CHAPTER THREE.

FINANCIAL STRUCTURE AND LENDING POLICIES OF THE WORLD BANK.

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INTRODUCTION

In this chapter the financial structure of the World Bank and its Lending policies are highlighted. Financial structure and the lending policies of the World Bank reflect how the institution operates the incoming and outgoing finances and its capitalization. The lending policies of the World Bank are accentuated by what former USA president John F. Kennedy said, "To those people in the huts and villages of half the globe struggling to break the bonds of mass misery, we pledge our best efforts to help them help themselves, for whatever period is required -- not because the Communists may be doing it, not because we seek their votes, but because it is right. If a free society cannot help the many who are poor, it cannot save the few who are rich" [1].

Therefore, the following are the highlights of World Bank's financial structure and its lending policies.

3.1 FINANCIAL STRUCTURE:

The World Bank is an institution owned and controlled by the member countries that constitute its shareholders. Its major goal at present is to finance economic development in member countries and fight poverty through project financing in less developed countries. The member countries are the ones, who contribute the Bank's capital. This capital constitutes the financial base of the World Bank. Its resources are supplemented by the profits it has opted to retain as reserve rather than distribute as dividends to the shareholders. World Bank borrows from private investors, financial institutions and member countries. World Bank holds its assets and liabilities primarily in US dollars, Euro and Japanese yen [2].

In technical terms, the major financial assets of the Bank are its outstanding loans and liquidity, liabilities, outstanding debts and capital reserves. The core goal is to make available resources for development at lowest possible costs of long term in nature to borrowers for priority development purposes without compromising its own financial standing. In order to understand clearly the financial structure and lending policies of the World Bank, we have elucidated these in various sub headings as shown below.

DOES THE BANK HAVE ENOUGH MONEY?

The World Bank's articles of agreement require that the ratio of its total subscribed capital and accumulated reserves to its outstanding loans, loan participations and loan guarantees be beneath unity. It is the World Bank's practice not to reschedule interest or principal payments on its loans, and the World Bank has never written off a loan. Does the World Bank have enough capital to pay its creditors incase it goes into liquidation? This is hypothetical however incase the World Bank winds off its business certainly it has sufficient capital to cover any needs to pay its creditors. The bank is obliged by its articles of association to add each year to reserves an amount consistent with the projected growth of its loan book. The World Bank is rated an AAA financial institution. The bank need to be confident in an abnormal year in which there is a large shock resulting for example a number of its loans becoming non-performing that it will be able to continue with its business.[3]

3.2 CAPITALISATION

The initial Capital of the World Bank as authorized in the Articles of agreement was US$ 10 billion. On September 1959, the authorized capital was increased to US$ 21 billion. The increase US$ 10 billion was due to a doubling of capital subscriptions by existing members, while the additional US$ 1 billion was to due to the admission of new members. The authorized capital went on increasing periodically as deemed appropriate to perform its functions satisfactory, for example US$ 1 billion on 1963 and US$ 2 billion on 1965. It was again increased by US$ 3 billion on 1970. The capitalization was doubled in 1959 for the purposes of increasing the guarantee obligations of member countries (most notably, the United States) represented by the uncalled portions of their subscriptions to the Bank's capital rather than obtaining funds from member governments for Bank operations. It was agreed that this capital consisted of three categories: Firstly, two percent payable by member government in gold or U.S. Dollars, secondly eighteen percent payable in local currency and finally eighty percent in reserve to be paid when called up.[4]

The capital structure of the Bank, as designed at Bretton Woods, provided that only 20 percent of each member's subscription could be called and used for its operation; the remaining 80 percent was either to constitute a large guarantee fund serving as backing for Bank's borrowing operations, or when the World Bank required covering for default or other loss. April 1988 and amounting to US$ 74.8 billion, the World Bank's total authorized capital stood at US$ 184.05 billion. June 30th1994 the total subscribed capital of World Bank was US$ 176.4 billion or 96 percent of the authorized capital. This increase was because of the 20 countries subscribing an aggregate of US$ 6.4 billion. Shareholder support for the World Bank is reflected in the capital backing it gets from its member countries. During the financial year 30 June2005 the authorized capital of the IBRD was $190811million of which $189718 million had been subscribed. Of the subscribed capital, $11483 million had been paid- in and, $178235 million was callable. The paid-in capital, $9,032 million was available for lending and $2,451 million was not available for lending. The terms of payment of IBRD's capital and the restrictions on its use that is derived. (World Bank annual report 2006) [5]

Table 3.1: Capital structure of the IBRD 1950 to 2005. (US $ Millions)

Year	Authorized capital	Subscribed capital
1950	10,000	8343
1955	10,000	9028
1960	21,000	19308
1965	22,000	21669
1970	24,000	23159
1975	27,000	30821
1980	41,016	39959
1986	80,000	77526
1990		125262
1994		176400
2000		
2003		
2004		
2005	190811	189718

Source, World Bank annual reports.

The following factors contribute to the capital increases of the Bank:

(i) Limits of the Bank's lending capacity are set by its capital base, which makes borrowing countries keen to have capital base extended.

(ii) Amount to be paid by each member (paid in portion).

(iii) Method of allocation of shares and thus the relative strength of various countries.

(iv) Authorized capital is increased with an intention of allotting the shares to certain member countries to better their relative strength or to enable allocation of shares to new members.

(v)The representation in the Board of Directors to various countries or groups of countries that is related to the subscribed shares.

(i) Paid-in Capital

Firstly $3,220 million of IBRD's capital was initially paid in gold or U.S. dollars or was converted from the currency of the subscribing members into U.S. dollars. IBRD may under the Articles, freely use this amount in its operations.

Secondly $8,119 million of IBRD's capital was paid in the national currencies of the subscribing members. Under the Articles this amount is subject to maintenance of value obligations and may be used for funding loans only with the consent of the member whose currency is involved, or used for administrative expenses without the need for consent of the member whose currency is involved. In addition, these national currencies may be used by IBRD following a decision by the Board of Executive Directors to invest or lend in that currency, or swap the national currency into another currency for investment or lending purposes, provided it has the consent of the member whose currency is involved. In accordance with such consents, $5,264 million of this amount was being used in IBRD's lending and investment operations at June 30, 2005. Thirdly $144 million of IBRD's capital was converted to U.S. dollars from the currency of the subscribing members by providing U.S. dollar denominated nonnegotiable, non-interest bearing demand notes, cashable in the currency of the subscribing member. This amount may, under the terms of the note, be cashed for administrative expenses or, after all subscribed capital has been called, IBRD will have the right to cash the note to meet its obligations.

