

The World Bank's treasurer: helping the poor through caution

The cliché most often heard about the World Bank is that 'it takes money from the poorest people of the wealthy nations and gives it to the wealthiest people of the poor nations.' This may show that of all the agencies created under the United Nations charter at the end of World War Two, The International Bank for Reconstruction and Development — the World Bank — is probably the least understood.

Conservative parliamentarians may rage over the largesse being doled out to the ungrateful poor. Third World leaders may wax strident over the "imperialism" inherent in World Bank demands that their loans be repaid. But among the major managers of the money markets of the world, the stock of the World Bank stands very high indeed. Well it might. The bank annually borrows more than \$4 billion a year and with a portfolio of \$7.75 billion it transacts more than \$100 billion a year in business in Wall Street, London, Frankfurt and elsewhere. Its sheer size makes the IBRD the biggest non-government presence in nearly every money market in the world, including New York, and the man responsible for the high reputation of the "Bank" part of the World Bank is its treasurer, Eugen H. Rotberg.

Rotberg began his career as an attorney on the US Securities and Exchange Commission's special study of securities markets in the 1960's. Later he became the chief counsel of the SEC's policy research office and ended his tenure there as associate director of the agency's powerful division of trading and markets. Since 1969, when Rotberg became treasurer of the World Bank, he has pushed the institution with an aggressive conservatism that keeps

the bank's portfolio highly liquid but constantly manoeuvring through the shifting yields of the money market. It's a tightrope act and Rotberg is proud of the applause he gets, even from the relatively small audience of money market managers. He explains why and how the World Bank will continue to walk the thin line in this interview with James L. Srodes.

I notice that you have already pre-borrowed \$600 million against your borrowing programme for the financial year '78, which began on July 1, 1977. Why did you do that?

The bank examines capital markets throughout the world. It borrows whenever it appears that interest rates, costs and maturities, are reasonable and consistent with financial prudence. Since we know what our borrowing programme is likely to be in forthcoming years (it is derived from our anticipated cash flow) if resources are available in say, May or June, we will borrow in anticipation of the forthcoming 12-month borrowing programme extending over the period July 1 through June 30. We hold substantial liquidity, so that we can decide when, where and at what cost to borrow. That policy permits us to avoid having to borrow in unstable markets.

It would seem, given the uncertainties of the market at the moment, that maybe you should have held off borrowing for a while. Why did you borrow the \$600 million now when you might have been able to get a better rate later on this summer?

After we borrowed \$600 million in the United States in April, rates increased. They have continued to increase. I do not know what will be the level of rates in the summer. Moreover, it may be that we will borrow this summer also if rates appear reasonable. It is not a question of a substitution of one borrowing for another. We expect to enter into the US market perhaps three times a year on a regular basis.

How do you see your fiscal '78 borrowings in terms of volume? Do you have any projections about how much you will need more or less than the \$4.1 billion that you borrowed this year?

We will look to borrowing \$4-4.5 billion before July 1, 1978 of which we have done, as of June 1, 1977, \$600 million. Assume, therefore, that we have another \$3.7 billion that we wish to borrow. I emphasize "wish to borrow" not "have to borrow" because we have \$8 billion in cash at this moment and can, if we wish, forgo market operations for some time.

Where will we borrow the balance of between \$3.5 to \$4 billion? Approximately \$1 billion represents rollovers or refinancing of obligations held by central banks. As you know we have substantial private placements with the Bank of Japan and the German Central Bank, the Bundesbank, which mature and are refinanced in tranches over a 5-7 year period. We have also made substantial placements of our two-year bond issues with some 80 central banks. These mature on specific dates twice a year and are refinanced or the amounts increased. These issues have been refinanced for the last 21 years, starting from outstanding holdings of \$50 million to current issues of \$350 million twice a year.

After the \$1 billion of central bank refinancings there remains perhaps \$2.7 billion gross to borrow. Of that \$2.7 billion, some represents borrowings which will be done in various capital markets to refinance maturing public bond issues and private placements.

You also refunded \$900 million in the financial year '77?

That's correct. In the financial year '78, apart from market refinancings which are not substantial, we will again be a significant borrower, we expect, in Japan. Indeed, we are now engaged in discussions and negotiations for borrowings in August of ¥50 billion — in excess of \$200 million. We will also borrow in Western Europe, though perhaps not as much as last year, when we borrowed almost \$2 billion equivalent in Germany and Switzerland alone.

