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before

U.S. House of Representatives

Subcommittee on

International Development Institutions and Finance

of the

Committee on Banking, Finance and Urban Affairs

May 11, 1988

First, let me express my appreciation for the invitation you have extended to me to comment generally on a United States contribution to a capital increase for the World Bank and on the so-called international debt crisis -- i.e., the indebtedness of developing countries to the banking system and to the World Bank. I have submitted to you a paper which, I believe, outlines the causes of that indebtedness and why it is still a very serious political, financial and economic problem for industrial countries, financial institutions, and developing nations alike, and a specific proposal. I will not repeat that analysis here. Instead, I thought it might be useful if I might comment about the World Bank and the relationship of a capital increase (paid in and callable) to the international debt crisis.

First, some historical perspective and data:

- The United States, over the 42 year history of the World Bank, has paid in about $1.6 billion to the

Bank in the form of its capital subscription. It paid in $635 million when the Bank began operations in the mid-1940s; nothing further until 1971, and over the next 17 years, it paid in another $950 million in furtherance of its capital subscription.

- The capital increase now under consideration would obligate the United States to pay in about $70 million each year over the next six years -- a total of $420 million.

- The $420 million, together with the paid-in capital of other member nations of about $1.8 billion, would be leveraged 33 fold, thereby permitting the Bank to lend $75 billion.

- It is useful to put the United States paid-in capital in some perspective. For example, since the founding of the World Bank, United States suppliers received contracts for goods and services on World Bank loans amounting to $12.8 billion.

- U.S. supplier/exporters received $1.6 billion last fiscal year alone -- an amount which is greater than the U.S. paid-in capital to the Bank over its entire history.

- Year in, year out, U.S. companies have received

almost 12% of the World Bank disbursements under international competitive bidding over the last ten years. Assuming that relationship holds in the future, United States exporters can look forward to receiving about $8.75 billion in export contracts against the $420 million U.S. paid-in capital subscription.

You may ask how a relatively small capital contribution can be leveraged to produce such substantial lending and disbursements. The answer is quite straightforward. The Bank borrows resources at market rates from the private sector through the issuance of its debt obligations, relends those resources at market rates, earns a profit, puts the earnings back into the Bank and lends and borrows more. In short, the paid-in portion of the Bank's capital now under consideration will constitute less than 3% of the resources the Bank will need to fund $75 billion of lending operations.

You may also ask the source of the borrowed funds. Of the World Bank's $95 billion of outstanding debt, less than $10 billion has been borrowed in the United States.

Far larger amounts have been borrowed in yen, Deutsche marks, or Swiss francs, or even dollars from non-U.S. institutions. By way of comparison, it is useful to note that the Bank has outstanding debt in Dutch guilders of $6.3 billion -- an amount close to the amount borrowed by the Bank in the U.S. medium term and long term bond markets -- an immensely larger

capital market. The fact is most of the World Bank's lending has been financed by the savings of Japan, Germany, Switzerland, much of Western Europe, OPEC and Central Banks.

And even the $10 billion of debt outstanding in the United States has remained in the United States. The Bank's liquidity -- its cash investments in United States government bonds and in United States banks by some margin exceeds the $10 billion borrowed in the United States.

The market borrowings of the Bank have financed lending of $146 billion over the Bank's lifetime. Thus, the United States $1.6 billion capital subscription has been leveraged almost a hundred-to-one as against the lending it supported.

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It may be useful here to set out some basic principles about those lending operations:

- The Bank provides objective economic advice and will lend only in support of high priority projects, programs or sectors.

- The Bank's role is to help developing countries to become productive, to facilitate world trade, and to increase the standard of living of the developing world.

- Loans are not made that, in the Bank's opinion, cannot be justified on economic grounds or to countries that are not deemed creditworthy. Loans are made to, or are unconditionally guaranteed by, member countries.

- The Bank lends only to countries that are in compliance with their debt service obligations to the Bank. The Bank normally suspends disbursements of all loans to a country that is more than 75 days overdue on any loan payment to the Bank.

- The Bank does not reschedule interest or principal payments on its loans or participate in debt rescheduling agreements.

- The Bank does not bail out commercial banks.

- Loans losses and late payments are minimal.

- It has been profitable every year since it started doing business in the mid-1940s.

The financial market support the Bank receives comes from a recognition of the quality of the Bank's lending activities -- projects, structural adjustment lending and sectoral lending; from a recognition of the objectivity of the Bank and from a recognition of the quality of the development dialogue between

the Bank and its borrowers. It comes from a recognition that the Bank targets resources in a "non-political" way. And it comes from an awareness of the care and attention given to the appraisal and supervision of loans. The buyers of Bank obligations simply trust the Bank with their money.

Nonetheless, it has been said that the Bank should do more and should take a more "activist" or catalytic role and "solve" the international debt crisis. I can only say, in response, that it is a naive understanding of the way the world works to attribute the failure to "solve" the international debt crisis -- a crisis derived from a complex set of political, social, and financial relationships -- to the World Bank. It is not a magic institution. The programs and adjustments that need to be implemented are particularly difficult to sustain, involving fundamental changes in the way fragile nation states are held together. There are no quick fixes and Bank managers, if past experience is any lesson, are not likely to write blank checks in response to pressures to "do its part." And I would hope that the United States government would not want it otherwise.