(ii) Callable Capital

Amount of $151,774 million of IBRD's capital may, under the Articles, be called only when required to meet obligations of IBRD for funds borrowed or on loans guaranteed by it. This amount is thus not available for use by IBRD in making loans. Payment on any such call may be made, at the option of the particular member, either in gold, in U.S. dollars or in the currency required to discharge the obligations of IBRD for which the call is made. $26,461 million of IBRD's capital is to be called only when required to meet obligations of IBRD for funds borrowed or on loans guaranteed by it, pursuant to resolutions of IBRD's Board of Governors (though such conditions are not required by the Articles). Of this amount, 10 per cent would be payable in gold or U.S. dollars and 90 percent in the national currencies of the subscribing members. While these resolutions are not legally binding on future Boards of Governors, they do record an understanding among members that IBRD will not call this amount for use in its lending activities or for administrative purposes.

No call has ever been made on IBRD's callable capital. Any calls on unpaid subscriptions are required to be uniform, but the obligations of the members of IBRD to make payment on such calls are independent of each other. If the amount received on a call is insufficient to meet the obligations of IBRD for which the call is made, IBRD has the right and is bound to make further calls until the amounts received are sufficient to meet such obligations. However, no member may be required on any such call or calls to pay more than the unpaid balance of its capital subscription. (World Bank annual report 2004).[6]

At June 30, 2005, $103,604 million (58.1%) of the uncalled capital was callable from the member countries of IBRD that are also members of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD). This amount slightly exceeded IBRD's outstanding borrowings including swaps at June 30, 2005. The United States is IBRD's largest shareholder under the Bretton Woods Agreements Act.

The following table 3.2 sets out the capital subscriptions of those countries and the uncalled amounts.

Table 3.2

TABLE OF THE CAPITAL SUBSCRIPTIONS (million dollars)

Member country	Total subscription	Uncalled portion of subscription
US	31695	29966
Japan	15321	14377
Germany	8734	8191
France	8372	7851
U.K	8372	7832
Canada	5404	5069
Italy	5404	5069
Netherlands	4283	4018
Belgium	3496	3281
Spain	3377	3171
Switzerland	3210	3012
Australia	2951	2770
Sweden	1806	1696
Denmark	1623	1525
Austria	1335	1254
Norway	1204	1132
Finland	1033	971
News land	873	821
Portugal	659	620
Ireland	636	599
Greece	203	189
Luxemburg	199	190
Total	110460	103604

(Source World Bank annual report 2006)

The General Counsel of the U.S. Treasury has rendered an opinion that the entire uncalled portion of the U.S. subscription is an obligation backed by the full faith and credit of the United States, notwithstanding that congressional appropriations have not been obtained with respect to certain portions of the subscription.

3.3 RESERVES AND NET INCOME

(i) RESERVES

This is paid in portion of the capital, which provides a cost free resource to the Bank, though only a part of it may be available for lending with permission of member countries. However, the most vital source of cost free resources in usable form relates to the net accumulated earnings, referred to as reserves. For many years the Bank has retained its earnings (consists of allocated amounts - Special Reserve, General Reserve, Pension Reserve and Surplus) as reserves instead of distributing them as dividends among shareholders. A small part of these dividends is transferred to IDA from time to time.

The retained earnings of the Bank are held in two reserves, only one of which is available for lending. The special reserve, established in accordance with Article IV, section 6, of the Articles of Agreement has been expanded by a commission of 1 percent charged on the outstanding portion of loans. According to Article IV, section 4(a), these charge, to be made for ten years after the beginning of operations. Might then be either decreased or increased, depending on how sufficient the reserve was to be considered.[7]

(ii) NET INCOME / PROFIT

The World Bank makes profits/Net Income and this constitutes another source. It has been increasing over the years. In the seventies it was about US$ 200 Million, in early eighties it was US$ 500 Million. This shows an increase over the years. Net income in 2003 was US$ 5344 and 2004 it decreased by US$ 2940 to 2404. In 2005 the net income was US$ 3831, which was an increase of US$ 1427.

Table 3.3: Net Income In millions of U.S. dollars

	2005	2004	2003
Debt funded	291	628	936
Equity funded	1298	1231	1483
Total loan interest	1589	1859	2419
Operating income	1320	1696	3021
Net income	3831	2404	5344

Source, World Bank annual report 2006

During FY 2003 the overall reduction in provision for losses on loans and guarantees amounted to $1,300 million, resulting from the following factors. The provisioning requirements were reduced by $709 million primarily due to a net improvement in borrowers' risk ratings, and to a lesser extent due to changes in the size and distribution of the portfolio including negative net disbursements (of which prepayments were $6,972 million).

(iii) Net Interest Income

In 2005 loan interest income decreased by $270 million largely due to lower returns on the debt funded component of loans, as a result of the lower lending rates of the cost pass-through loan products. Lower average loan balances, particularly in higher-yielding loan products, also contributed to the decline in net interest income. The margins for cost pass-through products in FY 2004 were high, in part reflecting the effect of favorable interest rate repricing lags in a falling interest rate environment.

Comparing 2004 and 2003 the loan interest income, net of funding costs, decreased by $560 million largely due to lower returns on the equity funded of loans, as a result of both the lower lending rates of loan and the effect of lower market interest rates. Lower average loan balances, particularly in higher yielding loan as well as lower margins from cost also contributed to the decline in net interest income. The margins for cost loan in FY 2003 were high, in part reflecting the effect of favorable interest rate repricing lags in a falling interest rate environment as well as significant prepayment premium income. Net no interest expense increased by $42 million primarily due to a $10 million increase in other administrative expenses, a $23 million increase in contributions to Special Programs and a $31 million increase in staff costs and operational travel. This was offset by a $33 million increase in service fee revenues and other net income [8].

