambiguously the make-up of its *usable capital* and to reach a consensus among all parties – i.e. the MDBs themselves, analysts in financial markets and the rating agencies – as to exactly what components of capital are to be regarded as usable.

### ***General and Selective Capital Increases***

The capital base of the MDB hard-windows has, since their inception, been increased several times (except of course in the case of the EBRD which is a relatively new Bank) through both *general* and *selective* (or special) capital increases. For example, in the IBRD, the authorised capital has been increased more than 18 times over the last fifty years through a number of formally negotiated capital increases. The purpose of a *general capital increase* (GCI) is to increase the share capital of the Bank concerned when it approaches the limits of its present capital base in expanding its lending capacity further. Under a GCI such an increase in capital is spread proportionately among existing shareholders on a *pari passu* basis i.e. relative to their extant weight in share ownership. However, almost every GCI negotiation has witnessed some marginal shifts in the relative shareholdings of member countries to reflect changes in their relative economic weight.

*Selective capital increases* (SCIs) on the other hand are not intended primarily to provide additional capital for an MDB. Instead, they are aimed principally at adjusting the relative weight and voting power of one or a few members in the shareholding structure of a particular MDB. SCIs are propelled largely by political impulses and are usually instigated at the urging of the larger more important shareholders of MDBs to reflect voting right

adjustments among themselves.<sup>5</sup> The considerations surrounding an SCI to accommodate a changed position for a major shareholder usually induce other smaller shareholders to also argue for periodic relative changes in their positions vis-à-vis their cohorts. Most SCIs attempt to correct the inevitable anomalies in their shareholdings as well, though not always successfully. The politics underlying an SCI are usually more difficult for MDB managements to handle than the imperatives of a GCI which benefit the standing of the institution more than the standing of particular shareholders within that MDB.

The main developments by way of GCIs and SCIs which have occurred in each of the MDBs since their inception are summarised briefly below.

### *The World Bank*

The World Bank (IBRD) has had six GCIs and several SCIs which have increased its authorised share capital from US\$10 billion in 1947 to US\$184 billion now. Subscribed capital has increased from an original amount of US\$9.1 billion to US\$170 billion at the end of FY94. The first GCI in 1959 more than doubled the original size of the IBRD's capital from US\$10 billion to US\$21 billion. The paid-in portion of the capital contributions was reduced from 20% to 10%, with the same proportions (1:9) being maintained for the convertible (i.e. payable in gold or US dollars) and domestic currency<sup>6</sup> payments. Thereafter there were three small GCIs between 1963-70 which increased capital by a further US\$6 billion, mainly to accommodate the entry of new members. The fifth GCI in 1979 increased the Bank's authorised capital base from US\$27 billion to nearly US\$72 billion while reducing the paid-in portion further to 7.5% and retaining the 1:9 ratio for convertible and domestic currency payments. The IBRD had a large intervening SCI in 1984 of about US\$8.5 billion aimed largely at improving the position of Japan from being the Bank's fifth largest shareholder to becoming its second largest

---

5 In the IBRD, *selective capital increases* can be triggered by (i) changes in relative IMF quotas among members; (ii) the entry of a new member country into the shareholding of the institution; or (iii) the particular circumstances of an IDA replenishment when the willingness of a major country to contribute substantially more concessional resources is made conditional upon an increase in its shareholding in the affiliated MDB. In the regional banks, SCIs are negotiated on much the same types of principles and grounds although often in different ways, given the differences in political modalities and relationships among countries in different regional institutions. What is a particularly sensitive issue in the regional banks is the shareholding of non-regional members.

6 For historical reasons dating back to the origins of the IBRD when the domestic currency portion of paid-in capital amounted to 18%, this element of capital has always been referred to as the *18% capital*.

with a corresponding decline in the share of the UK which dropped from second position to a joint fourth position with France. This was followed by two smaller SCIs in 1987 and 1988 and by a sixth GCI in 1988 which increased IBRD's authorised capital from around US\$88 billion to its present level of US\$184 billion. In that GCI the paid-in portion of capital was reduced to only 3%; again with the 1:9 ratio of convertible to local currency payment remaining intact. The most recent review of the capital adequacy of the IBRD did not signal any immediate need for another capital increase unless: (a) the Bank's sustainable lending level<sup>7</sup> of US\$21 billion annually was exceeded through the mid-1990s, and (b) other issues relating mainly to movements in exchange rates and the standard-of-value for the Bank's capital remained unresolved. The first eventuality seems unlikely to materialise if the sharp drop which occurred in the IBRD's lending in FY94 is repeated in FY95 and beyond.

Whereas the basis for successive GCIs in the World Bank has been fairly clear and largely unarguable – at least to those who favour a continuing expansion of its lending operations – the rationales for its SCIs have been more contentious. This is understandable because SCIs disturb the equilibrium of previously (and delicately) negotiated balances between the conflicting interests of different shareholders in what are rigidly constrained environments. As such, they raise difficult issues for the many in order to accommodate a few. Despite the pain and effort involved, SCIs are agreed to partly because of genuflection to notions of *fairness* but much more because of *realpolitik*. In the absence of such agreement the World Bank would probably have been deprived of as much funding for IDA from offended *nouveau riche* members (as it actually has obtained by increasing their shareholding in the IBRD, where votes really count).

As a general rule, the allocation of IBRD shares among its now 178 members is based on the principle that their relative shareholdings in the IBRD should, by-and-large, reflect their relative positions in the world economy. The catch, of course, is that no completely objective and unarguable set of criteria or of economic measurements have yet been devised which can translate a *theoretical* concept of relative standing in the world

---

7 This contrived, notional concept of the **sustainable level of lending** is roughly defined as the maximum amount of annual lending (in commitments) that the Bank can reasonably sustain indefinitely in nominal dollar terms under a certain set of assumptions (about exchange rates, repayments, etc.) without running the risk that disbursed and outstanding loans might exceed the amount of the Bank's total subscribed capital and retained earnings (or ordinary reserves). The SLL concept was devised in 1976, at the time of a selective capital increase, in order to accommodate a policy aimed at planning annual levels of future IBRD lending which would not require disruptive adjustments to be made in the event that further capital increases could not be agreed.

economy in concrete, mathematical terms that everyone can readily accept. In its *practical* application this principle has therefore been translated to imply that members' shareholding in the IBRD should be *parallel* to their relative quotas in the IMF. The other justification for the *principle of parallelism* with quotas in the IMF is that countries cannot become members of the World Bank unless they are already members of the Fund. IMF quotas are calculated on the basis of a number of mathematical formulae which, though flawed and imperfect, attempt to reflect in some consensual manner the overall weight of a particular country in the world economy. Consequently members who get special (selective) increases in their IMF quotas should also receive similar special increases in their allocations of IBRD shares. Yet, relative shareholdings in the IBRD do not reflect strict parallelism with relative IMF quotas for a number of reasons:

- Some countries (India, for example) have followed a policy of always exercising their *pre-emptive rights*<sup>8</sup> (enshrined in the Bank's Articles of Agreement) in previous increases of IBRD capital even though such rights negate the intent of an SCI.
- Some members have not taken up all the shares allocated to them.
- The issuance of an equal number (250) of membership shares to all members in the 1979 GCI has affected relative shareholdings. These shares were issued to protect the voting power of the smaller shareholders and to avoid too precipitate a decline in the collective voting power of developing countries relative to that of the developed countries.
- In 1987 and 1988 there were two SCIs for the developed (i.e. Part I) and developing (Part II) countries respectively which deviated from the principle of parallelism by taking into account, for example, relative contributions by Part I members to IDA replenishments.

