A BASIC SPEECH

1970's

Thank you for inviting me here today. As you know, I requested this opportunity to talk with you in order to describe the World Bank's new "Discount note" program and explain why we believe that our discount notes represent a highly attractive investment which is particularly appropriate for the financial markets at the present time. I believe that the best way that I can go about explaining our discount notes is to step back and spend a little time describing the World Bank to you and then go on to describe the characteristics of our discount notes. What I would like to do is pretend that I am asking you to consider buying a 20-year, fixed rate, illiquid bond from the World Bank. We at the Bank apply very tough credit standards to our shortest term investments and, therefore, it seems only fair to invite you to apply those same tests to us.

The World Bank is financially strong in two senses. First, in terms of our balance sheet we are a highly conservative financial institution, unlike any other institution you are likely to have seen in your credit analysis in the US market. Our financial policies are conservative and our implementation of these policies have been even more conservative, as I will explain in a few moments. More important, perhaps, than our internal financial practices, however, is our operating record based on the loans we make to developing country member governments who come to the Bank for World Bank loans.

The World Bank was established in 1945 to promote the reconstruction of the war ravaged economies after World War II and to support economic development in the less developed countries of the world. The United States established the World Bank as a major instrument for bringing about a vital and healthy postwar economic order, and I need hardly tell you how successful US policy was in reconstructing the economies of Germany, Japan, and other countries of Europe and

Asia. By now, the World Bank is known as a development institution in the sense that we lend money to countries who require our assistance in reaching their objectives for economic development within the international financial system. Our belief is that the policies that led to our creation and to the remarkable postwar economic recovery remain sound. We promote economic development by providing loans for specific projects, in the interest of sustaining the growth of international trade and improved standards of living through improved productivity.

The Bank has a simple balance sheet which I would like to review with you. Basically, there are only 4 major items adding up to $40 billion balance. On the asset side, we have cash and loans. And on the liability side, we have our borrowings and capital. I think in each of these areas, you will find we are surprisingly prudent, perhaps unique, in our approach to cash flow. Let me admit at the outset that the Bank's balance sheet is different from any private institution whose paper you may hold. The reason is that the Bank is an instrumentality of its member governments, including the United States. Our shareholders are governments who own the stock and also stand behind the Bank financially through a direct financial binding commitment. This interlocking of ownership, with financial liability and public purpose has led to a unique -- and exeedingly under leveraged financial outcome.

On the asset side, on June 30, 1982, the cash liquid assets of the Bank stood at $9.4 billion (more than $11.5 billion at the end of the year). The Bank has a policy of maintaining this extraordinary high level of liquidity in order to assure flexibility in borrowing decisions. The liquidity at the end of our fiscal year (June 30) was equivalent to approximately 30% of outstanding Bank debt and was equal to more than 80% of the debt issued by the Bank to private investors, maturing within 5 years. The Bank holds this liquidity for one reason -- flexibility. We want to be able to borrow when and where we think it's wise. And we want to have the cash on hand to stay out of markets when the costs are too high or when markets are unstable.

On the other hand, having the cash, we manage it very actively. The $9-1/2 billion traded more than $800 billion in the past year. It is a consistent profit center for the Bank. My colleagues in the investment area are charged with keeping the funds liquid, safe, and profitable. The maturities range from overnight to 5 years; it is invested in government securities and the paper of the highest credit banks. The liquidity is in 16 currencies, though about 70% is in dollars. All of it could be converted to cash to meet our commitments in about 48 hours.

Let me underline one fact. The liquidity is profitable, but even if it were not, we would hold it because ~~it is a~~ basic premise of our financial policies to be prudent -- which means to maintain flexibility -- that is, to draw it down and build it up -- opportunistically.

I could probably stop talking now and you might have two responses. After all, $11 billion in cash alone is enough support for a discount note program. Why are we issuing them? In brief, I would say that the World Bank established discount note program simply because we do not need the money! In other words, we continue to follow a policy of diversifying our techniques and sources of borrowings in order to assure ourselves major funding flexibility and continued growth in our liquid assets.

