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AN AGENDA

It is perceived both within and outside the World Bank that a good deal of staff energy, satisfaction, if not rewards, are associated with putting down or finding fault with new initiatives and generally protecting turf. Some bureaucratic game-playing undoubtedly occurs, but in the best sense, it derives from a genuine concern that there is a complicated world out there and it is best not to intervene with untested concepts or programs -- particularly in matters where mistakes are visible and benefits a long time in observing, and, moreover, where most initiatives require a consensus of constituencies whose interests are not really consistent with each other.

The world outside the Bank, however, expects us to move. It looks to us to "solve" the debt crisis, insure financial stability, and facilitate savings, investment and growth in the developing world. We read that if only we restructured our decision making processes, became leaner and meaner, and were more responsive to need, we would find that magic, yet elusive, policy which would facilitate growth and insulate countries from external shocks outside of their control. And by so doing we would encourage commercial banks to lend more with more confidence. The code words are responsiveness, initiative and innovation.

My own sense is that there are neither magic formulae, nor quick fixes, nor even long term programs which can be relied on with reasonable assurance to _painlessly_ resolve the problems of poverty, political instability and the maintenance of a healthy financial system. Much of what is called innovation simply shifts the risks and costs to the parties which are perceived to be able to bear the cost, specifically, the U.S. Government and/or the commercial banks, while the academic community looks for solutions which are even more unrealistic, that is, those in which there is a painless outcome to _all_ participants. I believe these kinds of proposals are non-starters and, worse, are counterproductive in that they unwisely politicize the issues and deflect attention from meaningful responses. Nor do I believe it is useful to offer litanies requesting patience and flexibility and pointing to the benefits of "privatization", "belt tightening" and long term development planning. Not because these are not wise or indeed fundamentally important concepts, but because they take us a very little way to understanding why they are not implemented and exactly how we might influence the preferred outcome.

I would contend that the best development ideas are probably in place, that fall back positions and risks for a variety of economic development approaches have been considered carefully, that alternative scenarios have been spelled out and that wisdom and goodwill are in abundance at the Bank. I would argue that political will, while fragile, is sufficiently realistic to accept a good deal of present pain and delayed benefits of pleasure.

I conclude, however, that our achievements are severely constrained -- because neither the _vehicles_ nor _volumes_ are sufficient to permit us to

have much of an impact. My thesis is quite simple: we ask too much and offer too little, not because our economic development programs are not well thought out or are too tough, but because the structure of the Bank constrains us and will, therefore, not permit the best of the ideas and programs to be executed. We have, in short, insufficient leverage.

I believe that the productive area for new initiatives or new policies will be found in changing the structure of the Bank -- not only in terms of its organizational structure, its budget processes, or even its economic development programs and how these are transmitted, but rather in increasing the amounts the Bank can lend, lowering the cost and creating confidence to facilitate increased commercial bank lending. It is simply not enough to refine the process of how we deliver "advice", or how macro-economic research findings are best developed and integrated into the lending process, or how the decision making process might be better managed. Certainly, there is room for improvement. But, I believe the major breakthrough to facilitate development will be found elsewhere -- in increasing IBRD leverage through a substantive restructuring of the institution and what we do.

Let me be specific. I have eight recommendations related to three problems.

INADEQUATE CAPITAL STRUCTURE

I believe our capital structure, which seriously limits how much we can lend, relegates us to a minor bit player in terms either of leverage or influence on developing countries to implement what we recommend, or to provide comfort to commercial banks to lend more. It is sufficient at current levels of lending to provide comfort to investors to finance only a modest positive transfer of resources. The problem, in short, is that we cannot readily increase our capital base and how much we lend and, therefore, how much influence we have. Nor is the issue likely to be resolved by requesting a capital increase. A GCI will be supported only if we can show an efficient use of our current capital and a commitment to use any future capital in an imaginative and effective way. I have three specific recommendations:

1. Sell off a portion of our loans coming due during any year in very short (6-month) increments, with a limited form of credit enhancement related to the entire portfolio (now $70 billion) to assure payment. This would be coupled with a firm five to ten year commitment under an irrevocable trust from the private sector to "guarantee" in each 6-month period the payment to the buyers (or the purchase of loans from us) should our total portfolio of loans being serviced in a timely fashion be insufficient to make whole the portion purchased by the buyer. This could free up to $5 billion loans from our books and provide the same amount of increased headroom for new disbursements.

2. Don't put disbursed loans on our books. Instead, delay our disbursement until after full disbursement by commercial banks. We would then "take over", i.e., repay them after their full disbursement or give to banks the right to "put" the credit to us after full

disbursement. This lag could generate a substantial new commitment authority over the next five to seven years, after which a capital increase would be required to meet the then current "take out" requirement.