Despite attempts by ad hoc committees of the IBRD's Executive Directors to establish a clear set of common criteria for the allocation of shares in the IBRD, no such criteria have as yet been established and no consensus has been reached on deriving or applying them. In the regional banks, similar complications and contentions apply in determining the share allocations of

---

<sup>8</sup> Under the Articles of Agreement of the IBRD, whenever the capital of the Bank is increased, for whatever reason, all members have the right to obtain sufficient shares to maintain their relative position should they so wish.



individual members. In these cases, the basis for allocation is more the weight of member countries in the *regional* rather than the global economy. Further complications arise when the relative weights and share allocations of the *non-regional* members have to be negotiated. One way of cooling down the desire of certain members to insist on SCIs for reasons of political prestige rather than economic justification would be to require them to provide 100% of their specially allocated share subscriptions in fully paid-in and convertible form. That measure would certainly benefit the MDBs more than present SCIs actually do. This measure could not, of course, be applied in cases where a change in relative standing was clearly justified on economic grounds (e.g. if a major change in relative IMF quotas had occurred) or in the case of admitting new members. The same measure might be contemplated for application to all members who insisted on exercising their pre-emptive rights.

### *The African Development Bank*

The authorised capital of the African Development Bank (AfDB) on its formation in 1965 was US\$250 million of which US\$218 million was subscribed by 1968. Of the amount initially subscribed, 50% was supposed to have been paid-in. In the event, only about 25% was actually paid-in by the regional members presaging the problem of chronic arrears in capital subscriptions which has since characterised the AfDB.<sup>9</sup> The Bank has since had four GCIs and eight special increases which have resulted in increasing its authorised capital to US\$22.25 billion at the end of 1993. The most significant of these increases were: (a) GCI-3 (comprising the combined capital increases of 1979 and 1981) which saw the admission of non-regional members into the shareholding of the AfDB, along with a substantial increase in the Bank's capital base to over US\$5 billion; and (b) GCI-4 in 1987 which increased the AfDB's capital to more than four times that amount. With GCI-3 the principle was adopted that regional members (i.e. those physically located in the continent of Africa) would at all times have among them no less than two-thirds of the subscribed capital stock of the Bank.

As noted above, prior to GCI-4 in 1987, the *paid-in* portion of AfDB's subscribed capital was 25% with the remaining 75% being callable. Under GCI-4 the paid-in proportion was reduced sharply to 6.25%. It was expected that when the shares allocated under the three previous GCIs and GCI-4 had

---

<sup>9</sup> See Culpeper, R., "The Regional Development Banks: Exploiting their Specificity", p. 227; Volume II of "Bretton Woods: Looking to the Future", A Report of the Bretton Woods Commission, Washington DC, July 1994.

been fully subscribed to by all members, the average paid-in proportion of all outstanding shares would amount to 12.5%. Prior to GCI-3 all payments for paid-in capital were required to be made in freely convertible currencies.

To accommodate the difficulties most of them faced in providing their paid-in portions in convertible currencies under GCI-3 *regional* members were given two options. They could pay in five equal annual instalments of which: (a) at least 50% was payable in convertible currencies and 50% in domestic currency; or (b) at least 20% was payable in convertible currencies and the remaining 80% was payable in non-negotiable, non-interest bearing serial notes. These notes were payable only in convertible currencies and encashable in ten equal instalments with the first instalment being encashed on the fifth anniversary of the date of subscription and the remaining instalments being encashed annually thereafter. *Non-regional* members were required to provide paid-in capital only in convertible currencies.

Under GCI-4, these options for the paid-in portion of subscribed capital were changed again. *Regional* members could provide their 6.25% of paid-in capital in two parts: (a) 50% of the amount due was payable in five equal annual cash instalments in freely convertible currencies with the first instalment being made on the date of subscription and the remaining four instalments annually thereafter; and (b) 50% was to be paid with the deposit of five non-negotiable, non-interest bearing, serial notes of equal value denominated in AfDB Units of Account (1 UA = 1 SDR) and encashable between years 6-10 from the date of subscription, in convertible currency amounts equivalent to the UA value. *Non-regional* members were required to make their payments in five equal cash instalments in their national currencies, if those currencies were freely convertible. If they were not then non-regional members were required to deposit notes denominated in convertible currencies and payable on demand. Failure to subscribe to shares allocated to members under GCI-4 within four years of allocation would result in members forfeiting their allocations and the released stock becoming available for other members to take up, providing the 2:1 ratio of subscribed capital between regional and non-regional members was not violated.

The failure of some regional members to subscribe to the shares allocated to them under all preceding capital increases by 1992, resulted in the desired level of callable capital being marginally below the intended level of 87.5% when all the shares allocated had been fully subscribed. Also the Bank was left with unclaimed stock from various prior GCI's which had the same share value (UA10,000) but with different paid-in requirements and terms, resulting in pre-GCI-4 stock becoming unmarketable. Accordingly, in May 1992 measures were taken to restructure the Bank's capital stock so as to achieve the intended average 1:7 paid-in to callable capital ratio. These measures entailed: (i) the general application of the AfDB's share transfer

rules to shares issued under all previous capital increases; (ii) cancellation of forfeited and unsubscribed shares along with (iii) their immediate reissuance as a single block of available shares with the same terms and conditions of subscription with a ratio of 7:1 for callable to paid-up shares; and (iv) requiring the statutory 2:1 ratio for non-regional to regional shareholdings to be maintained.

