EUGENE H. ROTBERG - REMARKS

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There are four matters I have been asked to talk about:

(i) How much has the World Bank lent and what are our future lending plans?

(ii) How will future lending be financed?

(iii) What are the constraints to increased lending?

(iv) What "innovations" in lending are likely?

(i) What have we done to date?

. By 1968, the World Bank had paid in capital of $1.8 billion. Its cumulative disbursements since 1946 stood at $8 billion; it had extended into loan commitments of about $11 billion.

. By 1985, paid-in capital had increased to $3.2 billion. The Bank had disbursed about $68 billion; total loan commitments were in excess of $113 billion. Thus it had leveraged a $1.4 billion increase in paid-in capital over the 17 years, 1968-85, to lend over $100 billion.

. The World Bank compound growth rate of loan commitments in the 10 year period 1974-1984 was 12%.

. The Bank plans, over the next three years, to make new loan commitments between $40-45 billion.

. Disbursements in the five year period 1986-1990 are projected at $60 billion, repayments of principal are estimated at $27 billion, for net disbursements of $33 billion to LDCs.

. Our share of <u>new funds</u> to be made available to LDCs over the next 5 years is substantial. Permit me to read to you a list of countries and then the IBRD percentage of the <u>increase</u> in resources which are expected to be borrowed by those countries over the next 5 years. The percentages are not in the same order as the countries.

. Indonesia, Turkey, the Philippines, India, Thailand, Colombia, Romania, Morocco, Ivory Coast, Kenya, Nigeria, Egypt, Argentina, Pakistan

. The World Bank percentage of the increase in external resources for these countries is: 21.3%; 51.8%; 41.6%; 35.5%; 18.2%; 25.7%; 11.1%; 57.4%; 62.5%; 18.5%; 18.6%; 16.8%; 12.9%; 13.0%.

. Permit me also to set out our share of the total external debt in those countries again as projected for 1990. The IBRD percentage of 1990

projected disbursed and outstanding external debt is 15.5%; 23.3%; 15.3%; 13.8%; 17.5%; 22.3%; 30.0%; 16.2%; 21.9%; 19.4%; 7.5%; 8.6%; 1.8%; 8.5%.

. I think it is fair to say that what we have done and what we expect to do is substantial both in terms of leverage, absolute amounts, and as a percentage of future flows.

(ii) <u>How was the lending program financed?</u>

. We financed our lending by borrowings in private capital markets at market rates of interest.

. In 1968 the World Bank had $3.2 billion of outstanding debt. In 1985 its outstanding indebtedness stood at $51 billion.

. We have borrowed over $80 billion in capital markets throughout the world over since 1968. We will have borrowed $140 billion by 1995. We are currently borrowing at the lowest spreads over government obligations in our history. We are borrowing in a dozen currencies; we borrow from institutions who are fully conversant with our financial and operating history. We expect to borrow on average about $12-13 billion a year over the next five years. And we will borrow at the finest rates for the best issuers.

. Basically the financial market support 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 the recognition that we target resources in a "non-political" way. And it comes from an awareness of the care and attention given to appraisal and supervision of loans. And from a recognition of a wide variety of financial, technical and advisory interventions by the Bank. It comes also from the fact that the Bank has been treated as a preferred creditor, not in the least because borrowers wish to maintain the financial flows and the development advice which is provided to them.

. The financial community has also come to rely on the financial structure and operations of the Bank. In financial terms they look at: $17 billion short term liquid assets; profits of $1.137 billion for FY85; an uninterruped history of earnings since it commenced its operations. Diversity of borrowings by source, currency, maturity; interest rate and maturity matches and a lending rate which linked to our cost of borrowing. Most important, there is a sense in the market that the Bank operates <u>as if</u> there were <u>no</u> callable capital i.e., it seeks to attract resources on the basis of its operating history - not the callable capital which provides support from its members - against the risk assets on its books. The market knows what the Bank does well and is fully supportive of those activities.

. The Bank does not now need a subsidy from its member governments or any credit enhancement. Nor does it need, as a financial matter, increased

financial payments in the form of paid-in capital from its members. As I have previously implied, member countries have rarely provided cash resources in the form of capital to the Bank, (as distinguished from IDA) and it is not required from a financial perspective now.

(iii) Why does not the Bank lend more? What are the constraints? What does "capital" have to do with the Bank lending program?