There are three reasons for launching this program which I would like to explain to you. First, the World Bank has substantial borrowing requirements in the present fiscal year -- about $9.5 billion -- and we expect to continue to have substantial borrowing requirements in the future years. These funds are used for our lending operations as well as to increase our liquidity in line with the size of our balance sheet. We believe that the enormous growth in the short-term capital markets of the US has made it a pool of funds which it was not sensible to continue to ignore. In other words, we established a program of short-term borrowings, of $1.5 billion in the US market, which may well increase substantially in coming years along with the growth of our overall pool of funds, diversified by currency, country, source, and maturity, that is used for lending to the LDCs as well as investment in our cash resources.

In addition to the long-term funding view that motivates us to commence a short-term borrowing program in the US, the timing of our decision this fall was influenced by our belief that it no longer made sense to borrow dollars only in the medium and long term markets, thereby locking in high yields for long periods of time at costs that will be passed on to our borrowers. In short, we did not believe that short-term funds would average 13% over the next 10 years.

Finally, I would be less than candid, if I did not say that we believe that the difficulties in the financial markets in the United States have led to a flight to quality which particularly favored the commencement of the World Bank short-term discount note program. The flight to quality paper has favored us in the medium and long term markets already, and we believe it is favoring us in the short-term market. Unlike other short-term borrowers, we can assure investors of repayment through our existing liquidity, without relying on outside credit lines from banks whose own credit has been deteriorating in the present financial context. Nor do we lend to private corporations whose balance sheets cannot avoid being strained in the present financial climate -- given their poor liquidity, constrained sources of funds and inadequate capital base. And we have government guarantees, which I will describe, that are greater than any other institution outside direct US Treasury obligations and guarantees. In fact, when we speak of our short-term program, it is difficult to envision any vehicle, including US Treasury government securities, that would be a safer place for funds in the short-term market.

The Bank's other asset is its portfolio of outstanding loans which are made to support economic development in member countries of the Bank. All loans by the World Bank are sovereign credits. All are guaranteed by the government where the funds are lent. Loans made by the World Bank since 1946 to June 30, 1982, totalled about $80 billion. After repayments, $29 billion was disbursed and outstanding, and about $30 billion, committed but undisbursed. This great lag between commitments and disbursements is what distinguishes us from banks and other private lenders. We do not simply transfer funds. We make payments over a long time to assure orderly completion of projects.

The Bank's loan portfolio is diversified by country and project sector. No loans are made in countries not deemed creditworhty and country creditworthiness of all borrowing members is kept under continuous review. The overwhelming proportion of Bank loans are in support of individual projects to promote the economic development of member countries. These projects must produce acceptable rates of return to the Bank; they must be of high priority in the country's development program; they are supervised by Bank employees until physical completion. Projects loans are typically disbursed over a period of 3 to 7 years against documented expenditures reviewed by the Bank. Bank loans are used primarily to finance goods and services procured under international competitive bidding, and the payments are made directly to outside supplier of goods and services. Typically, a Bank loan covers less than half of the overall project costs with the balance coming from borrower's resources and external loans.

The heart of the Bank is its lending program. Literally, thousands of staff work with developing country governments to create a viable program of economic development and then to develop, appraise, and implement the productive projects within that program. We look at the GNP, the savings rate, the population growth rate, the infrastructure, the agriculture, and the balance of trade. The projects are discrete and each must meet the highest standards of rate of return that are used in the market place. But taken together, the projects in each country make sense within the framework of a policy dialogue that will lead to overall increases in productivity and, finally, self-sustaining growth.

In the last fiscal year, the Bank committed more than $10 billion towards the financing of 150 operations in 43 borrowing countries. These projects were in the sectors of agriculture, education, energy, industry, telecommunications, urbanization, water supply and sewerage, and more.

Time does not permit me to describe the operations of the Bank in more detail. Nor am I the appropriate spokesman, as you know, since I work in the part of the Bank that looks after the overall balance sheet. Permit me therefore to give you a summary in financial terms.

The Bank has never suffered a loss on a loan or had a non-accruing loan. We have never had a default. We have a firm policy of not participating in reschedulings. We do not change the terms of our loans and we do not refinance them. Of the $4 billion in loan payments due to the Bank in the year ended June 30, 1982, only $2000 was overdue by 90 days on that date. The figure for 60 days was $409,000 for interest and $88,000 for principle. By December 31, the figure for 60 days was zero!