As of March 1994, over 93,000 allocated shares (or about 6.1% of total allocated shares) remained unsubscribed. GCI-4 was intended to support AfDB lending operations between 1987-91. In the event, the rapidly deteriorating creditworthiness of most African borrowers resulted in that capital increase being stretched out to meet AfDB's capital needs for another five years. With annual lending now approaching its sustainable limit under the present capital base, and with the prospective entry of South Africa in its membership, the management has initiated discussions on proposals for a further increase in capital (GCI-5) to the Board of Governors at the AfDB's Annual Meeting in May 1995. If the presently unsubscribed shares were to be fully taken up by the members to whom they have been allotted, a further US\$1.3 billion in subscribed capital and (US\$163 million in paid-in capital) would be made available to the AfDB thus reducing the urgency of negotiating the next GCI.

### *The Asian Development Bank*

In May 1994, the Asian Development Bank (AsDB) announced a fourth GCI which would raise its authorised capital base (for its Ordinary Capital Resources) to around US\$48 billion and provide sufficient capital for that institution to expand lending into the next century. The paid-in portion of only 2% (with 98% callable) for GCI-4 is the lowest negotiated for any GCI in any MDB so far. It continues the trend of lowering the paid-in portion that was set in train by the IBRD in 1959. In all of the AsDB's capital increases, the 40:60 ratio (equivalent to the World Bank's 10:90 ratio) for convertible to domestic currency payment of the paid-in portion of capital has remained unchanged.

The AsDB was originally capitalised at US\$1 billion at its formation in 1966 with the capital base being increased through four subsequent GCIs (in 1971, 1976, 1983 and 1994) and a few smaller special increases (in 1983, 1985, 1987 and 1988) to an authorised level of almost US\$48 billion at the end of 1994. At inception its usable capital resources amounted to US\$700 million. The paid-in proportion which was 50% of total capital at the time of the AsDB's formation has been progressively reduced in successive GCIs to a level of 5% for GCI-3 and of 2% for GCI-4. The most recent *special* capital increase (1988) was agreed to enable Japan, Sweden and the USA to increase

their relative shares. Part of GCI-4 (50,000 shares) has been earmarked to accommodate the entry of three Asian republics of the former Soviet Union into the AsDB's membership.

The AsDB is bound by a statutory regional (including Japan) shareholding requirement of 60%; this shareholding amounted to 63% of the total shares subscribed at the end of 1993. The AsDB has employed variations of the same stretched-out note deposit and encashment formulae for meeting the paid-in portions of members' subscriptions as in the IBRD and AfDB. This device made it easier for members facing budgetary pressures to commit themselves to taking up their subscriptions in full while paying for these subscriptions in instalments.

### *The Inter-American Development Bank*

Starting with an initial capital base of US\$1 billion in its Ordinary Capital Resources (OCR) of which US\$850 million was subscribed (with 50% of that amount paid-in) when it was established in 1959, the Inter-American Development Bank (IDB) has since had eight General Increases in Resources (GIRs).<sup>10</sup> As a result, IDB's authorised OCR capital base has increased to its present level of over US\$101 billion with subscriptions amounting to US\$54.2 billion at the end of 1993. The largest increments to IDB's capital base have occurred since 1978 when GIRs 5 to 8 have added a total of US\$90 billion to the capital stock. Thus, over 90% of the IDB's existing capital base of the IDB has been contributed in the last 15 years and 66% in the last four years alone with GIRs 7 and 8 in 1990 and 1994 together adding a total capital increment of US\$66.5 billion.

The paid-in component of capital has fallen progressively from 20% in the original capital base to 7.5% under GIR-5, 4.5% under GIR-6 and 2.5% under GIRs 7 and 8. The proportion of paid-in capital provided by the *borrowing members* (except Venezuela) in convertible form has varied with each GIR. Upto GIR-5, the ratio of paid-in capital provided by the regional borrowing members in convertible form vs domestic currencies was 1:1 (i.e. 50% in gold or US dollars and 50% in domestic currency of the member) except in the case of Canada which paid its subscription entirely in Canadian dollars. In GIR-5, this ratio was changed to 2:1 for the borrowing members

---

10 These have combined simultaneous increases in its OCR – including inter-regional capital – and FSO resources. An Intermediate Financing Facility (IFF) was established under GIR-6 in 1983. It was replenished under GIRs-7 and 8 which came into effect in 1990 and 1994. The capital base of the IDB was earlier divided into two parts, regular OCR and inter-regional capital. The distinctions and make-up of these two components are rooted in history and need not be delved into here. They are explained in some detail in Annex D of the Proposal for GIR-6 dated February 1983 (Document AB-910). In GIRs-7 and 8 these distinctions became moot.

with the USA, Canada and Venezuela providing all their paid-in capital in convertible form (US dollars). In GIRs 6 to 8, *all members* were effectively required to provide paid-in capital entirely in convertible form although in GIRs 7 and 8 that requirement was expressed in somewhat convoluted fashion.<sup>11</sup> The requirement that the full amount of paid-in capital from all members be paid in convertible form goes further than in any of the other MDBs. It should be seen as a useful precedent which other MDBs might emulate especially as the amount of paid-in capital with each successive GCI or GIR diminishes to virtually insignificant levels. As in the other MDBs, note deposits and stretched-out payment and encashment schedules for capital subscriptions are also resorted to in the IDB in order to ease the budgetary burdens on members. Shareholders have the option of depositing non-interest bearing notes which are encashable over a period of years with some back-loading under GIR-7 but not under GIR-8.<sup>12</sup>

The IDB's Articles specify clear boundaries on inter-regional as well as non-regional participation in its shareholding and capital structure. Until 1994 when GIR-8 was agreed, no capital subscription could become effective, and any rights to such subscription had to be waived, if it had the effect of reducing the voting power of: (i) the regional developing country members below 53.5%; (ii) the USA below 34.5%; and (iv) Canada below 4%. This left only 8% of voting power (and as a rough proxy, for shareholding) for *non-regional* members, primarily from Europe, Japan and the rest of Asia. Though the IDB's General Rules provided for voluntary waiver of these three distinct rights by those members which had them, in practice such waivers have not been applied. Indeed, to the contrary, in order to accommodate the perennial legislative difficulties that the US has had (and will continue to have) in meeting its obligations to the MDBs on schedule, the IDB has had to postpone the due dates for accepting all four instalments of members' subscriptions to the OCR capital under GIR-7, and to regulate the acceptance of other members' subscriptions in order to avoid breaching these voting power limits.<sup>13</sup> It will probably have to do the same under GIR-8. At

---

11 The actual wording in the Proposals for GIRs 7 and 8 being: "For the paid-in capital, payments shall be in the currency of the member, in such a manner as to assure that the currency is freely convertible for the purposes of the Bank's operations or with the agreement of the member to convert on behalf of the Bank its currency into those of other members for the same purpose".

