# Bankers to the world

## The World Bank is becoming more involved with housing finance systems. Bertrand Renaud examines this and other aspects of the Bank's role

THE World Bank has been a leading economic development institution for 40 years. It has been active in urban development for 15 years and is now becoming increasingly concerned with the sound development of financial systems for housing in developing countries. The following profile of this large and complex organisation focuses on the World Bank as a financial institution and on its activities in housing finance.

### THE WORLD BANK GROUP

THE World Bank group consists of three separate legal entities which differ by their objectives, sources of funds and types of operations. However, all three have one central purpose: to promote economic and social progress in developing nations by helping raise productivity so that their people may live a better and full life.

The World Bank or International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation (IFC) have three interrelated functions: to lend funds, to provide advice, and to serve as a catalyst to stimulate investment by others. The three institutions are closely associated; both IDA and IFC are affiliates of the IBRD. The IBRD and IDA share the same staff. While IFC has its own operating and legal staff, it shares certain administrative and other services with the Bank. The same person is president of all three institutions.

Of the three institutions, the World Bank, established in 1945, is the oldest and the largest. Currently it is owned by the governments of more than 140 countries that have subscribed to its capital. Only countries that are members of the IMF can be considered for membership of the Bank. Voting rights are defined by the ownership of shares and not on a one-country one-vote basis.

### The World Bank as a financial institution

The World Bank — as distinct from IDA and IFC — finances its lending operations primarily through the sale of debt obligations to private investors, financial institutions, and governments. The structure and substance of the Bank's lending operations are different from those of commercial banks. The Bank's loans are different from those of commercial banks. The Bank's loans are tied to specific projects or economic programmes that are evaluated on the basis of their financial and economic soundness. The projects must produce acceptable rates of return and must be of high priority in a country's overall economic development programmes.

The project cycle is a unique activity by which the Bank assists beneficiaries of its loans to prepare and implement projects within the context of agreed development objectives. It is an elaborate process which is fundamental to the quality of the Bank's credit. Since July 1982, World Bank loans bear variable rates adjusted every six months at 0.5% above the average cost of outstanding borrowings, with typical maturities of 17 years and a grace period of four years on principal.

The Bank's experience with respect to its loan portfolio has been excellent without a single write-off in its history. There are two major reasons behind this record. First, the project/programme concept does not leave much room for losses, write-offs, non-accruing loans or rescheduling. Second, there are substantial pragmatic reasons why borrowers do not default on World Bank loans.

In the event of a default, no further disbursement would be made on that loan or on any other loan outstanding but not yet disbursed to the country. Given the substantial amount of the Bank's undisbursed loans, borrowers would be extremely reluctant to take steps which would jeopardise access to future resources.

Further, a default to the Bank would very seriously affect the international credit standing of the country involved. It is also of vital importance to the quality of the portfolio that World Bank decisions continue to be made by professionals strictly on economic and financial grounds.

The World Bank's borrowings operations constitute the major source for financing its lending operations. The Bank borrows about 70% of what it lends. The outstanding debt of the World Bank is presently of the order of $65 billion and annual borrowings amount to about $10 billion. The diversity of its borrowings is unique. Securities are denominated in more than 15 currencies.

The Bank's liquidity policy, whereby short-term liquid assets

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represent about one third of its outstanding debt, gives it considerable flexibility to decide where to borrow, how much, at what cost, and on what terms — possibly for as long as a year. This liquidity base allows the Bank to smooth out the impact of interest rate fluctuations and to minimise the cost of funds to the Bank and to borrowers.

The capitalisation of the Bank is central to its strength as a financial institution and it has some unique features. First, the Bank's lending operations were restricted by its founders in an extraordinarily conservative way. Under the Articles of Agreement, the Bank's outstanding and disbursed loans must not exceed its subscribed capital and reserves — i.e. a ratio of "one-to-one".

This is in sharp contrast to commercial institutions where risk assets often exceed 15 to 20 times their equity base. Currently this statutory lending limit is $74.8 billion and outstanding loans amount to 77% of the limit. The second notable feature of the Bank's capital is the distinction between "paid-in capital" and "callable capital".

Paid-in capital represents only 10% of the subscribed capital, it is available for general operations and no dividends are paid to shareholders. Callable capital, which makes up the remaining 90% of subscribed capital, can be used only for the protection of bondholders.

Such a structure was considered necessary at the end of World War II for the Bank to play its role of leading international financial intermediary between capital markets and foreign borrowers of poorly known credit worthiness.

The financial strength of the Bank and the management of its operations are such that its net income for the fiscal year ending 30 June, 1986 is expected to be of the order of $1.3 billion with two-thirds coming from loans and one-third from investments. Part of this income will be allocated to reserves and the balance will be transferred to IDA in lieu of payments to shareholders.