(iv)Income from Loans

Income from loans declined by $248 million during FY 2005 in comparison with FY 2004. Of this decline, $233 million is attributable to lower average loan balances, with reduced prepayment premium accounting for an additional $58 million decline. The decrease in loan income was partially offset by a $32 million increase in income attributable to increased lending rates and the net effect of

$28 million from loans being placed into no accrual status or restored to accrual status. In comparison, during FY 2004, there were no loans that were either placed into no accrual status or restored to accrual status.

The net income is attributable to a number of factors:

Firstly the Bank charges its borrowers a rate of interest that is expected to give a spread of 0.5 percent more than estimated cost of its borrowings, secondly the Bank is capable to invest and earn income on cost free resources such as paid in capital and reserves, Thirdly the Bank is in capacity to manage its liquidity in manner that the cost of carrying liquidity is minimized and occasionally gives positive return. Fourthly the Bank recharges its charges to the borrowers in terms of charging commitment fee and introducing valuable rate system.

3.4 LIQUIDITY

The World Bank's borrowing Programmes are greatly influenced by its sound liquidity policy [9]. Under its liquidity policy a high degree of liquidity at a level of 45 percent of the net cash requirements for the subsequent year is maintained.

Disbursements for a project may extend up to five to seven years or more. Cash requirements for disbursements against loans are therefore spread over a period. Further, the Bank needs funds to discharge debts servicing obligations and for its own maintenance. In carrying out borrowing decisions, financial prudence requires that there should be a well thought out liquidity policy, which is maintained at level of 45 percent of its cash requirements for succeeding three years. The World Bank did not borrow from the USA markets in 1969, 1973 and 1974. Despite the discretionary factor involved, the massive liquidity totaled built up by the World Bank gave it great staying power and it could ride out with relative ease. This put the World Bank in as advantageous position in respect to cost term.

Under World Bank's liquidity management policy, aggregate liquid asset holding should be maintained at or above a specified prudential minimum. The minimum is equal to the highest six months of debt service for a fiscal year plus one-half net loan disbursements as anticipated for a fiscal year based on commitments at the beginning of that year.

3.5 BORROWINGS

The World Bank's borrowing operations constitute a major source for financing its lending program. It borrows about 70 percent of what it lends. It borrows in various currencies and in different capital markets globally. World Bank diversifies its source of funding by offering its securities to institutional and retail investors globally on terms acceptable to World Bank [10]. Under its Articles, World Bank may borrow only with the approval of the member in whose markets the funds are raised and the members in whose currency the borrowing is denominated and only if each such member agrees that the proceeds may be exchanged for the currency of any other member without restriction. Funding raised in any year is used for World Bank's general operations like loan disbursements, re-financing of maturing debt and pre-funding of future lending activities. The World Bank repurchases or pre-pays its debts to minimize the cost of borrowings and reduce exposure of refunding needs in a particular year or meet other operational needs.

The World Bank first borrowed in 1947 in the U.S. Market. World Bank's borrowing operations are determined by: Firstly the need for diversifying the markets for meeting its obligations in order to avoid undue dependence on particular market. Secondly it has to seek the clearance of the government concerned for purpose of borrowing in particular market. Thirdly Circumstances restrict the entry of a limited number of countries during particular years. Initially U.S.A. was the only major market. Presently major markets are Germany, Japan, and Oil countries. The Bank does not carry exchange risk it passes it on to the borrowers; fifthly the Bank favors longest maturities slowest target rates since its lending is a long-term basis.

3.6 LOAN PORTFOLIO

The Bank only is allowed to lend to government or other entities under the guarantee of each government. It is expected to finance programs or to support structural adjustments. The projects financed, should be related to economic development and not military projects. Mostly, World Bank funds organised sectors, which are directly productive or economic infrastructural investments. World Bank's success is considered to closely related to a financial institution, which is linked to the quality of its loan portfolio and uses the loan where it is appropriate. The period for repayment of loans ranges from 15 to 20 years and grace period ranging from 5 to 7 years. However, the repayment depends on the economic strength of a country concerned and whether is IBRD or IDA.[11]

Table 3.4: World Bank Lending in Africa in sector wise in recent years (US$ milliond)

World SECTOR	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Agriculture, Fishing, and Forestry	111.5	212.0	210.4	303.4	268.5	215.3
Education	189.8	209.5	472.6	423.6	362.9	369.0
Energy and Mining	176.3	198.0	490.3	324.4	365.8	509.5
Finance	118.4	200.1	192.8	67.2	165.7	68.6
Health and Other Social Services	183.1	889.9	616.6	775.9	723.1	590.3
Industry and Trade	104.7	170.6	266.7	92.7	95.4	253.8
Information and Communication	17.3	21.1	33.8	41.4	52.9	20.0
Law and Justice and Public Administration	838.2	880.8	906.9	721.8	1,004.0	1,077.5
Transportation	263.9	229.8	491.1	690.5	716.6	507.2
Water, Sanitation, Flood Protection	155.9	357.8	112.2	296.3	360.8	276.2
Sector Total	**2,159.1**	**3,369.6**	**3,793.5**	**3,737.2**	**4,115.7**	**3,887.5**
Of which IBRD	97.7	0.0	41.8	15.0	0.0	0.0
Of which IDA	2,061.4	3,369.6	3,751.6	3,722.2	4,115.7	3,887.5

Source, World Bank annual report 2006

The articles state that the loans disbursed and outstanding should not exceed the capital of the Bank subscription and reserves. In terms of distribution of loans among member countries, financial prudence demands the portfolio to be diversified. According to this, the World Bank sets limit on individual exposure. When giving any loan to a member country, the World Bank must be satisfied on the ability of the concerned government to service the debt. This is done after assessing more economic policy.

3.7 WORLD BANK'S FUNDING STRATEGY

IBRD, known as "The World Bank", lends only to sovereigns or for sovereign-guaranteed projects in countries with per capita income over a certain level (currently US$965). Countries with less capacity to repay loans receive long-term loans at zero percent interest and a 0.75 per cent service charge or grants from the concessional lending window, the International Development Association (IDA). Lending in 2005 was Finance 10 per cent Law & Public Administration 25 per cent Water & Sanitation 12 per cent Agriculture 11 per cent Industry & Trade 6 per cent Energy & Mining 6 per cent Education 8 per cent Transport 15 per cent Health & Social Services 7 per cent.