12 With respect to paid-in capital subscriptions the encashment of notes under GIR-7 was scheduled so as to complete encashment of about 41% in the first three years with the balance of 59% being encashed in the following three. Under GIR-8 the arrangement was for both paid-in and callable capital to be provided in six equal annual instalments between 1994-1999.

13 See, for example, the Memorandum to the Board on the Seventh General Increase in the Resources of the Bank: Fourth Instalment of the Increase in OCR and FSO, Document FN-436-10 of the IDB dated January 24, 1994.

the end of GIR-7 the relative shareholdings of the developing members were 53.8%, that of the US and Canada, 34.69% and 4.38% respectively and that of the non-regional group, 7.14%. In GIR-8 a major change in this pattern of shareholding was agreed. The shareholding of the *non-regional* group was increased from 7.1% to nearly 16% with corresponding reductions in the shareholdings of developing members from nearly 54% to 50%, the US from 34.67% to 30%, and Canada from 4.38% to 4%.

### *The European Bank for Reconstruction & Development*

The European Bank for Reconstruction and Development (EBRD) was established in record time in mid-1990 and began operations in 1991. Its initial capital base was ECU10 billion (over US\$11.5 billion) with a paid-in capital requirement of 30% (ECU3 billion or US\$3.4 billion) making it the most budgetarily expensive of the MDBs for member governments to have financed in recent times. By comparison, the paid-in capital requirements for the last GCI's of all the other MDBs together amounted to only US\$3.7 billion. The paid-in capital of EBRD is to be contributed in five equal annual instalments with 50% being paid in either ECU,<sup>14</sup> USD or JPY, and the remainder in promissory notes encashable on demand (in theory) but on a three year fixed encashment cycle (in practice) with the final encashment due in 1997. Such notes are to be non-interest bearing and non-negotiable and denominated in the same three convertible currencies. Even callable capital, in the (unlikely) event of a call being made, needs to be provided in any of these three currencies. Hence there is no provision for inconvertible domestic currency contributions being made by any member to either the paid-in or callable capital of the Bank. The adequacy of the EBRD's capital stock is to be reviewed by its Board of Governors at intervals of no more than five years.

The Articles of Agreement of the EBRD require the European Union (EU) and the European Investment Bank (EIB) together to always have the majority of issued and subscribed capital stock. In the initial capital structure, the 12 individual members of the EU (which then included a divided Germany) had subscribed to 45% of the issued shares. The EU as an entity in its own right and the EIB subscribed to 3% each, thus exceeding the majority

---

14 Payment in ECU -- which is not an issued currency as such but a composite European Currency Unit of Account representing the weighted value of the currencies of member countries of the EU which, until September 1992 were all included within its Exchange Rate Mechanism (ERM) -- requires to be discharged by payment in any convertible currency equivalent to the value of the relevant obligation denominated in ECU on the date of payment or encashment. Subscriptions to initial capital which are made in USD or JPY are settled at fixed exchange rates defined in Article 6.3 of the Articles of Agreement for this purpose at: 1 ECU=US\$1.16701; and JPY169.95.

condition (Article 5.4) with a combined total of 51%. European countries, which were not in the EU when the EBRD's capital structure was agreed, but some of which may shortly become members of the EU, subscribed a further 11.37% of the capital while the *borrowing* countries of Eastern Europe and the republics of the former Soviet Union (FSU) together subscribed 13.45%. Out of the remainder, 24.17% was subscribed by non-regional countries, with the USA and Japan having a 10% and 8.52% share respectively. With the possible accession of Austria, Finland, Norway and Sweden to the membership of the EU, the combined EU plus EIB share could rise to 58.08% with a corresponding fall in the non-EU European share to 4.31%.

Following the reunification of Germany, the 15,500 shares originally allocated for East Germany were added to the unallocated shares available to new members for subscription. Of these, 1000 shares were allocated to Albania at the end of 1991 and 1,000 shares each were allocated to Estonia, Latvia and Lithuania in 1992. At the end of 1993, therefore, 11,625 shares of the EBRD remained unallocated. The shares originally allocated to the FSU were reapportioned among the separate republics in 1992 with Russia retaining two-thirds of the original allocation and ending up with a 4% share in the EBRD. In early 1993, an initial 100 shares each from the block of 12,800 shares formerly allocated to Yugoslavia in the EBRD were reallocated initially to Slovenia, Croatia and Macedonia. This pragmatic step facilitated their early membership without holding that process hostage to arriving at a final determination of what proportion of the total Yugoslavian shareholding these republics should be allocated. The remaining 12,500 shares have been set aside for accommodating the entry of other republics from the former Yugoslavian federation. When all these republics have become members, the original Yugoslavian shareholding will be more appropriately distributed among them. The shares originally allocated to Czechoslovakia were divided between the Czech and Slovak Republics in early 1993. With the process of political reorganisation in Eastern Europe and the FSU not yet having been completed, further changes in the membership of the EBRD can be anticipated before its relative shareholding structure stabilises.

Like the other MDBs, the EBRD's Articles require it to limit loans, equity investments, and guarantees to the amount of its *subscribed capital* and reserves. A second limitation (which does not apply in the other MDBs) is that the EBRD's outstanding *equity investments* may not exceed its *paid-in capital* and reserves. Finally, the EBRD is required by its Charter to limit its lending to the state sector of its borrowing members to 40% of its committed loans, guarantees and equity investments. This limitation applies both to its overall lending as well as to its lending in individual countries. This is in contrast to the other MDBs whose Articles require them to lend mainly to

borrowing governments directly, or to their instrumentalities or other bodies with the guarantee of the government concerned. The shift in emphasis from the public to the private sector reflects the new development thinking, which is reinforced by unprecedentedly large private capital flows through securities markets and the progressive withdrawal of the state from the ownership and operation of productive enterprises and utilities. In such an atmosphere, all the MDBs are now focusing on finding ways of orienting their operations more towards supporting the private sector directly and indirectly through lending, investments and guarantees. Thus there is a clear trend being established in the movement of the entire MDB system toward the EBRD type of structure.

### *General Issues raised by the Capital Structure of the MDBs*

The capital structures of individual MDBs and their substantial expansion especially in the last two decades, raise several issues, of which three are worth exploring further. These concern: (a) the consequences of diminishing proportions of paid-in capital in successive GCIs; (b) the valuation of MDB share capital and (c) the need to maintain the value of such capital in terms of an acceptable *numeraire*.