In our recently concluded fiscal year World Bank lending for the first time for many years declined slightly in nominal terms. There were several reasons:

1. Some countries could not supply their share of the local costs for projects nor could they obtain other external resources at reasonable costs to support the total cost of desirable projects.

2. Some countries could not prudently take on additional debt servicing given their prospects for earning foreign exchange and their GNP/debt service ratios.

3. Others could not accept, as a practical matter the "constraints", the advice, the suggestions by the Bank with respect to their medium/long-term development programs. These involved some painful measures and some countries did not have in place the administrative will/capacity to implement what must be done.

4. Others had weak economic plans; on our part, therefore we did not believe it appropriate to lend.

5. A few had other sources of finance believed to be less costly and/or without the conditions and time lags associated with World Bank loans.

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. But after all has been said, there still remains substantial room for increased lending - even after taking into account all of the factors noted above, and there is a capacity to finance increased lending - assuming the Bank maintains wise policies, is perceived as doing the job it is equipped and capable of doing, and receives from its member governments the authority to borrow the resources in member countries currencies and markets.

. The constraint to increased lending essentially is a legal one. The capital structure of the Bank does not permit the Bank to have oustanding loans and guarantees greater than the sum of its paid in capital, callable capital and retained earnings (reserves). That binding constraint is the cornerstone of the Banks risk taking capacity - incorporated in its Bank's Articles of Agreement.

. Despite the financial strength of the Bank, the limitations on the Bank's risk taking capacity (lending and guarantees) is looked to by the financial markets as a source of comfort since it restricts the Bank's risk assets to its equity base on a one to one basis (inclusive of callable capital - which provides the greatest proportion of that equity base).

. The Bank's callable capital provides comfort and protection because it may never be called to operate the Bank. It may never be called to pay administrative expenses or to make disbursements on loan commitments to LDCs already made or to be made. It can only be called in one event - namely, if the Bank cannot meet from its own resources its obligations to its creditors and to those who hold its guarantees. Thus the callable capital in effect can only be called in connection with the winding up or the insolvency of the institution. Obviously it has never been called. The stockholders of the Bank have insisted on policies - both financial and operational - to assure (to the extent that wisdom and care can provide assurance) that the Bank is operated with good judgement and an awareness of risk - with the expectation that the callable capital - the contingent liability - will never have to be called.

. The issue then is whether governments wish to provide increased capital, the vast majority of which will involve no cash transfer to the Bank so that the Bank can, under its Charter, have the legal power to increase its lending.

. While the response of the United States to a capital increase at this juncture remains unannounced, it would appear there is a great deal to recommend it. Frankly, I would find puzzling a holding back of support for a capital increase both in terms of the "cost" to the United States and the implications of not providing for the capacity to increase lending. Let me provide some facts:

. When the Bank was founded (1946/47), the US paid-in capital - was $635 million. Over the succeeding 38 years, it has paid in to the Bank only $500 million in the form of increased capital contributions as follows as the Bank increased its capital base:

. The US made no capital payments in the 25 year period 1947 through 1972. The US paid in $150 million in the period 1972-1977 and has made additional capital contributions of about $350 million since then.

. I noted earlier that the Bank has leveraged these rather modest amounts of paid in capital (and the paid-in capital of other countries) to increase its loan commitments to LDCs by almost $100 billion since the late 1960s.

. That lending was financed by market borrowings in world capital markets - not from capital contributions of member governments. Stated another

way governments gave the Bank the power - the authority to lend by providing callable capital. The markets provided the money to finance the lending.

. More particularly, the lending, in fact was financed virtually exclusively from Japanese, Swiss and German savings and from investors in other countries who invested in our bond issues in those three currencies. The facts are as follows:

. While the World Bank outstanding indebtedness from borrowings denominated in US dollars and raised in the United States stands at about $9.5 billion, none of it has been disbursed on loans. The dollars borrowed have not been used to finance the lending program. The dollars remain either in US government bonds or in US dollar denominated Bank deposits as part of the Bank's liquidity. Of the World Bank currently outstanding loans of $41.3 billion only $6.7 billion is denominated in US dollars - an amount <u>less</u> than the US dollars borrowed from sources <u>outside</u> the United States, that is from Central Banks or in Euro or Asian markets, or from other member governments as part of their capital contribution in dollars.

. In a very direct and real sense, therefore, the World Bank has disbursed Deutsche Mark, Yen and Swiss Franc and to a lesser extent Dutch Guilders and has retained the dollars it has borrowed - in the United States or elsewhere - as part of its liquid investment portfolio.