## International Development Association

There is considerable confusion in the market place and in public debates between the World Bank and IDA, in addition to very inaccurate knowledge of the operations of the Bank. The World Bank is the premier credit in the market place and has nothing to do with "the taxpayer's money" as is sometimes wrongly stated in the national press of some countries. On the other hand, IDA is a special fund whose "credits" were initiated in 1960 because, irrespective of cash flow from a project, a very poor country may not be able to generate sufficient foreign exchange resources to service conventional debt while pursuing valid developmental goals.

The World Bank and IDA are legally and financially separate entities in respect of assets, liabilities, and capitalisation. IDA is funded on a three-year cycle with grants from governments. Lending terms are highly concessional: the average loan maturity is 50 years, with a grace period of 10 years, and there is no interest.

The same standards of country and project evaluation apply to Bank loans and IDA credit. Currently 80% of IDA "credits" go to the poorest countries with annual *per capita*

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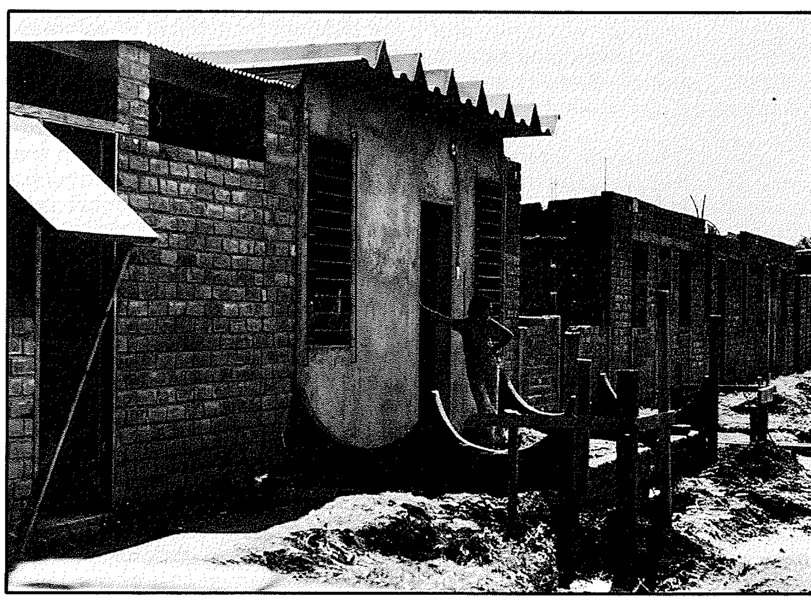

*A housing project in El Salvador funded by the World Bank.*

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income below $410. All borrowers have *per capita* incomes below $795. In fiscal year 1986, IDA represents 19% of the total planned loan production of the World Bank staff with World Bank loan commitments of $12.8 billion and planned IDA credit commitments of $3 billion.

### International Finance Corporation

The International Finance Corporation was established in 1956 and complements the work of the World Bank in a number of ways. In addition to loans, it can offer kinds of financial services that are unavailable from the Bank such as equity participation, convertible debentures, underwritings and standby commitments.

Unlike the Bank, it makes loans without a government guarantee; in fact it may not accept a government guarantee. Following a capital increase in 1978 there has been a rapid expansion of IFC's activities. The IFC now approves about 75 investments in new projects per year. It holds equity participations in about 400 firms, its total capitalisation is about $1.5 billion and its annual net income $30 million.

## URBAN DEVELOPMENT AND HOUSING FINANCE AT THE WORLD BANK

A POWERFUL tide of urbanisation is sweeping through developing countries during the last quarter of this century. More than half of the world's population will be living in urban areas by the year 2000. The urban population is expected to grow from 1.3 billion to 3.3 billion, an increase equivalent to the world's population in 1965. Africa, which is the least urbanised region of the world, will see its urban population quadruple in 20 years.

Countries that have been largely rural are being transformed within two generations, and this transformation is bringing both promises and problems. An enormous level of investment is taking place in cities, and it must be structured, organised and made more efficient through better public and private institutions. There is a great contrast now with the industrial countries where urbanisation has essentially run its course and capital infrastructure maintenance and the co-existence of urban growth and urban decline are leading issues.

The World Bank initiated an urban lending programme in 1972 in response to requests for assistance from member countries. The elaboration of operational objectives for urban projects provoked considerable debate within the Bank and among borrowing agencies over issues such as whether lending should focus on promoting urban development or alleviating urban poverty, or whether projects in shelter, infrastructure, and transport can contribute to the management of the urban sector as whole.

The debate was further complicated because the awareness for urban needs had developed at the same time as an international consensus was emerging that the rural sector should be the priority for assistance.

The Bank eventually adopted a development strategy which differed markedly from previous investment policies for urban services. It advocated new, low-cost approaches in shelter and urban infrastructure which would be consistent with the purchasing power of the majority of a rapidly growing urban population in contrast with the high standard, high cost products supplied by public agencies which required very large subsidies and reached only a tiny — mostly middle income — fraction of the total population.