#### *Diminution of Paid-In Capital*

As is evident from the foregoing paragraphs, apart from the case of the EBRD, the proportion of paid-in capital which member governments are willing to provide to MDBs under successive GCIs has been diminishing relentlessly. This is particularly true of developed country governments whose capital contributions remain critical in supporting or limiting the amount of borrowing and lending any MDB can undertake. This situation is, of course, changing. Several developing countries are becoming economically stronger by the day, especially in East Asia and Latin America. These countries are achieving both acceptable levels of creditworthiness and of currency convertibility to join their OECD counterparts in providing credible support for MDB capital or indeed, as Mexico has just done, joining the OECD themselves. In other words, the amount of *usable capital* in the total capital base of the MDBs will, with the temporary exception of the AfDB, gradually and inevitably increase. Yet, paid-in capital will remain difficult to come by.

The reasons for continually diminishing proportions of paid-in capital are not hard to find. *First*, most OECD governments are now hard-pressed to compress their burgeoning fiscal deficits even under benign economic conditions. It is therefore becoming increasingly difficult for them to agree to



maintaining former proportions of paid-in capital in the GCIs of MDBs.<sup>15</sup> *Second*, the size of recent GCIs has become much bigger than was contemplated when these MDBs were first established. Capital increases are now between 15-40 times larger than the original capital of the MDBs when they were set up. Each succeeding capital increase is almost double the size of the previous one. Keeping to the same proportions of paid-in capital would therefore require very substantial cash contributions to these institutions. In the current political and economic climate prevailing throughout the OECD world, such contributions would impose burdens which were (except in a few small countries) politically unacceptable, if not legislatively impassable. *Third*, the strong financial performance of the MDBs (except for the AfDB and, for the time being, the EBRD) has resulted in a steady accretion of retained earnings and reserves on their balance sheets. With the MDBs not paying out any dividends to their shareholders, these retained earnings/reserves are, in effect, coming to be seen by the members as almost perfect substitutes for paid-in capital. *Fourth*, smaller paid-in capital contributions reduce the budgetary and foreign exchange burdens on the *poorer* members in subscribing to their shares, especially when only a part of them have to be paid in convertible form.

Taking into account all of these reasons, and extrapolating from them the obvious trends, it is entirely possible to envisage future GCIs, especially for the World Bank, AsDB and IDB, which involve no paid-in capital at all. Indeed this was more than a theoretical consideration when the last GCIs for all of these institutions were negotiated. In all three cases, it was broadly acknowledged that there was no real *financial* need for members to provide paid-in capital. MDB managements and shareholders were convinced however that a token fraction of paid-in capital was necessary to indicate to international capital markets that member governments did indeed support these institutions and were not taking a soft option. Whether that conviction was contrived or genuine cannot be proven, unless it is tested in the marketplace.

Obviously, reducing the paid-in capital proportion in GCIs or providing

---

15 Employing this line of reasoning, which has become time-honoured in its use, the very high paid-in proportion for the share capital of EBRD, and the stunning speed with which that institution was established, came as a surprise (if not as a rude shock) to those who had been labouring on negotiating hard-window GCIs, soft-window replenishments in the other MDBs, and replenishments of various UN development funds, with decreasing success in getting OECD governments to loosen their purse-strings. Clearly the political will for establishing the EBRD -- especially in Western Europe -- was far greater than the political will required to support the expansion of the other MDBs. That contrast is especially vivid when one considers that, had OECD countries decided to finance the same amount of lending through the World Bank's last GCI to support the former East Bloc, rather than to create a new institution, they could have done so for only 10% of the cash contribution they had to make to set up the EBRD.

no paid-in capital at all has its downsides. There are three main disadvantages. *First*, the absence of *usable cash* equity leaves MDBs virtually no room for reducing the interest charges they levy on their lending. With no additional free equity, all intermediated resources have to clear at above the market rate. This may require the MDBs to enlarge their spreads as they will have a significantly reduced proportion of *own funds* with which to leaven or lessen their spreads. *Second*, it cannot be assumed that all retained earnings can or should be used as a paid-in capital substitute for relending purposes. Because of a growing problem of arrears the operating environment of MDBs has become more difficult, involving greater risk of deferred repayments or default (as the AfDB case shows dramatically) which now has to be explicitly provided for. Hence prudential loan-loss provisions need to be allowed for in the reserves that MDBs accumulate.

*Third*, with further constraints on paid-in capital MDB managements may be pushed into *overcharging* their creditworthy borrowers to generate net income surpluses and accumulate sufficient reserves. Three undesirable effects might result. Such a loan pricing policy would probably drive the more creditworthy borrowers away from the MDBs, even more rapidly than is the case at present, to borrowing directly from capital markets. In turn, that would affect adversely the quality of MDBs portfolios by concentrating them in the less creditworthy countries. Moreover, such an attempt would be almost tantamount to shifting the burden of financing the *paid-in capital substitute* from the developed countries to borrowing member countries. The asymmetry would lie in borrowing members effectively financing through MDB net profits the build-up of a paid-in capital equivalent (i.e. reserves) but with no advantages accruing to them in terms of their shareholdings or voting rights in these institutions. And finally, the absence of paid-in capital would constrain the ability of the MDBs to self-finance their soft-loan windows as the World Bank had been doing previously in the case of IDA.

### *Automatic Attachment of Callable Capital to Retained Earnings*

Against these obvious disadvantages to reducing further the proportion of paid-in capital in future GCIs, there is one possibility which might represent a reasonable compromise and which might be considered in modifying the financial architecture of the MDBs to address future needs. That prospect concerns the *automatic* attachment of a callable capital component to the retained earnings of MDBs. Such a measure would do away with the long, protracted, increasingly difficult and contentious negotiations (at a very high cost) every five years or so on the GCIs for individual MDBs. With the replenishment negotiations of their soft-loan windows as well, these negotiations are beginning to impose heavier burdens and costs on the

overstretched administrations of all member countries. An automatic increase in callable capital, which expands total capital each year by an agreed multiple of retained earnings accumulated in that year, might also have the salutary effect of imposing discipline on MDB *borrowers* as well as MDB *managements*. The borrowers would see more clearly the costs to the institution concerned of their poor repayment performance. The managements on the other hand might become more responsive to the concerns of their shareholders about budgetary profligacy and about reducing their institutionally embedded tolerance for excessively high levels of administrative cost.