Table 3.5: World Bank Changing Lending Volumes (million US$)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
IBRD	135	129	141	151	131	97	91	96	99	87	118
IDA	108	127	100	135	145	126	134	133	141	158	160
Total	243	256	241	241	286	276	223	225	229	245	278

World Bank annual reports various issues.

The funding strategy of World Bank has four basic objectives.

(i) Availability of funds

The major goal of the World Bank is to ensure the availability of the funds to the institution. To attain this objective, the World Bank seeks to maintain a margin-unutilized access to funds, in the markets in which it borrows. The main guiding principle in this is the diversification of sources and a concern for maintaining a long-term position in the market.

(ii) Minimizing effective cost

This second element affects the currency mix of its borrowings and the timing of borrowing. The World Bank tends to maximize borrowings in currencies with low minimal interest rates except in cases in which potential movements in currency exchange rates seems likely to offset or reverse the nominal interest rates savings. Costs are kept low by the timing of borrowings. When interest rates are expected to rise, the World Bank may seek to step up its borrowings and conversely when interest rates are anticipated to fall. It can afford such flexibility of its estimated net cash requirements over the next 3 years.

(iii) Controlling volatility

Due to the volatility in interest rates, the Bank introduced in July 1992 the pool based variable rate lending approach. It uniformly adjusts interest charges applicable to the outstanding balance on all loans made under it. Then in the next few years, the majority of loans and borrowings in the balance sheet are incorporated into new lending system; the interest rates risks caused by the World Bank will be much reduced. However, the variable rate lending has increased potential feature of volatility into borrowers' costs. A minimum of volatility however is today unavoidable the challenge that the World Bank faces is to find that point at which equilibrium can be struck between the susceptibility of the lending rate to change and the pursuit of its other core funding strategy objectives.

(v) Development Effectiveness

The Bank aims on continuous improvement in its improvement to development effectiveness. Noteworthy measures to make Bank assistance more effective include decentralization of Bank staff, greater focus on local level ownership and participation in projects and strategy formulation, flexibility in tailoring new lending and non-lending instruments to achieve client requirements. The Bank evaluates its operations time after time and provides real-time input to management of Bank's loan portfolio.[12]

Over the past six decades of its operation, World Bank has realized that financing for only projects is not enough. The biggest challenge facing it relates to measuring and achieving efficacy at the level of not only Bank projects but also overall economic development of the country. The Bank's main mission is to help developing countries reduce poverty and improve living standards. Effective poverty reduction strategies and poverty focused lending are central at achieving these objectives and have been fundamental to Bank activities in the recent years. The Bank tries to incorporate gender issues in development strategies, strengthen economic management, reduce countries vulnerability to crises, strengthen public institutions and anti-corruption efforts and build the institutional, structural and social foundations needed for a sound macro-economic stability which will foster economic growth and development.

3.8 INTERNATIONAL DEVELOPMENT ASSOCIATION (I.D.A)

The International Development Association (IDA) is the part of the World Bank that helps the world's poorest countries. Established in 1960, IDA aims to reduce poverty by providing interest-free loans and grants for programs that boost economic growth, reduce inequalities and improve people's living conditions. IDA lends money on concessional terms. This means that IDA credits have no interest charge and repayments are stretched over 35 to 40 years, including a 10-year grace period. There was a growing view that the developing countries had to invest in their infrastructure, e.g. railways, ports, power projects and telecommunications and also had to improve their human capital by providing better and more diversified education, by improving skills and safeguarding health. Programmes like this consumed time. Tangible benefits could not also be accurately measured in monetary terms. Private investors were unlikely to be attracted by these. Again, such activities though productive in the long run, may not be translatable into foreign exchange earnings, which could be used to service external debt.[13]

Table 3.6: Selected Financial Data In million (US $)

Particulars	2005	2004	2003	2002	2001
Commitments to member countries	13,611	11,045	11,231	11,452	10,487
Gross Disbursements	9722	10109	11921	11256	11784
Net disbursements	5131	8408	7996	812	2091
Loan income	4155	4403	5742	6861	8143
Total assets	222008	228910	230062	227454	222748

Source, World Bank annual report).

(i)ORGANISATIONAL STRUCTURE OF THE IDA

Membership of the nations in IBRD is a prerequisite for being a member in the IDA. The president of the IBRD is the president of the IDA. The IDA activities are confined to the mainly in Africa and south Asia that have low GDP per head. IDA is financed from profits of the entire World Bank group and by grant from member countries [14]. The voting power in the IDA is in line with that of the World Bank.

The Board of governors is common for both World Bank and IDA. Executive Directors elected for the Bank are ex-officio directors for the IDA. Meetings for both World Bank and IDA are jointly held. Donor nations comprise not only industrial members countries like France, Germany, Japan, the U.K. and also the U.S.A. but also developing countries such as Argentina, Botswana, Brazil, south Korea, the Russian federation and Turkey some of which were previously IDA borrowers themselves.

(ii) LENDING POLICIES

Lending policies have been modified over the years. During World Bank's establishment, it was meant for financing the reconstruction of Western economies. Later there came in Development. Lending commitments for the FY 2005 was $ 13.6 reflecting an increase of $ 2.6 billion from the financial year 2004 of $ 11.0 billion (World Bank annual report 2006) [15].

Table 3.7 IDA lending in recent years

IDA MILLIONS OF DOLLARS	FY05	FY04	FY03	FY02	FY01
Commitments	8,696	9.035	7,282	8,068	6,764
of which development policy lending	2,301	1,698	1,831	2,443	1,826
Number of projects	160	158	141	133	134
Of which development policy lending	32	23	24	23	15
Gross disbursements	8,950	6,936	7,019	6,612	5,492
Of which development policy lending	2,666	1,685	2,795	2,172	1,280
Principal repayments	1,620	1,398	1,369	1,063	997
Net disbursements	7,330	5,538	5,651	5,549	4,495
Credits outstanding	120,907	115,743	106,877	96,372	86,572
Undisbursed credits	22,330	23,998	22,429	22,510	20,442
Undisbursed grants	3,021	2,358	1,316	148	—
Development grant expenses	2,035	1,697	1,016	154	—

Source, World Bank annual reports various issues.