The reasons for this impeccable record are many. On the one hand, we are trusted and we have developed, long standing relationships. On the other hand, we are very tough on this issue. If a country falls behind by 30 days, we inform all member governments. If there were a significant break in repayments we would stop all disbursements on all their projects -- and remember we have more undisbursed funds than those outstanding. Finally, we are an instrumentality of our member governments including the United States. A rupture with us would be a break with the world's financial system. And no country can afford that.

Now let me turn to the liability side of the Bank's balance sheet.

The Bank's average outstanding borrowings during the fiscal year ended June 30, 1982 was $31.8 billion. These borrowings were denominated in 18 currencies and carried an average cost -- I think this will surprise you -- 8.15%. All of these borrowings were originally contracted as medium to long term fixed rate obligations. The maturity during the past fiscal year was short-term to 21 years. The average life of outstanding borrowings was close to 6 years. The Bank enjoys access to capital markets worldwide on the basis of its reputation as a premier credit. Our medium and long term US publicly issued, notes and bonds have been rated AAA/Aaa/AAA by Standard & Poors', Moody's and Fitch. Securities issued outside the United States without ratings have been at yields comparable to government or government guaranteed debt.

The Bank is a major borrower in world-wide capital markets. We are the largest non-resident borrower in highly conservative markets such as Germany and Japan, where we borrow on terms close to, or even through, government rates. In the Swiss capital market we have unparalleled access, having borrowed close to SwF 2 billion in private placements and public issues in the last fiscal year alone.

The Bank follows a policy of diversifying its borrowings by currency, country, source, and maturity to provide maximum flexibility in funding. The Bank's liabilities in each currency are matched by assets in the same currency. Finally, on June 30, close to $8 billion, or one quarter,of the Bank's debt was held by central banks or other government authorities. The $8 billion held by member governments is at market rates and relatively short maturity, but it has proven to be a permanent source of funds as we are an established security in the portfolio of central banks world-wide. Borrowings from the public were equal to about $24 billion.

The Bank's borrowing program has to be viewed in the context of our overall institution. We have liquidity to give us borrowing flexibility and we have relations with our shareholders which assure us access to markets beyond that open to any other borrower. I have already mentioned our high level of liquidity. And, still, there is more to the story. For, finally, I would like to describe what is perhaps most unique about the Bank -- its capital structure.

The Bank has two kinds of capital pledged by member governments. There is paid-in capital which is available to the Bank in its daily operations. On June 30, 1982, the paid-in capital of the Bank stood at $4.1 billion. In addition, the Bank has made a profit every year and its accumulated reserves are not distributed as dividends -- they are put back to work at the Bank.

As of June 30, 1982, the Bank had reserves equal to $3.7 billion. Therefore, the total of paid-in capital and reserves of $7.8 billion results in a debt/equity ratio of 4.1 to 1. The ratio of outstanding loans to equity is 3.7:1. The cost of total funds is 6.75. I think you will agree that those are very conservative ratios, unknown to commercial banks or, for that matter, US government agencies.

There is one last piece in the uniquely conservative structure of the Bank. The paid-in capital is the tip of the iceberg. Member governments are obligated to provide 10 times their paid-in capital to the Bank. It is called Callable Capital. On June 30, 1982, callable capital of member governments stood at $39.1 billion, of which $8.7 billion was pledged by the United States, and $25.8 billion by the member countries of the Development Assistance Committee of the Organization for Economic Cooperation and Development. Callable capital is solely for the protection of bondholders and can only be used for that purpose. The callable capital may not be used in Bank operations for disbursements or for administrative expenses. In fact, the Bank's Articles of Agreement require a call on the callable capital, if the Bank is unable to meet its obligations to our bond or noteholders in full out of its other assets. And that is not about to happen and never has. But more, the Bank is presently implementing a general capital increase under which $35.7 billion has been authorized and will be available for subscription by members. Proforma, that would raise our capital to about $75 billion.

Finally, under the Bank's original charter (the Articles of Agreement), the Bank is limited to a ratio of 1:1 of outstanding and disbursed loans ($29.2 billion) against the sum of paid-in and callable capital, reserves and retained earnings ($46.9 billion). There is no parallel in the private marketplace. We are simply under leveraged as a result of our institutional history. The Bank was established at the end of World War II and the United States and its allies were determined to avoid economic instability. From the standpoint of the countries who need our support this is, no doubt, an undue constraint. But for the marketplace I hope you will agree that it makes us a credit second to none.