Seen from the viewpoint of shareholders, and especially the larger, more powerful shareholders, the major *disadvantage* of *automatically* increasing the capital base of MDBs would be the perceived diminution of political power and control over these institutions. The absence of periodic GCIs requiring parliamentary ratification, would lessen the ability of legislatures to influence periodically MDB policy and direction. Legislators might object to such a device on the grounds that in removing MDBs from parliamentary scrutiny it would place too much power in the hands of Treasury or Foreign Ministry bureaucrats who represented the interests of these countries on MDB Boards. There are clearly other, and certainly better, ways than the painful and costly process of negotiating and ratifying GCIs to ensure on-going rather than sporadic parliamentary interest and influence over the MDBs. But established habits and procedures die hard. Therefore, such a proposal – if it were ever to be considered – would raise profound objections. Nonetheless, as what is seen to be politically impossible today often becomes received wisdom tomorrow, this suggestion needs to be preserved and considered until the time is ripe for its adoption and implementation. Indeed, it is the logical consequence of a trend which can only culminate in a regime of zero paid-in capital for the GCIs of MDBs in the not too distant future. Of course, this argument only holds to the extent that one sees the need to expand the lending or guaranteeing capacity of the MDBs indefinitely for the foreseeable future. If, however, one sees the value and size of the MDBs as having reached their peak, then the rationale for the above proposal is weakened considerably.

### *Valuing MDB Share Capital*

The standard-of-value (SOV) is a central feature in the Articles of all the MDBs. Essentially, it is the unit which determines both the price of the MDBs' shares and the mutual rights and obligations of the MDB to, and among, its members with respect to their relative shareholdings. Except for the EBRD, which has valued its share capital in ECUs, all the other MDBs have been grappling for several years with the issue of how their capital is to be valued. Yet it remains unresolved. The issue arises with the other MDBs

because their Articles all established their capital stock and expressed the par value of their shares in terms of US dollars of the weight and fineness (of gold) in effect on a date close to that on which the Articles of the MDB concerned were agreed. As a result, the value of the shares of the IBRD is expressed in “US dollars of the weight and fineness in effect on July 1, 1944” or, in vernacular terms, the 1944 *gold dollar*. Similarly, the par value of the IDB’s shares is expressed in 1959 gold dollars, that of the AfDB in a Unit of Account equivalent to 1964 gold dollars and that of the AsDB in 1966 gold dollars.

With the breakdown of the Bretton Woods Agreement in the 1970s, the simultaneous repeal of US legislation which established the value of the US dollar in terms of an amount of gold, and the Second Amendment of the Articles of the IMF on April 1, 1978, the gold dollar standard of value effectively disappeared. There was no longer any basis for translating 1944, 1959 or any other gold dollar into *current* US dollars. In the aftermath of the Second Amendment of the IMF’s Articles, the opinion of the General Counsel of the IBRD was that the Executive Directors of the MDBs could take either the *current* SDR or the 1974 SDR (at a fixed value of US\$1.20635) as the SOV for maintenance-of-value provisions. In the AsDB, the legal opinion was less ambiguous in seeing the *current* SDR (i.e. whatever its value might be in any other currency) as the proper SOV successor to the 1966 gold dollar.

In all the MDBs, all members except the US supported adoption of the *current* SDR as the new SOV. But, in none of the MDBs has it been possible upto now to reach unanimity on this issue. A final decision in favour of the SDR as the successor SOV to the gold dollar thus remains elusive. As a result, in all the MDBs the SOV for their share capital has been defined on a conditional basis for the sake of expediency. The choice of any single currency (e.g. the US dollar) as the SOV for all the MDBs was dismissed because: (i) there was no way of valuing any single currency against a neutral SOV applicable equally to all other currencies; (ii) it would result in an unequal application of maintenance-of-value (MOV) obligations among all members with the member whose currency was chosen being exempt from such obligations; and (iii) it would result in higher MDB vulnerability to excessive and sudden exchange rate fluctuations across currency than if a currency composite (such as the SDR) was accepted as the SOV.

To fill the vacuum, the Executive Boards of the MDBs have adopted different approaches to dealing with the practicalities of an undefined situation. The AfDB’s Board of Executive Directors decided in May 1978 that, effective 31 December 1977, one AfDB Unit of Account (UA) would be

redefined as being equivalent in value to one SDR.<sup>16</sup> However, ratification of this decision by the membership of the Bank (i.e. its Board of Governors) which is essential for its becoming effective, has not yet occurred. For the same reasons which apply to all the MDBs (except the EBRD), such ratification has been indefinitely deferred. Pending ratification, however, the AfDB has continued, for its financial purposes and statements, to define the UA as equal to one SDR. Similarly, the AsDB also temporarily values its capital stock for the purposes of its financial statements in terms of the *current* SDR<sup>17</sup> with the caveat in its financial reports that the Bank “could decide to fix the value of each share at \$12,063.50 based on the 31 March 1978 par value of the US dollar in terms of gold” (i.e. at the value of the 1974 SDR).

The Executive Boards of the IBRD (in October 1986) and the IDB took the other decision: i.e. to value share capital at the 1974 SDR with the US dollar equivalent being translated at the *fixed* rate of 1 SDR=US\$1.20635; i.e. at US\$120,635 per IBRD share and US\$12,063.50 per IDB share respectively.<sup>18</sup> These decisions were taken subject to eventual adjustment of values when the SOV issue was finally settled.<sup>19</sup> Effectively, this means that the IBRD and IDB have agreed to fix *for now* the value of their shares in terms of *US dollars* while the AfDB and AsDB have done so in terms of *SDRs*. The IBRD’s Executive Board agreed to review this decision every three years.<sup>20</sup> These interim arrangements, of course, do not provide a definitive basis for determining members’ obligations with respect to *callable* capital. This too has been indefinitely deferred, but with no practical consequence

---

16 The value of the SDR which varies from day to day is computed daily by the IMF in the equivalent of US dollars and (using prevailing cross exchange rates) for all other convertible currencies. For its accounting purposes the AfDB uses for each quarter the SDR rate quoted by the IMF on the last day of the preceding quarter.

17 For their financial statements for the year ending 31 December 1993 therefore, both the AfDB and the AsDB valued their capital in US dollar terms at the equivalent of 1 SDR=US\$1.37356 i.e. at US\$13,735.60 per share. The effective value of each of their shares remains at 10,000 SDRs and is translated into US dollars in interpreting their financial statements at the prevailing SDR to US dollar exchange rate.

18 Each share of the IBRD is valued at 100,000 1974 SDRs, those of the IDB are valued at 10,000 1974 SDRs; those of the AsDB are valued at 10,000 SDR and those of the AfDB are valued at 10,000 UA (equivalent to 10,000 *current* SDRs).

19 The IBRD Board suspended periodic maintenance-of-value settlements between April 1978 and October 1986 when it adopted the 1974 SDR temporarily as the SOV (until consensus could be reached on using the *current* SDR as the SOV).

20 Such a review was undertaken in 1989. See IBRD Board Document No R89-180, dated August 31, 1989 entitled “Report of the Ad Hoc Committee on the Valuation of Bank Capital (CVBC) to the Executive Directors”, for an excellent and lucid exposition of this complex subject. That Report provides an appreciation of the several options that were considered and why they were rejected. Again that Report stressed the preference of all members except the USA for choosing the current SDR as the successor to the 1944 gold dollar as the SOV for the IBRD’s shares.

because of the extremely unlikely eventuality that a call might actually materialise in the interim.