Table 3.8: World Bank Lending in Africa in recent years

THEME	2000	2001	2002	2003	2004	2005
Economic Management	78.2	138.5	138.7	37.8	67.8	46.5
Environmental and Natural Resource Management	172.4	110.0	159.9	227.0	195.3	217.2
Financial and Private Sector Development	466.7	625.8	780.7	383.6	810.9	768.2
Human Development	208.5	399.4	739.0	811.4	618.2	620.2
Public Sector Governance	495.3	429.6	851.9	432.4	818.5	708.0
Rule of Law	26.7	34.0	22.5	34.5	28.3	30.9
Rural Development	151.8	296.3	329.2	384.1	360.7	537.2
Social Development, Gender, and Inclusion	210.5	491.8	347.4	420.0	374.3	221.8
Social Protection and Risk Management	140.5	376.4	98.3	543.7	209.2	294.3
Trade and Integration	53.7	261.5	46.4	37.2	371.5	232.0
Urban Development	154.9	206.1	279.6	425.5	261.2	211.4
Theme Total	**2,159.1**	**3,369.6**	**3,793.5**	**3,737.2**	**4,115.9**	**3,887.5**

Source, World Bank annual report VARIOUS Issues

Table 3.9: World Bank lending by region sector wise in 2005.

Purpose	Africa	East Asia $Pacific	Europe& Central Asia	Latin America &Caribbean	Middle East & NorthAfrica	South Asia	Total
Agriculture, Fishing, Forestry	276.88	3,900.85	2,707.97	4,429.34	2,215.57	1,405.63	14,936.25
Education	143.83	3,587.93	1,972.67	7,655.75	1,297.12	113.18	14,770.47
Energy and Mining	597.23	11,733.23	9,423.76	3,893.80	1,094.35	6,583.29	33,325.65
Finance	104.15	7,694.16	6,919.76	11,352.34	2,139.95	1,678.30	29,888.65
Health & Social Services	160.55	2,203.21	4,154.26	10,527.79	1,073.14	295.50	18,414.45
Industry &Trade	356.42	5,573.47	9,155.28	3,550.83	2,791.57	1,270.49	22,698.05
Information & Communication	221.57	1,636.61	716.66	519.35	270.06	72.23	3,436.47
Law,Justice,Public Administration	479.79	5,610.24	12,862.49	23,891.63	2,157.40	1,492.47	46,494.02
Transportation	185.33	12,424.44	5,149.00	10,480.67	1,707.82	5,147.56	35,094.82
Water, Sanitation, & Flood Protection	550.82	5,966.29	1,920.64	5,500.05	1,955.12	848.54	16,741.46

Source World Bank annual report 2006)

In the sixties the financing of a project was in the context of total development of a country. Therefore, the Bank suggested that there should be an assessment of policies of the economy as a whole so that the Bank could identify its role and decide upon the suitable sectors to be covered and the projects that could be considered attractive enough. To make these effective, meetings of working groups were designed. Under these circumstances, there is an annual meeting of all donors to consider the economic policies of each country and decide upon the kind of assistance for it. The assessment of economic policies of the borrowing countries was done by the World Bank's own staff.

Sector wise, the Bank's initial focus was involved in transportation, electric supply telecommunications and irrigation and flood control in developing countries. Agriculture, education and industry were sectors recognized in the sixties. In the seventies, expansion was made to social sectors like education, population planning and organizational aspects. Poverty alleviation became an issue in the same period and the Bank acted upon it directly. The World Bank is a leading development institution and its lending operations have generally grown over the years. The World Bank has expanded it's lending from financing the reconstruction work then specific projects to finally emphasizing on a package of economic policies of a country concerned through structural adjustment lending. Throughout the eighties and present the Bank's lending to a country is determined by was an "appropriate economic response". This analysis is presented in terms of lending criteria, graduation principles, Terms of Lending, the project cycle, Procurement of goods and work[16].

See tables 3.7, 3.8 3.9 and 3.10 how the World Bank has been funding projects in different sectors and theme in the member countries.

Table 3.10: World Bank lending by theme and sector in recent years:

(i) IBRD

IBRD MILLIONS OF DOLLARS	**FY05**	**FY04**	**FY03**	**FY02**	**FY01**
Commitments	13,611	11,045	11,231	11,452	10,487
Of which development policy lending	4,264	4,453	4,187	7,384	3,937
Number of projects	118	87	99	96	91
Of which development policy lending	23	18	21	21	15
Gross disbursements	9,722	10,109	11,921	11,256	11,784
Of which development policy lending	3,605	4,348	5,484	4,673	4,393
Principal repayments (including prepayments)	14,809	18,479	19,877	12,025	9,635
Net disbursements	(5,087)	(8,370)	(7,956)	(769)	2,149
Loans outstanding	104,401	109,610	116,240	121,589	118,866
Undisbursed loans	33,744	32,128	33,031	36,353	37,934
Operating income	1,320	1,696	3,021	1,924	1,144
Usable capital and reserves	32,072	31,332	30,027	26,901	24,909
Equity-to-loans ratio	31.4%	29.4%	26.6%	22.9%	21.5%

World Bank annual report various issues.

3.9 LENDING POLICIES

The Policies of the Bank mostly relate largely to methods and standards by which the Bank uses to assess a country before committing a loan as to how much it can prudently lend, what types of loans are likely to attain its efficacy and what are the conditions which will assure that the Bank's financing will be used effectively for development purposes [17].

(i) **Eligibility:** The Bank prescribes a per capita level of income, above which a country will not be eligible to draw from World Bank. The limit is not fixed in the Articles, but the Directors determine it. The present level (2004) US $ 965.

(ii) **Size of the Country:** In addition to the per capita issue, population plays a major role. This means that a larger the population the larger the transfer of resources from the World Bank to the country. India and China stand a good chance here and Nigeria in the African Countries

(iii) **Country's projected gap in external finances:** A consideration again here is the extent to which the finances it can be met from non-Bank sources. This means that the World Bank considers that there is no other appropriate source of the funds for the country.

(iv) **Economic and social performance:** This relates to the level of productions, growth of the economy, savings and investments trend and efficient use of capital. In short like entire macro-economic policies are pursued. Nevertheless, there are other aspects like measures towards population control and accent of distributive justice. However considerations are given place to the extent of market orientation and liberalisation and globalisation of the economy.