We will borrow in the United States capital markets. I would assume that the US capital market borrowings won't be substantially higher than our borrowings in the last year or two.

I emphasize, however, that, if interest rates appear too high, or if maturities are too short, we will simply draw down our liquidity to finance our requirements.

At present our liquidity is equal to two-three years of our anticipated disbursements on loans. It is equal to all the debt outstanding which matures in the hands of the public for the next ten years. It's equal, at present, to almost half of our entire outstanding indebtedness — even including debt that does not mature for 25 years.

And that's an increase, too, because — if I remember your speech of May 1975 — it was, at that time, higher than the level held in 1974.

Yes. Of course our liquidity changes, perhaps up a little or down a little, depending upon the phasing of our borrowing programme. But this bank looks very carefully at its cash flow requirements and wants to have liquidity, which is increased basically by borrowing, well in advance of when it actually needs the resources in order to give it market flexibility. It's rather straightforward and conservative financial management.

You have stressed this point a number of times, both today and in speeches and elsewhere. Is this a peculiar function of the World Bank itself? Does the bank have to be this liquid in order to be able to bargain in the capital markets, or is this what you would do if you were directing any bank anywhere?

I just think it's financially more cautious and more prudent to be liquid. Particularly if there is a rather minimal cost. Indeed, on occasion there is even a positive financial advantage to carrying liquidity. Moreover, keep in mind that we are a long-term lending institution at fixed interest rates. Therefore, we should be a relatively intermediate or long-term borrower in rather volatile capital markets. We are not like a commercial bank which essentially is a short-term lender, which funds loans basically through short-term deposits. By contrast we must enter capital markets which on occasion can be costly. Therefore, for an institution such as ours — a long-term lender — we think it's prudent to borrow when we commit funds and not wait until these commitments, at fixed rates, are disbursed. It is fundamental to understand that our borrowings are linked to our commitments now and projected for the future, our anticipated disbursements, which lag our commitments, our anticipated loan repayments and our net income and the anticipated repayments of maturing obligations. I might add that

Rotberg: I just think it's financially more cautious and more prudent to be liquid



normally it takes six or seven years to fully disburse a loan. Our current borrowing programme is based therefore on cash flow projections of our present and future commitments and the anticipated requirements resulting from these commitments.

What about the cost of carrying that liquidity? Do you pay a price for it?

Sometimes a price is paid; sometimes there is no price paid; and sometimes it is to our advantage. It depends upon the slope of the yield curve and how well we manage our liquidity. As you know, there have been times in the recent past where there is a negatively sloped yield curve; that is, short-term rates were higher than intermediate-term rates. But even in the fiscal year just completed, where there was a very substantial spread between short-term money, that is three- to six-month rates, and ten-year resources, the bank did not have any significant cost in carrying its liquidity. The portfolio was cautiously but actively managed. The realized rate of return on our liquid

portfolio this year will be somewhere between 7.3 and 7.5%, even though short-term rates averaged much less than that. We obviously did not buy three-month CDs or Treasury Bills, yet the average life of the portfolio did not average one year.

The total cost of borrowing over \$4 billion in the financial year '77 was 7.4% for an 8.1 year average life.

What is the figure of 5.85% I see in the prospectus?

That is the total cost of all funds available to the bank, which includes all outstanding borrowings, our paid-in capital and our reserves, which are considerable.

Is there a comparable figure for the investments?

The return on investments of about \$8 billion will be approximately 7.3%. It represents the total return on the total cash portfolio and obviously is a positive return as compared to the cost of total funds of 5.85%.

'We have not borrowed in Japan for three or four years because rates were too high'

We have talked about your borrowing strategy for this year. What about the year ahead? Are you going to seek, aside from your Japanese borrowings, any substantial shift away from the American money market, say, to Europe?

In the year just concluded we borrowed almost \$2 billion equivalent in Germany and Switzerland alone. I would doubt that we would seek those amounts in these two markets in the financial year '78, but it depends on rates, maturities and other alternatives. I might add that we might also borrow in guilders this year.

How much of your borrowings in Switzerland and Germany is really Arab money?

I do not think it is more than 15%.

Describe your borrowings in Germany.

First, there is non-resident interest outside of Germany in the Deutschmark. Second, we do public bond issues, which are sold to German institutional and individual investors.