Though dealt with in these two pragmatic but quite different ways for accounting purposes, the SOV issue remains open in all the MDBs except the EBRD. It is likely to be settled finally in all the MDBs simultaneously when it is resolved in any one. Why has the SOV not been resolved for all this time, despite the interminable meetings and technical discussions among the staffs and Boards of the MDBs? Basically it is because the US, which is the largest single shareholder in the IBRD and IDB, and the second largest shareholder in the AsDB, is not yet *politically* able to accept a resolution which puts it on a par with other countries in the MDBs.<sup>21</sup> In other words, the US finds it difficult to accept having open-ended obligations to maintain the value of its share capital in the MDBs, should the value of its currency decline *permanently* relative to that of other countries and therefore to the SDR.<sup>22</sup> In accepting the terms of the original Articles of Agreement all the other countries explicitly undertook to maintain the value of their shareholdings in terms of the respective gold dollars which were accepted originally as defining the values of MDB shares. Shifting to the *current* SDR as the new standard-of-value therefore poses no insuperable political or technical problems for them in the same way that it does for the US. In the case of the EBRD, where the ECU is the SOV, the MOV issue has been finessed by Article 6.3 which enables all payment obligations of members for subscriptions to the initial capital stock to be *fully settled* (with no further MOV obligations) in ECU, USD or JPY on the basis of the average ECU exchange rate of the USD or JPY between 30 September 1989 to 31 March 1990 (i.e. at rates of 1 ECU=USD1.16701 or JPY169.95).

### *Implications of Not Resolving the SOV Issue*

There are three main implications of leaving the SOV question unresolved. *First*, an ambiguous position on the SOV is unfair to those countries (like Germany and Japan) whose currencies have appreciated structurally over the long-run against the intended SOV versus countries like the US, the UK and most developing countries (other than some NICs) whose currencies have

---

21 In a response to the CVBC (see the footnote immediately above) the US authorities stated that: "The United States has consistently opposed a change in the IBRD's standard-of-value, because it has been the judgement of all US Administrations since the mid-1970s that the open-ended dollar commitment inherent in SDR denomination would be impossible to obtain from the US Congress".

22 It should be noted here that the US did make maintenance-of-value payments to the IBRD in 1972 and 1973 when the US dollar was devalued twice against gold to maintain the value of its capital in terms of the 1944 gold dollar par value.

depreciated structurally in the long-run. While the issue remains unresolved, the countries with appreciating currencies have, in effect, paid more for their shares in the MDBs than those whose currencies have depreciated. Put another way, in the absence of compensating repayments to countries whose currencies have appreciated even against the intended SOV (the gold dollar), they should have a larger vote in the MDBs than that to which their proportionate shareholding entitles them. *Second*, till the standard-of-value issue is resolved definitively, the capital of the MDBs (and therefore the structure of their balance sheets) remains vulnerable to exchange rate fluctuations. In particular, any major appreciation of the SDR vis-à-vis the US dollar would affect the *lending* headroom which the IBRD and IDB might have because of the effective resultant shrinkage of their capital base. In the extreme case, a sudden sharp fall in the value of the US dollar might precipitate the need for a premature GCI or, alternatively, require the lending operations of these two MDB hard-windows to be curtailed drastically and disruptively. Given the time it takes to gear up for and negotiate a GCI, the latter alternative would inevitably be taken to the detriment of these institutions and their borrowing members. The opposite would be the case in the AfDB and AsDB where any such appreciation would (possibly perversely depending on the circumstances) create more lending headroom.

*Third*, it is odd that within the same multilateral system different MDBs should be valuing their shares differently when the original basis for valuation was the same. For instance, at the end of 1993, the AfDB and AsDB were valuing their shares at the equivalent of US\$13,735.60 while the IDB and IBRD were valuing their shares at US\$12,063.5 and US\$120,635 respectively. *Fourth*, vulnerability to exchange rate fluctuations on the value of capital because of the expedient choice of a temporary SOV also leaves MDBs exposed to risk on inadvertently and suddenly breaching their *borrowing* limits. If the outstanding borrowings of MDBs have a different currency composition to their capital, and exchange rate movements affect the value of outstanding borrowings in the opposite direction to the way in which they affect the value of the capital base, then the MDB could be exposed to a technical default on its undertakings for bond issues.<sup>23</sup> This eventuality is not merely a hypothetical one.

---

23 This issue is well explained in some analytical depth in a confidential document of The Asian Development Bank on "Valuation of the Bank's Capital and Maintenance of Value". To illustrate: if a particular MDB's capital is effectively valued in USD, while the bulk of its borrowings are in DEM and JPY, then a sudden depreciation of the dollar against the DEM and JPY would result in shrinking the effective value of the capital base while expanding the effective value of its borrowings. Since borrowings are usually limited to usable (callable and paid-in) capital rather than to total capital, the threat and impact of sudden turbulence in foreign exchange markets of the sort which has occasionally occurred could result in some MDBs breaching borrowing limits without any purposive action on their part.

## *Resolving the SOV Issue*

For these and other reasons, it is essential that the SOV issue is resolved in favour of adopting the *current* SDR as the successor SOV to the gold dollar in all the MDBs other than the EBRD. The issues surrounding that action have been considered time and again in every one of the MDBs affected. The inability of the US to agree with other members on resolving the SOV issue remains a serious stumbling block. It is unclear as to whether the passage of time alone will lead to a situation in which the US' reluctance to address the issue will gradually be eroded or overcome. In the meantime, the IBRD and IDB are exposed to greater exchange rate risk and to the threat of inadvertently breaching lending or borrowing limits than the AfDB and AsDB. A more appropriate solution would be for all the MDBs to adopt a consistent policy with respect to the *interim* SOV. That policy should adopt an interim SOV which all member countries except the US favour; i.e. the *current* SDR.

## *Maintenance-of-Value Obligation (MOV)*

Logically connected to the concept of a SOV for the share capital of an MDB is the need for members to maintain the value of their payments for MDB shares in terms of the chosen SOV. The Articles of Agreement of each of the MDBs (except, as noted earlier, the EBRD) require periodic payments to be made either from a member to the MDB, or *vice-versa*, an amount of that member's currency sufficient to maintain the value of its paid-in capital subscription against the applicable SOV. The MOV provisions apply to both the *convertible* and *domestic currency* portions of the paid-in amount. These MOV provisions in the Articles were inserted in order to protect the value of the MDBs' capital over time from the deprecations of currency devaluations.

