QUESTIONS

1. Should the interest rate on direct loans be a uniform rate for all countries?

2. Should the guarantee fee be a flat charge of 1 per cent for all countries?

3. Should the 1 per cent guarantee fee be applied to the total loan or only to the portion outstanding?

MEMO

1. There is general agreement that both the interest charge and the guarantee fee should vary to some extent with the condition of the financial markets. The British state that the standard rate of interest shall be "modifiable from time to time for new loans" (Art. IX, 4, i ) and that "the flat rate of 1 per cent per annum guarantee fee shall be alterable by the Bank from time to time at its discretion for new guarantees in the light of experience" (Art. IX, 6).

2. Some difference of opinion exists, however, concerning the desirability of also varying the interest charge and the guarantee fee to take account of other factors, including the credit standing of the borrower, the maturity date of the loan, the nature of the project, and the special position of countries whose home areas have suffered considerable damage from enemy occupation and hostilities. The flat 1 per cent guarantee fee implies, furthermore, that the Bank will always guarantee the entire loan. Attention should be given to the advisability of permitting the Bank to vary the extent of the guarantee and to adjust the guarantee fee accordingly.

The major difference of opinion has turned on the question of whether the Bank shall adjust both the interest rate on direct loans and the guarantee fee to take account of the credit standing of the borrower. The British have taken the position that political considerations make it impossible for an international institution such as the Bank to allow for differences in risk. They also favor a uniform rate in view of the fact that the loans made by the Bank are expected to serve the general welfare and that charging a full risk premium would increase the risk by increasing the burden on the borrower. The only variation the British would allow is in the special investigation fee provided for in Article IX, 4, ii and in the amortization agrangements.

Although it is generally agreed that the rates charged by the Bank both for guarantees and direct loans would vary within a substantially narrower range than that prevailing in the private capital market, considerations of equity may require that the Bank provide for a moderate differentiation of rates, depending on the credit standing of the borrower and the maturity of the loan. A plea is also made in the attached memorandum for a specially low rate for the basic public utility projects of undeveloped countries.

The consequences of a uniform charge on (a) the ability of the Bank to dispose of the securities in its portfolio, (b) the pattern of interest rates in the private capital market, and (c) the possibility of increased opposition from the private investment institutions in the United States should also be considered.

In view of the desirability of allowing the Bank some flexibility in its own operations in the security market, it might be desirable, should the uniform rate concept be adopted, to allow the Bank to levy a uniform effective rate rather than a uniform coupon rate.

3. The British have favored levying the 1 per cent guarantee fee on the total loan in order to build up more rapidly a reserve which will decrease the necessity of calling on the unpaid portion of the capital.

The arguments against this position rest on questions of (a) equity, (b) the heavy burden on the borrowing country in the later years when the substantial portion of the loan has been amortized, ________ a burden which will considerably decrease the advantage of the guarantee to the borrowing country, and (c) the effect of such an arrangement in deterring rapid amortization since the borrower bears the same charge whether he amortizes rapidly or slowly.