What we do at the Bank, however, is forget the anomaly of our capital. We run the Bank as a profit making institution, viable as far into the future as we can see. The Bank has earned profits every year since 1946. Net income for the year ended June 30, 1982 was about $600 million ($597.6 million). The profitability of the Bank results from several factors. The overall cost of funds to the Bank is comparatively low, representing the blended cost of diversified borrowings, substantial paid-in capital, reserves, and retained earnings. The average cost of funds to the Bank for the fiscal year ended June 30, 1982 was 6.7%. Substantial profitability is further derived from the return on actively managed liquid assets. The Bank also follows a policy of pricing loans to cover borrowing costs, administrative expenses and to earn a reasonable return on equity. Loan charges currently include 1/2% spread over the cost of borrowing, an interest rate of 11.43%, a commitment fee of 3/4% on undisbursed loan balances ($25 billion); and a front-end fee of .75%. The Bank's income is exempt from taxation.

Role of the United States

Now, I have told you something about the Bank's balance sheet, its conservative financial structure and lending policies. I would also like to review with you the position of the United States government in the World Bank. As I mentioned before, the US created the World Bank as part of its postwar economic structure. The US government became a member of the WB pursuant to an act of congress known as the Bretton Wood's Agreement Act of 1945. Through this Act, and other legislation designed to permit the World Bank to borrow in US capital markets and increase its shareholder's capital, the World Bank has functioned as an instrumentality of the US government and its other member governments. The United States is the largest shareholder and exercises more than 20% of the total voting power. The US Secretary of the Treasury represents the US on the Bank's Board of Governors. In addition, there is a permanent US Executive Director and an Alternate Executive Director, both of whom are appointed by the US President with the advice and consent of the Senate.

The US government has given substantial financial backing to the World Bank in order that it may pursue a clear public purpose of the United States. The US has substantial ownership, control, and supervision of the World Bank. As I mentioned before, approximately 90% of the Bank's capital has not been paid-in and is subject to call; it may be called only to meet the Bank's obligations on borrowings. The callable capital of the US alone is $8.7 billion. This is a full faith and credit obligation of the United States. Of this amount, $7.7 billion may be paid by the Secretary of the Treasury without any need for further congressional action. What I hope I have explained is that even apart from this financial backing of the US government for the Bank's obligations and its relationship to the United States, the financial operations of the Bank are by far stronger than any other paper in the market. I must, of course, also note the Bank is also an agency of other major industrialized countries, and their callable capital is also obligated to meet any calls which may be made. The callable capital of the US and the 15 other industrialized countries which are members of the OECD's Development Assistance Committee is presently $25.8 billion. These countries together hold 62% of the total voting power.

Security and quality is the major theme we stress in marketing our discount note paper, and we believe it is the key concern of short-term investors. There are several other characteristics of our paper, however, which may be of special interest to the investment community.

The Bank maintains a level of about $1.5 billion outstanding of discount notes. Our maturities are tailored to investor needs. IBRD discount notes are offered with maturities up to 360 days. Maturity dates are fixed at the time of sale and are at the discretion of the buyer, subject to general limitations prescribed by the World Bank. The Bank, as I have stressed before, does not <u>need</u> money for any particular date. We are not relying on the funds raised in the short-term discount note program to meet our cash flow requirements. Thus, if the marketplace has particular requirements, we can meet them. As is the convention, we post rates daily which reflect competitive market yields. Like the other agency notes, our paper is a liquid investment in negotiable bearer form, with a secondary market supported by our dealer group -- a group that I think you will agree represents the greatest strength in the marketplace.

Like other agencies, IBRD notes are issued and redeemed through the Federal Reserve Bank of New York. Payment for the notes is made in federal funds. And redemption of the notes is made at maturity in federal funds at the Federal Reserve Bank of New York. Finally, the eligibility characteristics and special tax status of the World Bank -- for example, we are exempt from withholding tax -- may be of special interest to some of you today. My colleague and I (lawyer accompanying) would be happy to answer any specific questions you might have.

In summary, I hope I have given you a sense of the unique financial strength of the World Bank, in today's financial context. With ample funds already at our disposal, we had the luxury of substantial time in preparing and designing this program, with the assistance of our very capable dealer group. We believe that we are offering to the marketplace a short-term instrument that is particularly adapted to investor needs. And now I would be delighted to respond to any questions you might have. Thank you.

* * *