Third, we do private placements with the Deutsche Girozentrale and the Deutsche Genossenschaftsbank which are the central institutions, at the federal level, of regional savings and co-operative banks, and tap German domestic depositary savings. Fourth, we tap intermediate-term commercial bank resources at a fixed interest rate. In the year just completed, we did 16 separate operations in the Federal Republic of Germany.

I would doubt, frankly, that we would do that many in the financial year '78, but we do expect, as I indicated, to borrow in Holland, Switzerland and Japan. We are also looking at Hong Kong, perhaps the Eurobond market, if there is no appreciable or inappropriate difference in cost to the US market for the same maturity. Further, we also expect to do private placements in several different currencies directly with OPEC. Clearly some of our public issues might be purchased in part by OPEC states.

The Saudi Arabian Monetary Agency?

We have placed with SAMA. We have placed with Libya. We have, in the past, done substantial transactions with Kuwait, and with Iran and with Venezuela. We've also done private placements with Nigeria, Oman and Abu Dhabi.

How about the proportion of borrowings from OPEC? Is there any way to attract more OPEC money to the bank — or is there any motivation to do it if you can

go to Japan at lower costs?

We have attracted OPEC funds and we expect to attract more. OPEC states hold about 20% of our outstanding debt. These are market-based investors who look for the same things that other investors look for. They look at the currency; they look at the maturity; they look for a fair interest rate; they look for a liquid instrument. We have offered fair terms and conditions and they have been accepted. We will continue to do so.

How do you see the market in the year ahead? There seems to be a rather large pot of liquidity floating around. You obviously would be judicious in your shopping, but where do you see the optimum places for rates and terms and size?

The World Bank borrowing programme is not large in the context of the increment of growth in savings throughout the world. We are talking about perhaps a total borrowing programme, excluding the refinancing with central banks and what has already been done, of less than \$3 billion.

The United States capital market alone probably is generating something on the order of \$200 billion a year in new investments in fixed interest obligations of one type or another. We simply will look to find those currencies, maturities and rates which are appropriate for this bank. We seek the longer maturities at the lowest interest rate that's available. And we will choose only those markets which are better than alternative sources of funds at any given time.

Do you see any attraction at all in going to London as a borrower in sterling or dollars?

Interest rates have dropped considerably in sterling. However, they still are higher than comparable maturities in guilders, yen, Swiss francs, Deutschmarks, dollars and Belgian francs. We may go into the dollar Eurobond market if there is not a substantial cost differential from the United States capital market.

But not in sterling?

Not in sterling right now. We do not predict what will happen to the sterling interest rates in the next year. If rates decline, then we would seek access to that market after having received the consent of the United Kingdom. If rates do not decline, then we won't borrow or ask to borrow. That is precisely why we have liquidity. So that we can pick and choose. If all rates in all currencies stay high, and if all maturities stay short, we would draw

down our liquidity, until capital markets stabilized, inflationary expectations diminished and maturities lengthened. And we would slowly come back into those markets which seemed more appropriate.

You certainly don't foresee that happening in the year ahead? Definitely not.

Let's talk about your Japanese trip. How long are you going to be there? What are you going to talk about?

The Japanese domestic market. We have not borrowed in Japan for about three or four years because rates were too high. Rates have declined substantially, and the market is now an attractive alternative source of borrowing. We will also borrow in the international yen market and thereby tap non-resident demand for yen. As you know, the Japanese government has expressed an interest in making yen available internationally in capital markets, to a prescribed extent.

We will also discuss the investments of our liquidity, which are denominated, in part, in yen. I might mention here that the bank never takes a currency risk on its borrowings or the investment of its earnings. Therefore, when it borrows yen, it must invest yen temporarily. When it borrows Deutschmarks, it must make investments in Deutschmarks. It never shifts for its own account from one currency to another. Therefore, at the time the bank engages on any borrowing programme in a particular currency, it simultaneously discusses with the government authorities and the private sector the most appropriate temporary investment of its liquid resources.

Where are you going to invest your yen?

The bank's liquidity is invested in designated market instruments. The authority to invest is determined by the board of executive directors of the World Bank. Basically, we can invest in the direct unconditional obligations of commercial banks, and in government or government-guaranteed obligations, or in government agencies which are specifically approved by our board of executive directors. We do not invest in any commercial paper. We do not invest in any corporate paper. Essentially, we will manage our investments in Japan the way we do all over the world after appropriate consultation with governments and negotiation with the private sector. Our investments are limited to obligations with a maturity not in excess of five years and three months.

You frequently do not stay out the maturity of your investments. I understand you move with some degree of rapidity as you see the yields changing.