3. Form a new bank. It would be capitalized through an investment by IBRD. Its funding would come from deposits and the inter-bank market -- mainly U.S. dollars and Yen, in Japan, at prevailing short term rates. Its market confidence would come from the Bank of Japan as a "lender of last resort", i.e., supervising central bank in the country of domicile, and from the diversity and strength of our deposit base. The deposits would be lent only in conjunction with IBRD (and commercial bank) lending, thereby freeing up IBRD lending capacity for new loans since the loans made by the new Bank would not be backed by IBRD callable capital.

COMPETITIVENESS OF PRODUCT

Our loans are perceived as too expensive by our better standing clients and with too high a currency risk by all the LDCs. They, therefore, are ambivalent about our loans and we accordingly lose influence.

I have three recommendations:

1. Permit LDCs to borrow 20-25 percent of the loan from us at LIBOR in dollars. Fund the loans by borrowing either FRNs, short term, or through swaps below LIBOR. Possibly permit borrowers, at their option, to borrow other currencies from us.

2. Provide, without charge to LDCs, an extensive program of financial technical assistance ranging from how they might manage exchange rate risk or interest rate risk; how they might conduct their external borrowing operations in the private sector to cope with future adverse circumstances, and offer advice and support staff vis-a-vis debt restructuring negotiations.

3. Buy long-term insurance against currency risk or interest rate risk on behalf of our borrowers if they want it. The premium or cost could be paid for by us out of our profits, or shared between the Bank and borrowers who want it.

COMMERCIAL BANKS ARE NOT PREPARED TO RESUME VOLUNTARY LENDING

This one is a bit tricky since there is a responsible body of opinion which holds (a) banks shouldn't lend more because some highly indebted LDCs can't afford the debt service obligation (b) banks will have to lend anyway, whether voluntary or not if they expect to receive interest on existing loans, (c) the complaint about "voluntariness" is merely a make-weight to increase the "moral hazard" obligation of governments to take care of them, should matters become sticky in the future, (d) whatever we lend simply displaces commercial bank lending, and adds nothing.

But let us assume that increased commercial bank lending to highly indebted countries is not in the cards. Let us assume that commercial banks also want our involvement in defining, delivering and monitoring economic development programs. Let us further assume that commercial bank lending is necessary to facilitate economic growth, political stability and, as a by-product, preserve the integrity of the financial system. Certainly not insignificant objectives. How might their comfort level be increased without jeopardizing the IBRD credibility or increasing the risks and obligations on Part I countries indirectly (by providing callable capital should our involvement later prove unwise) beyond what they wish to assume directly.

Generally, I support the trend to link commercial bank new money packages, for highly indebted countries and those involved in debt restructuring agreements, to IBRD programs, projects and conditions. I leave it to Ernie where and how such links -- not generic guarantees unlinked to meaningful IBRD conditionality -- might be best implemented. But we will have to put up something of substance and take some risks.

I have two recommendations:

1. Guarantee in selected cases, in substantial amounts, that for each dollar of a new money package if, and only if, linked to a meaningful IBRD development program, we will guarantee X% of the principal after 20 years if put to us by the commercial banks, provided that the funds so paid out by us to the banks will be simultaneously relent to us for 20 years at U.S. Treasury bill 3-6 month rates. The banks, therefore, on their books take no credit risk on principal; we have no claim on our capital for 20 years; we have a guaranteed source of funding for 20 years thereafter at a lowest cost rate; the banks suffer only an opportunity loss after 20 years, should they decide to "put" their loans to us, in receiving a rate of return equal to what they receive on their government bonds rather than LIBOR or prime. The point would be to leverage our economic advice by linking it to increased commercial bank flows, and in turn to encourage those flows by providing a "penalty put" to us should banks want out. There are a number of variations on this proposal which are designed to move risk into opportunity losses rather than trigger provisioning under current conventions.

2. I recommend that the Bank take the credit risk on interest rate swaps to restructure LDC debt from floating to fixed rate in order to facilitate stabilizing the cost of their future debt service flows. (Or, alternatively, we might examine an interest rate cap on LDC debt.) The certainty of debt servicing obligations should, in turn, encourage commerical banks to increase their lending as the advantages to LDCs of higher export prices are not eroded by increases in the level of interest rates.

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The three "problems" addressed here are relevant, are recognized as such, and most important, probably would obtain the concurrence as central policy issues by our member governments. The recommendations are action

oriented. The recommendations, however, require coordination within the Bank of a number of different fields of expertise and knowledge which have not previously worked easily or well together.

- Financial engineering and market practice;
- An understanding of our own financial and legal structure;
- What the private markets expect of the Bank and would find as an acceptable role;
- What our member governments - both developing and Part I are prepared to support and encourage.

Finally, I believe that the package could be put in place earlier than a GCI, would not be hostage to a GCI, and would be seen as complementing a GCI. The package would be perceived as an "innovative" market/client oriented approach, acting on problems that simply cannot await inter-governmental budgetary response. In short, it will work.