(v) **Absorptive capacity of a country:** The borrowing country should be in a position to provide an appropriate policy environment and especially be able to identify fundable projects and ensure that the funds are utilized appropriately.

(vi) **Credit worthiness of a country:** The World Bank should be convinced about the policy of the borrowing country to make foreign exchange available for servicing debts. Therefore, a decision is made about the country's present and prospective external debt and outlook of foreign exchange earning. Very poor countries are eligible for assistance from IDA. However, World Bank may act otherwise by financing a project in a non-credit worthiness country that may earn surpluses to the Bank.

(vii) **Country limit set:** The Bank tries to distribute its investment portfolio equally and is not concentrated in a particular country. Therefore, a limit is imposed on the amount of debt that would be outstanding to the Bank from any country hence country limit.

TERMS OF LENDING

There are three parameters in terms of the Bank lending namely the rate of interest, commission charges and grace as well as amortization period.

Rate of Interest

The Bank normally makes two types of development loans medium and long-term loans. The Bank raises most of the money it lends to developing countries through its own borrowings from investors who buy its obligations. Investors require a competitive return on the money they lend to the Bank. Since the largest source of the Bank's loan funds are the capital markets on which it sells its obligations, the cost of funds in these markets is the major determining factor in the setting of the Bank rate of rate of interest from which the Bank charges from its borrowers The Bank's capacity to raise funds in the capital markets of the World depends on the soundness of its investments. As it does maintain a sound financial position, it can borrow in the capital markets of the world at the lowest available rates. It lends to developing member countries at or near the rate of interest it itself pays [18].

Adjustments in the World Bank's lending rate either lower or high, reflect the changing costs to the Bank of the money it raises. These adjustments do not affect the rate of interest on existing loans but only the rate charged on loans made subsequent to an adjustment. The Bank realizes the burden of borrowing costs on the foreign exchange resources of developing countries and tries to keep its lending rate as low as is compatible with its own ability to raise money in the capital market.

Grace and Amortization Period

The Bank grants development loans with the principal repayments commencing at the end of grace period and thereafter over the remainder of the life of the loan. The grace period in which interest but not amortization payments are due, is determined in relation to the anticipated lapse of time between the date of commitment and the time at which the project will be functioned and start to yield substantial net returns. In setting up the length of its loans the Bank has normally followed the principle that the term should bear some relationship to the estimated useful life of the equipment or plant being financed.

TYPES OF LOANS

1. Specific Investment Loan

The aim of this investment is to create new productive assets and economic and social infrastructures, to restore to full potential or to ensure their maintenance. It focuses on technical, financial, economical and institutional viability of a specific investment and its maintenance, and on those aspects of sector policy framework that bear directly upon the productivity of the investment for example, input and out put prices, operational efficiency of enterprises et cetera. It also assists in the design of investments and in entrepreneur and training programs. The Bank staff does appraisal of investment. The loan proceeds are spent for pre-identified equipment, materials and services. It can as well be used for civil works for particular investments. The disbursement period may range anywhere from eight to nine years.

2. Sector Investment and Maintenance

What is expected here is to bring sector investments in line with economic priorities and ensure that they are efficiently functioning and maintained. It assesses sector expenditures, especially balance on new investments, rehabilitation and maintenance, institutional, capacity to plan, implement and monitor investments. It requires agreements on well designed sector program to meet priority development needs, as well as on specific measures, to strengthen entrepreneur and policies and a sector institution capable of carrying out the program using agreed appraisal criteria for individual parts of the program. The loan proceeds are used to buy various types of equipment, materials, services and civil works related to the whole or a particular part of the sector program. The disbursement period is normally from 3 to 7 years.

3. Financial Intermediary Loan

The focus is to provide funds for enterprises and small medium sized farmers through an intermediary within a competitive environment. Until the mid-seventies, investments in financial sector used to be exclusively to individual, specialized Development Financial Institutions (DFIs) it focuses on the different categories of client types of investments, service levels and cost of capital. It requires agreement on criteria to select sub-borrowers and appraise their needs on lending rates. There is special emphasis on institution building. The Bank policy has sought to increase the relative emphasis on the development and performance of the whole financial system. The Executive Directors in fiscal

1986 noted that in order to promote country assistance strategy for financial development, the issues to be applied would have to be selective and would depend on differences in country size, stage of development and economic system. Similarly the prescription of policies is modified on country's situation.

4. Sector adjustment loan (SAL)

The major goal of sector adjustment loan is to encourage the introduction and effective implementation of sector policies necessary for sustained rapid growth. It was designed to spur comprehensive policy reforms and institutional reforms in a specific sector. It aims on major sectoral issues and investment program, especially incentive framework, for example tariffs, prices, taxes and institutional capacity. These loans are normally given usually to countries that either lack administrative and political capability to formulate and implement comprehensive programs or as following to stabilisation programs to deepen reforms in a sector. Sector adjustment operations are normally monitored with release of the second part of the funds being linked to the progress of sector adjustment program. The loan proceeds are used mainly for importing goods and raw material that are needed for that sector with actual users either being pre-identified or to be selected on certain specified formula.

5. Structural-Adjustment Loan

Structural Adjustment Lending (SAL) was introduced in fiscal 1980 in response to the markedly deteriorated prospects that were then foreseen for developing countries during the eighties. The objective of SAL has been to first Support a program of specific policy changes and institutional reforms designed to achieve a more efficient use of resources and thereby contribute a better sustainable Balance Of Payments in the medium and long term to spur growth in the face of severe constraints. Secondly act as a catalyst for the inflow of other external capital to help ease the balance of Payments (BOP) situation. These kinds of programs are intended to be flexible in order to suit the individual countries. They could involve measures to adjust production to higher energy prices, enhancement of export competitiveness and emphasis on labour intensive investments.

6. Technical Assistance Loan

Engineering related such as feasibility studies, engineering design and construction supervision and Institution related such as diagnostic policy and institutional studies, management support and training. The objective of technical assistance loan is to strengthen local institutions concerned with:

(i) Formulating and adopting policies, strategies and institutional approach which will spur economic development in a sector or in the economy as a whole.

(ii) Preparing, implementing or operating specific investments or

(iii) Conducting out specific tasks related to the preparations, implementation or operations of investments.