While the status of the SOV remained unresolved, even on an interim basis, the MOV provisions were effectively suspended. They were revived when interim decisions were taken by the Executive Boards of these institutions on the use of a temporary SOV, pending final resolution of the issue. In theory the concept of MOV is understandable and generally unarguable. The operating rules and procedures required to translate that theory into practice have proven to be quite another matter; they have posed some difficult technical issues and choices for the MDBs, especially in determining the amounts and the appropriate periodicity of MOV settlements.

These difficulties have arisen for a variety of reasons and complications. The issues concerning the *amount* of MOV obligations which need to be transacted between MDBs and their members concern: (i) calculating and



making MOV payments under floating exchange rate regimes being procedurally quite different and administratively more onerous than in the case of the previous fixed exchange regime; (ii) difficulties over interpreting what level of change in the value of currencies for the purposes of the MOV Articles can be construed as “significant” in a floating exchange regime and therefore how frequently MOV payments need to be made and adjusted; (iii) determination of the amount of MOV obligations being influenced by interpretations what amount of currency being held by any MDB is actually subject to MOV;<sup>24</sup> this amount differs in the case of different MDBs; (iv) the amount of currency holdings which are unprotected by MOV and therefore subject to exchange risk; these amounts are larger for the IBRD, AfDB and AsDB than they are for the IDB; (v) issues of “equity of treatment” across members in the application of MOV provisions, such as the fairness of holding one member liable for MOV on those of its currency holdings which have been contributed by another member to meet the latter’s payment obligations, or requiring members to take on MOV obligations on that portion of its currencies which are held by an MDB through the accrual of its cumulative retained earnings (on which MDBs earn a market return); (vi) domestic budgetary procedures in member countries which complicate settlement of MOV obligations; (vii) the desire of members, especially developing country borrowing members to absolve themselves of further MOV obligations by making payments for their capital subscriptions in another (developed) member’s (convertible) currency; and (viii) the large MOV obligations that might arise if eventual resolution of the SOV issue was in a direction different to the interim SOV presently being used by the MDB.

Issues concerning the *timing* of MOV settlements include: (i) balancing the

---

24 In the IBRD the convertible portion of paid-in capital is payable only in gold or in US dollars with the latter being treated as equivalent to gold for the purpose of payments for capital subscriptions. Therefore the MOV provisions in the IBRD’s Articles apply only to the domestic currency portion (i.e. the 18% currency). This is not the case in the AsDB and IDB where MOV obligations apply to both the convertible and domestic currency portions. Moreover there are differences between the AsDB and IDB as to what extent of a particular member’s currency holdings are subject to MOV. In the IDB, MOV provisions apply *without any limitation* to all holdings of a member’s currency other than those amounts in that currency which are obtained from borrowings. In the AsDB, MOV obligations apply to all holdings of a member’s currency irrespective of source (excluding those from borrowings) but such obligations are *limited* only to an amount equivalent to the value of the paid-in portion of that member’s capital subscription. In the AfDB, payments for capital subscriptions under original capital and GCIs 1 and 2 had limited MOV obligations. Under GCI-3 these payments were fixed in their national currencies with no MOV obligations attached. Under GCI-4 payments by members in USD were fixed at 1 UA=US\$1.20365. As a result of these variable practices and very loose MOV requirements, the losses or gains which arise when converting currencies received for capital subscriptions into UA are debited or credited to a Cumulative Exchange Adjustment Account on Capital Subscriptions and are carried forward through the AfDB’s income statement.

interests of the MDB vs that of its members;<sup>25</sup> (ii) establishing the size of variation in currency values which triggers an MOV settlement – the IBRD, IDB and AsDB use a 5% exchange rate variation rule to trigger settlement of MOV obligations while the AfDB simply courses all changes through its Exchange Adjustment Account; (iii) the burden put on members to settle large MOV obligations in any given settlement period – usually the MDBs provide for settlement in affordable instalments which are negotiated between the member and the MDB; (iv) the burden put on MDBs in managing their currency pools; (v) loosening of restrictions on the use by MDBs (either for lending or for administrative expenses) of their domestic (the inconvertible) currencies imposed by developing country members; (vi) clearing of MOV obligations in arrears before a member could exercise an option which would remove future MOV obligations;<sup>26</sup> and (vii) conflict between members' budgetary cycles and fiscal year ends and the fiscal year ends of MDBs when MOV settlements need to be made.

In concluding this chapter on the capital structure of the MDBs and the issues which it raises, the key features of the present situation are summarised in Table 4.

---

25 The issue arises in recognising that, under a floating exchange regime, with large currency movements occurring within short periods of time, deferral of MOV settlements adversely affects the financial position of the MDB, while frequent settlement demands impose high burdens on the overstretched administrative capacity of members.

26 This issue arises in the case of the IBRD which in 1990 offered members an option of substituting a special US dollar note deposit in lieu of its 18% currency contribution. If members exercised that option then they would have no further MOV obligations on their 18% currency contribution.

**Table 4 Characteristics of MDBs' Capital Structures 1993/94**  
(billions of U.S. dollars)

	IBRD	IDB	AsDB	AfDB	EBRD
Authorised Capital	184.05	100.99	48.00	22.25	11.16
Subscribed Capital	170.00	54.20	23.08	20.97	11.02
Callable Capital	159.34	51.03	20.29	18.41	7.72
Paid-In Capital	10.67	3.17	2.78	2.57	3.31
Ret. Earnings/Reserves	<u>14.47</u>	<u>4.76</u>	<u>4.91</u>	<u>0.93</u>	<u>0.00</u>
PI+RE	24.14	7.93	7.69	3.50	3.31
Paid-In/Subscribed	6.28%	5.85%	12.04%	12.25%	30.00%
PI+RE/Subscribed	14.79%	14.63%	33.31%	16.69%	30.00%
No. of GCIs	6	8*	4*	4	0
Last GCI In	1988	1994	1994	1987	1991
Paid-In % for last GCI	3.0%	2.5%	2.0%	6.25%	30.0%
Interim SOV	1974 SDR	1974 SDR	Current SDR	Current SDR	ECU
Net MOV Deferrals	0.88	0.04	0.29	0.36	(0.01)

\* GCI-4 for the AsDB was agreed in March 1994 increasing its authorised capital to US\$48 billion with 2% paid-in. GIR-8 for the IDB was agreed in July 1994 increasing authorised capital to US\$101.5 billion with 2.5% paid in.

*Note:* IBRD's fiscal year (FY) ends on June 30; for the other MDBs it ends on December 31.

*Sources:* Annual Reports of the regional MDBs for FY 1993 and the IBRD for FY 1994 (ending 30.06.94).