I certainly would agree that we manage the portfolio. We don't nearly turn it over, of course, to the same extent that a

government securities dealer would turn over its portfolio. But it's quite correct when you say that we may not hold to maturity. We do make decisions, based upon our projections of interest rates, whether we wish to be in one-week money or three-month money or five-year obligations. And after having made those decisions, if we believe that we then prefer to be relatively shorter or relatively longer, we will carefully, very carefully, shift the maturity of our portfolio. We do it essentially passively and obviously not in a way which would affect the market.

'We do make decisions, based upon our projections of interest rates'



Eugen H. Rotberg

If interest rates are rising around the world, does that mean you are going to be a little more active in the year ahead in your portfolio management?

There is no correlation between our activity and an increase in interest rates. If we were now convinced that interest rates were about to rise quickly, in every currency, at the same time, all over the world, and for a prolonged time, our portfolio would be rather inactively managed. We would simply shorten the portfolio and maintain it in a short position until our expectations changed. We have no such prediction, however, with respect to interest rates all over the world.

How do you see rates in the United States trending?

I can't answer that question because it depends on whether you mean over the next week, over the next month, in three months or in six months. It also depends upon whether you are talking about the federal funds market, the three-month bill market, the one-year bill or the five-year Treasury note, all of which may not move in the same direction at the same time. Third, your question also involves a determination of the degrees of our certainty for each of these instruments for each time period in the future.

Thus, we may feel quite certain about one particular maturity over the next three months, and highly uncertain about another maturity over the next three weeks. It is a fairly complex matrix. We take great pains in disaggregating our predictions of interest rates by time periods, maturities, and certainty of opinion, and I am sure that you don't want to hear about that matrix now.

Do you feel that the Federal Reserve's current efforts are creating an artificial pressure on rates? If left to its own devices — let's just take the federal funds

market — rates might not be nearly as high as they are if it were not for direct Fed intervention.

It is difficult for me to conceptualize a federal funds market without the Federal Reserve System as a participant in it.

But they are very obviously tightening the screws on credit and money supply growth.

As of early June, 1977, I think it's fair to say that they had, and I put that in the *past tense*, tightened somewhat. I do not know what they are going to do today or tomorrow. Further, I would be very cautious in even labelling it a considerable tightening or minimal tightening. That's a value judgement, not a statement of what happened. All I know, as of now, is that the federal funds rate rose from the $4\frac{1}{2}$ level to the $5\frac{3}{8}$ level over the last six weeks. Period.

What do you consider the true federal funds rate — $4\frac{1}{2}$ or $5\frac{3}{8}$?

The rate speaks for itself. I cannot disaggregate a market without one of its component elements.

Does that mean that, in planning your strategy, you would tend to avoid those vehicles that might be more responsive to the federal funds rate pressure?
No.

You're a bank and yet you are supposed to help the poor. You have until now seen no conflict with the running of a sound bank and the development projects of the bank?

There's no conflict between being a bank in the financial sense, and between, as you put it, helping the poor. Those who need external resources to improve their standard of living will and can use effectively and productively projects which make sense. The point of the development effort is to allocate resources

which produce a better standard of life for those who don't have it. We are convinced that projects in education, population control, agricultural development, can be fully justified in bankable terms. These projects have high economic rates of return, directly increase foreign exchange earnings and productivity. There are measurable and substantial benefits. There are costs and those costs can be translated and put into financial and economic terms, and measured against their benefit. Projects which produce a literate and smaller population or a food supply have a direct and beneficial financial effect on that society. They produce the wherewithal to develop the internal resources in that society to facilitate the export of goods and reduce reliance on costly imports. There is, in short, no conflict between being a bank and a development institution dedicated to human needs. The discipline is rather straightforward. Define the problem: What of handling the problem? What are the alternative costs? What are the benefits? Projects which don't provide incentives (and the kind of incentives vary) — projects which don't meet people's aspirations, needs, absorptive capacity — projects which don't have an advantage — projects which are improperly supervised — will not aid the cause of development. They also happen not to be bankable.

People are used to thinking of assistance or aid to the poor as simply the handing over of a cheque or making a direct transfer payment. We do not operate that way. We identify projects, try to make sure the project works and is of measurable advantage to those for whose benefit it was intended.

It is unfortunate, perhaps, that more programmes are not structured that way. But ours are. □

'We identify projects, try to make sure they work to the advantage of those who will benefit'