These loan proceeds are used in hiring the services of specialized consultants, conducting studies and training manpower. The disbursement period ranges from

2 to 6 years. Experience has shown that there are a number of preconditions for the success of technical assistance programs, in the first place, borrower should acknowledge that specialist's services are needed, secondly, there should be clearly and understood objectives. Thirdly, there should be agreement on the design and phasing out technical assistance work on the degree of local involvement and on the professional relationships of specialists to the borrower and the Bank. Trained specialists and experienced managers would be needed on an urgent purpose in strengthening economic development. Ideally speaking technical Assistance is utilized where legitimate skill scarcity exists and consequently then replaced by local personnel who become available through the two channels of training by technical assistance.

7. Emergency Reconstruction Loan

The objective of this loan is to support rebuilding activities and rapid restoration of physical structure and productive activities after disasters and calamities. It focuses mainly on restoring pre-disaster situations with emphasis on strengthening institutions to handle reconstruction effort and prepare them for future. The loan proceeds can be used for a wide variety of materials and instruments needed for reconstruction needs. The disbursement period for such loans varies from two to five years. IDA, as the World Bank affiliate loans for drought floods and other calamities affecting developing countries. It as well finances imports. Together with the World Bank, they speed up the economic development in less developed countries through this type of loan [19].

LENDING OPERATIONS PRINCIPLES

(i). World Bank makes loans to governments, governmental authorities or private enterprises in the territories of member countries. A loan that is not made directly to the member in whose territories the project is located must be guaranteed as to principal, interest and other charges by the member or its central bank or a comparable agency of the member acceptable to the World Bank. A guarantee by the member itself has been obtained in all such cases to date.

(ii) Investment projects financed by World Bank loans are required to meet bank's standards for technical, economic, financial, institutional and environmental soundness. Specific provisions apply to development policy lending financed by World Bank loans, including the treatment of the macroeconomic framework, poverty and social impact. Decisions to make loans are based upon, among other things, studies by World Bank of a member country's economic structure, including assessments of its resources and ability to generate sufficient foreign exchange to meet debt-service obligations.

Under funding

(iv). World Bank must be satisfied that in the prevailing market the borrower would be unable to obtain financing under conditions which, in the opinion of IBRD, are reasonable for the borrower. However, this does not preclude lending to members who may have access to international credit markets.

(v) IBRD makes arrangements intended to ensure that funds loaned are used only for authorized purposes and, where relevant, with due attention to considerations of cost-effectiveness. (b) To maximize competition in the procurement of goods and services by using, wherever possible, international competitive bidding or, when it is not appropriate, other procedures that ensures maximum economy and efficiency. In addition, World Bank considers the use of borrower country environmental and social safeguard systems in selected operations where these systems are assessed as being equivalent to World Bank's systems and where the borrower's implementation practices, track record, and capacity are considered acceptable to IBRD.

3.11 GRADUATION PRINCIPLES

The World Bank is governed by basic guidelines/principles that are satisfied by a country concerned before it is lent loans What the Bank needs from its member countries before lending is embodied in Article II of the Articles of Agreement. The following are the graduation principles.

Graduation of borrowers from the World Bank is firmly established principle and has been a consistent one. It is a process of gradually phasing out World Bank lending as a borrowing country reaches certain satisfactory level of development, management capacity and access to capital markets that permit it to carry on without World Bank financing. Graduation should be both flexible and fair and sensitive to each country's individual circumstances. Graduation principles normally occur within five years after a country reaches the percentage Gross National Product (GNP) benchmark of US$ 2850 at 1984 prices. This period might be longer if the economic situation deteriorates during the phase out period.

3.12 THE PROJECT CYCLE

World Bank over its life has developed great strength in a project lending. This is a tribute to the systematic and meticulous way in which it has carried out this task. Each loan goes through six steps that the World Bank terms as project cycle [20]. The process of identifying and appraising a project and approving and disbursing a loan often extends over several years. However, on numerous occasions World Bank has shortened the preparation and approval cycle in response to emergency situations such as natural disasters. Generally, the appraisal of projects is carried out by World Bank's operational staff (economists, engineers, financial analysts, and other sector and country specialists). With certain exceptions, World Bank's Executive Directors must approve each loan. Loan disbursements are subject to the fulfillment of conditions set out in the loan agreement. During implementation of World Bank Supported Operations, experienced IBRD staff review progress, monitor compliance with IBRD policies and assist in resolving any problems that may arise.

Each project financed by the Bank is required to pass through a procedure of stages of a well-established project cycle [21]. Therefore following steps in order indicate the laid down project cycle procedure.

(i) Identification of the Projects

Identification has assumed paramount significance with McNamara's emphasis on higher lending. The objectives of the proposed project should attract wide support and should be in conformity with long-term coherent development strategy that the country has in view. The World Bank, the non-governmental organizations and government are the main players in identifying a project. The Bank collects much data about a borrowing country's economy and analyses the data with an aim to asserting its creditworthiness especially World Bank's loans as the Articles indicate. This data is used for dialogue between the government concerned and World Bank. In this way the Bank arrives at tentative conclusions in regard to the quantity of lending to the borrowing country for a few years in future.

The Finance Ministry may sponsor some schemes for World Bank financing leaving others to be financed by bilateral or other multilateral aid agencies. At this stage a pre-feasibility report regarding the proposal considering different alternatives is important. The World Bank works a pre-feasibility report into a project brief. A number of project ideas are narrowed down. In some circumstances, the borrower country may have already embarked on a long-term development plan and is ready with number of projects. All the alternatives are worked upon precisely to ensure a deserving project for financing and achieving its efficacy development goals.

(ii) Preparation of the project

A project in brief is prepared whereby objectives, pertinent issues, gestation period, financial, technical, economic and also institutional aspect are specified. For traditional infrastructural and industrial projects, the technical aspects would involve surveys, preliminary engineering, and preparation of cost estimates and, the most suitable technology, and estimation of the demand and finally the realization anticipated from the sale of the products.

Table 3.11: Time span of project cycle.