Permit me to speak frankly and directly about that subject. The Bank apparently is now caught in a political bind. It is inappropriate and it deserves better. Its capital increase is under close scrutiny, as apparently a number of legislators in the United States contend -- and I believe without justification -- that it would serve to "bail out" commercial banks, while others contend that no capital increase is justified unless the

bank uses its powers to "alleviate" the debt crisis -- by guaranteeing, directly or indirectly, commercial bank debt! I can think of nothing which would more endanger the bank and thereby place the burden on to taxpayers through a call on the Bank's capital ($30 billion proforma for the U.S.) than moving the Bank into that role. Alas, the Bank cannot square that circle; to the contrary, it is hostage to divergent views about its role and responsibilities. And, unfortunately, what the Bank does is not often well understood.

The fact is the conditionality -- the macro-economic changes the Bank insists on -- is more thoughtful, tougher, wiser, and based on better information than in any other place in the world. But Bank managers will lose the leverage to insist on those macro-economic changes, often painful ones, if they cannot lend. That is what the capital increase is all about. That is not bailing out banks. If a country -- an LDC -- becomes stronger, more productive, more competitive, more politically stable -- with a greater hope for the future because of World Bank lending, and therefore can better service its commercial bank debt, it would indeed be a disservice to call that a commercial bank "bailout."

And it is in our own self interest to increase LDC capacity to service debt and increase its capacity to export and import. Indeed, the Overseas Development Council found that United States exports to the Third World fell from $88 billion in 1980 to $77 billion in 1985. United States exports would have risen to $150

billion had the developing world maintained their growth of the 1970s. That $73 billion shortfall between performance and potential meant a loss of 1.7 million jobs in the United States -- over 1/5 of all United States unemployment in 1985. The loss of exports, alone, to Mexico, Argentina, Venezuela and Brazil cost us 600,000 jobs. United States exports to Latin America alone fell by 26% between 1981 and 1986. I would contend that to facilitate LDC capacity to import from and export to the United States is not "bailing out" banks.

On the other side, I know there are some who counsel the Bank to "move" on the debt crisis, to come up with a "formula," or "initiative," which would either make the problem go away or "alleviate" the burden on poor countries. Let's leave aside for a moment the signal that debt relief of principal or interest would send to commercial banks and to LDCs; let's leave aside the implications of the hazards of government insisting on below-market rates for contracted debt; let's leave aside where one draws the line -- for political friends, for all countries, for the poorest ones, for those who have succeeded or for those who have failed; let's leave aside who bears the loss and is it voluntary or involuntary. (Is it commercial bank stockholders or taxpayers -- just U.S. taxpayers?) And let's leave aside the implications of commercial bank write-offs on the prospects for future lending to those countries and what that would mean for political stability in LDCs, for their growth, and for our exports. Let's forget all of that for a moment. And let's not even ask what is meant by "alleviate" the debt crisis or "take

initiative," or exactly what is meant by a "solution." The fact is, if those expressions are designed or have the effect of moving the risk out of the commercial banks or lessening the debt burden of the LDCs by shifting it to the World Bank, it would lead to the potential destruction of a great institution. For as I have said earlier, the World Bank is owned by governments -- not financed by governments. The private world capital markets finance the World Bank. It is my view, based on the experience of having borrowed $100 billion for development, that they would withdraw their funding support if the burden of that commercial debt were shifted to the World Bank. They would simply find it unacceptable. Quite apart from the market reaction, it would seriously undercut any World Bank leverage to have LDCs come to grips with painful macro-economic changes to increase their productivity. And that leverage comes not from offering debt relief or guaranteeing interest payments on old debt, but from having the power to lend for quality programs and projects linked to fundamental adjustment of their economies.

This is not to say that there are no initiatives possible. I have submitted a framework for one -- specifically designed to be politically acceptable, to encourage new lending, give the countries a reasonable chance to grow and not send unwise signals. But give the Bank a fighting chance. For decades it has shown itself staffed by men and women of the highest integrity, superb values, and commitment to objectivity and professionalism. It has received the respect and support of a wide range of the body politic, private and public, for four

decades. With very little government money it has become the premier lending and financial institution in the world, working in an area beset with complex political issues in LDCs, trying to make fundamental changes in the economic and social structure of nation states with fragile political systems. The bank is trying to effect initiative, motivation, organization and management, the distribution of wealth and power, the use of public expenditures and subsidies in a highly competitive world.

The Bank staff seeks to implement policies which can support savings, investment, export and growth -- with meticulous attention to incentives and priorities. And those values, though not publicized, have always been what the Bank is all about. The Bank has developed credibility -- great expertise in its dialogue about growth with LDCs -- an area hardly touched by the private sector. It should not be relegated to providing an exit for commercial banks or a facility to subsidize debt service by providing lower than market rates of interest. It should not be hostage to pressures within governments to move to a "new stage" in the debt crisis when there is no agreement of what is meant by "new stage," the nature of the "crisis" and the implications of "moratoria" or "forgiveness." Fatigue is not a reason to move backwards, and impatience with intractable problems is assuredly not a reason to deny a capital subscription.

Thank you.

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