### Lessons of experience

Together with borrowing agencies and other lenders, the Bank has learned much since it made its first loan to Senegal in 1972. The process of learning by doing is still going on and many cities are still under great stress, but considerable progress has been made in formulating policies and action programmes. Once highly controversial principles, such as cost recovery and affordable standards of urbanisation, are widely accepted by the international community, if not yet uniformly practised. It is now finally recognised that the planning of urban and rural development is not a zero-sum game; quite to the contrary — the two sectors can, and should be, mutually supportive.

The futility of welfare approaches to urban development in developing countries has also become abundantly clear with recent economic problems, and the appropriate division of labour between the public and

**Fifteen years of World Bank lending in Urban Development and Water Supply (Fiscal Years 1970 through 1985)**

| | Number of Projects Total | % | Size of Loans ($ Million) IBRD | IDA | Total | Total Project Costs ($ Million) |
|---|---|---|---|---|---|---|
| 1. | 43 | 14.1 | 252.2 | 400.8 | 653.0 | 1,172.4 |
| 2. | 33 | 10.8 | 500.3 | 195.9 | 696.2 | 1,382.0 |
| 3. | 75 | 24.6 | 2,230.0 | 259.6 | 2,489.7 | 5,959.0 |
| 4. | 78 | 25.6 | 3,267.2 | 145.7 | 2,412.9 | 10,161.0 |
| 5. | 45 | 14.7 | 1,864.6 | 104.0 | 1,968.6 | 4,863.8 |
| 6. | 31 | 10.2 | 49.1 | 1,371.8 | 1,420.9 | 2,681.6 |
| Total | 305 | 100.0 | 8,163.4 | 2,477.8 | 10,641.2 | 26,219.8 |

1. Eastern and Southern Africa; 2. West Africa; 3. Europe, Middle East and North Africa; 4. Latin America and Carribean; 5. East Asia; 6. South Asia.

the private sector is being re-examined. In shelter, governments which had assumed — at least in theory — responsibility for all aspects of housing delivery have found that it is to their comparative advantage to improve the structure of economic incentives and to modernise policies, regulations and standards.

Governments now recognise that they should concentrate on the production of the public goods such as land tenure, urban infrastructure and sanitation which private individuals cannot provide for themselves; otherwise they should concentrate on better urban policies and regulations (particularly in the land market), and encourage the development of more efficient financial services in order to improve and increase the broad supply of private housing which is now taking place at all income levels, but very inefficiently.

Following the undertaking of a series of shelter level projects in about 40 countries, basic concepts of affordable housing, appropriate infrastructure and investment co-ordination, cost recovery, programme sustainability, operations and maintenance are considerably better understood. But problems remain in institutional development, decentralisation of decision-making, resource mobilisation and resource management, cost recovery, the transition from demonstration neighbourhood projects to sustained nationwide programmes, and, inevitably, manpower planning and development.

Loans in the urban and water supply sectors now represent 11% of the World Bank-IDA portfolio and 200 on-going projects where the Bank finances about 40% of total country investments of about $24 billion.

## Objectives of the Bank in housing finance

The interest of the Bank in housing finance began with low-income shelter projects and the concern with affordability problems of the borrowers. However it soon became clear that 80 to 90% of the housing investment in many developing urban areas does not rely on institutional loans. The development of viable and efficient housing finance systems is now very important to the Bank because of the need to make the transition from a first generation of individual projects, however large, to operations which can achieve long-term sector wide impacts in housing.

In addition, some of the heavily indebted countries have experienced serious domestic credit problems which have involved housing finance institutions. The concern for better institutions in the housing sector and the broader need for sound financial development in developing economies have therefore jointly lead to the emergence of a new agenda for the Bank in housing finance.

In addition to better housing sector policies, the central aim of the World Bank in housing finance has four broad dimensions: efficient resource mobilisation and the encouragement of household saving in financial form; equitable access to financial services for all income groups; on the private finance side, the progressive elimination of the various constraints which prevents the emergence of viable systems of private housing finance and related financial infrastructure facilities; on the public finance side, government programmes must be reconsidered, subsidies granted through credit systems must often be reduced, they must become accurately measurable, and their direct and indirect impacts on the government budget made predictable.

Housing finance work in a given country must consider its size, its state of development, its economic system and degree of openness to the world economy, and the sensitive nature of financial sector issues. The nature of World Bank activities varies widely according to whether they take place in heavily-indebted countries, middle-income countries or low-income countries.

The World Bank is currently active in Chile (housing finance based on a mortgage bond market and up-front, low-income subsidies); Mexico (restructuring of commercial bank compulsory lending programmes); Ecuador (public housing bank); Tunisia (restructuring of housing public agencies); Morocco (new activities by a public housing bank); Portugal (creation of a refinancing institution for social housing); Turkey, India (private sector finance for middle- and low-income families, improved regulatory framework); Indonesia (housing sector loan); The Philippines (restructuring of the housing finance system); Korea (modernisation of the financial sector); the Ivory Coast (restructuring of public sector agencies); Zimbabwe (new lending activities by building societies); and Malawi (development of housing finance).

The IFC, which was involved in housing finance much earlier than the Bank with the creation of six housing banks, is also involved in the creation of new secondary mortgage facilities. ■

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