Stage	Name	Time elapsed	Staff input (staff years)
1	Identification and selection	0.5	0.2
2	Preparation and design	1.5	0.6
3	Appraisal	0.7	1.4
4	Negotiation with borrower and approval by the bank's executive director	0.3	0.3
5	Implementation and supervision	7.5	1.7
6	Evaluation after completion of the project		

Newer projects where human and socio-economic factors are involved, the returns may not be quantitative and the institutional aspects call for closer assessment. Financial aspects call for fairly clear cost estimates and an overall financial plan together with estimates of the likely returns. For traditional projects, the financial ability of the project has to be assessed. The economic aspects require an assessment of the pricing policies and the overall policy framework within which the project will be operating. Foreign exchange, labour and taxes are scrutinized.

Everything has to be arranged to establish the financial viability, predict the financial and economic rates of return and detail the institutional arrangements for the implementation of a project. Time frame for the project would also be well spelt out. The Bank maintains that the borrower is responsible for the preparation of the project to be financed by the former including the feasibility report and the availing of all the data that may be asked from time to time.

(iii) Appraisal by the Bank of the Project

This responsibility purely rests on the Bank staff, assisted if necessary by consultants and calls for one or more visits to the field. The Bank examines the technical, financial, economic and institutional aspects. Technical part entails: sound design, appropriate engineering, suitable agro-economic practices, and education et cetera. Analysis of the project in its sector setting, overall relevance to development, cost and benefit to the country are also examined. During the economic appraisal, the project is examined in its sectoral setting where key government policies are analysed. The principle seems to be that even a sound project cannot succeed if the policy environment in which it operates is not conducive to efficient functioning. The financial analysis involves projections of cash flow, balance sheets, and profit and loss accounts for the number of years to ensure the financial viability of the project and its ability to pay back the loan. Under the financial review, the financial plan is scrutinized as the Bank attempts to gain the most leverage from its participation. The Bank as a rule does not finance the entire cost and the borrower is expected to meet the cost of the remaining amount from its own sources. Therefore, the process of appraisal is completed with the production of detailed appraisal report and draft of legal agreement between the World Bank and the borrower.

(iv) Negotiations between the World Bank and the Borrower

Negotiations start immediately the objectives and scopes of the projects have been accomplished. They get formalized in the loan documents. Nevertheless, the borrower ensures that the project description is flexible as per the changing circumstances, which do not make legal obligation difficult to undertake. Procedures of employing a consultant whose qualifications are suitable to the Bank are included in the negotiation. This is necessary in Project design or technology negotiations include procedure for procurements of goods on award of contract for civil works, which are vested with the borrower. At times, the Bank needs this to be conscious of its different roles namely financing, development and co-operative roles.

(v) Implementation by the borrowers and supervision by the Bank

The project cycle reaches the stage when missions are sent out from Washington periodically to inspect work in the field. Project implementation is the duty of the borrower after the approval by the World Bank. This process takes about 18 to 36 months of the project. Although, it is hard to visualize all obstacles wherein and in the development process, the Bank has to take responsibility as well as supervision and implementation. This is done in order to ensure that the implementation gets notified regularly and on mutually agreed basis without detrimental work on the basis of legal framework and objective. The Bank considers this process as an exercise of eliminating problems of the same though of late its role is decreasing. Recently there is an increasing emphasis on monitoring and evaluation within the project.

At times, supervision depends with the condition of a country concerned and the nature of the project. Supervision takes the form of review program report at headquarters provided by monitoring cells established in the project as per the agreement. The Bank's involvement in supervision makes it possible to obtain valuable feed back on accounting basis without delay.

(vi) Evaluation after the completion of the Project

The Bank's continuous involvement with a project even after loan approval is the need to profit from the lessons learned. During the term of Mr. Robert McNamara as the President of the Bank, Operations Evaluation Department (OED) was created, an independent organization headed by a Director General directly who reports to the President and to the Executive Directors. The procedure involved here is the preparation of completion report after the project is over. The costs and benefits are ascertained and updated. They are compared with the corresponding figures when the project was approved. The report of the OED provides material to assess whether the project cycle laid down by the Bank and the constant supervision and monitoring conducted by it are justified by the results achieved. [22]

vi Procurement of Goods and Work

The articles of Agreement prohibit the Bank from tying the use of the proceeds of any loan to expenditures in any particular country. At the same time the articles require the Bank to ensure that the proceeds are used for the purposes for which the loan was granted with regard to the considerations of economy and efficiency. Hence, all countries, which make borrowings from the Bank, are at liberty to use the proceeds of their loans in making purchases in any country wherever they wish, provided they observe a proper standard of economy and efficiency.

In the willingness of the borrowing country the Bank attaches great importance to the procurement of goods and services needed for any World Bank financed project in the cheapest possible market consistent with satisfactory performance. Moreover, as co-operative international institution one of the principle purposes is the promotion of the long-range balanced growth of international trade. The main reason for this is that the Bank wants to have a fair opportunity to supply goods and services, which are financed by Bank loans. In this effect it supports its borrowers to make purchases on the competitive international basis unless this procedure is clearly inappropriate. In addition to ensure that maximum returns is obtained from this system of procurement, the Bank advises its borrowers to employ a qualified consultant to assist in determining the qualifications of bidders, in preparing specifications and in analysing the relative merits of bids where such considerations as delivery dates, quality and performance must be taken into account.

The procedure of procurement ensures efficiency and economy in the use of proceeds of the Bank loans but this policy can be criticized on the ground that it is more time consuming. Managing the procurement procedure is a vital aspect of project implementation the responsibility for the execution of works and award of contracts lies with the borrower. In large projects, international competitive bidding is normally the appropriate manner of ensuring efficient procurement safeguarding against waste or corruption and satisfying the interest of lending agencies that all qualified firms are permitted to bid. Local competitive bidding is more appropriate for small procurement of Goods and works in which foreign firms will not be interested. Alteration in procedures may be vital to ensure effective competition among local firms in view of commercial interest involved and information on procurement by countries.

3.12 CO-FINANCING

In co-financing, the World Bank finances portion of the project cost and the remaining is expected to be financed by the borrowing country. Co-financing is firmed up when the Bank board approves the project. It enables the Bank to provide lesser amount of participation in each of the projects it spreads its resources in a wide area. In the early and mid eighties there was an emphasis on co-financing[22]. Perhaps this came up due to the reluctance of the Reagan administration to raise bank finances and it's willing to promote private investments for development projects acted as a catalyst. The logic appeared to be that the Bank's scarce resources could be stretched or leveraged by associating other parties and persuading them to also partly finance development projects.

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