. Over the last 38 years US corporations have won contracts for goods and services on World Bank financed projects in excess of $10 billion. The dollars used to pay those corporations were purchased from the proceeds of our Deutsche Mark, Yen and Swiss Franc borrowings.

. Our cumulative <u>receipts</u> of dollars from the US (capital and borrowings) less the amounts <u>paid</u> to the US, (interest on debt, holdings of dollar deonominated instruments, payments to US suppliers of goods and services, etc.) have resulted in a positive cumulative balance from the Bank to the US in excess of $32 billion.

. I think it is not unreasonable to say that of all member governments, the US financial institutions have the most to lose and are the most at risk if the world perceives that the World Bank, because of a capital constraint - cannot lend more.

. I say that US financial institutions are at risk for the following reasons:

1. I do not believe that any significant principal from countries now in debt restructuring and for many others, will be repaid in the long term foreseeable future. By repaid I mean that all repayments of principal will be accompanied by a debt restructuring or a virtual simultaneous refinancing. Commercial bank exposure, in short, will not be reduced.

2. The developing world must grow. That growth will only be accomplished with increased indebtedness; not less indebtedness. If growth/indebtedness of the major indebted countries were to level off, political instability would be the rule not the exception. I need hardly say more than that a developing world with little prospects for growth cannot under such circumstances be in the US best interests.

3. In the foreseeable future new funds from commercial banks will not cover, for the most heavily indebted countries, the interest debt due to the commercial banking system.

4. To the extent, that increased commercial Bank exposure does not cover the interest due, the resultant negative transfer from poor to rich countries will not be sustainable, as a political matter, for very long in the developing world. That in turn will make the industrialized world's financial system vulnerable - to say the least.

. Under these circumstances, increased lending by the World Bank accompanied by a well thought out development programs should increase the comfort level of commercial banks who look to World Bank involvement as a source of support in maintaining or increasing their exposure. These banks and their portfolios would be weakened by a withdrawal or leveling off of the World Bank involvement.

. If the World Bank cannot increase its lending - which in turn is dependent on a capital increase - we too, just as commercial banks will shortly be receiving more from LDCs than we are disbursing to them. The figure I offered as projections earlier assume a capital increase.

. Why then, considering the cost, the measureable leverage of the capital contributions and the fragility of the financial system, have we not had a clear signal in support of a capital increase?

. It may be that governments might feel that there should be a change in policy, as yet not operationally defined, in the way the World Bank conducts its operations; perhaps governments are looking for increased leverage for as yet unknown and undefined purposes, - perhaps a sense of holding back until a plan is developed to better shape the Bank's response to crisis situations; perhaps a sense that a way must be found to have the Bank "responsive", sensitized, to the prevailing political sentiment about the role of "aid" in general, whether through multilateral institutions or otherwise.

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(iv) What innovations are in the wings?

. In an environment I have described, there is a tendency to become active and to talk about "leveraging" capital. The code words are "exotic", "imaginative", "innovative", "catalyst", "last resort", "there is no other game in town", "let's do our part", "flexible", "responsive" and "flaky", -

all depending on ones view of the particular initiative. The code words are rarely linked to the comparative advantage of the institution or even whether it has the capacity or expertise to do what is required. Rarer still is a technical knowledge of the financial structure of the institution, an assessment of risks and benefits and the implications for a particular initiative as it could effect the standing and viability of the institution. In short, the method by which it responds sometimes gets lost in the rounding and obscured in the reaction to implicit adverse criticism; e.g., "What is the Bank doing?"

- A case in point is the latest public talk that the World Bank should "use" its guarantee power. Let me start off by admitting up front that I tend to tilt more negatively than positively with respect to that particular initiative though I must also say that my views are in a minority and are not likely to carry much weight.

Permit me to provide some background - some reality testimony:

- Guarantees count against our capital just like loans.

- We are not a deposit taking institution. We have no inter-bank funding. We cannot call on Central Banks to provide us with liquidity as a lender of last resort. We do not have a natural deposit base. In short, we do not fund ourselves like a bank nor do we have in place the safety nets available to commercial financial intermediaries. Our "market" is made up of pension funds, insurance companies, state and local retirement systems, man-

aged funds - all of whom lend to us at fixed interest rates for medium to long term. These investors do not ordinarily lend to commercial banks for reasons that prudence and taste do not permit me to describe.

. It is my expectation markets in which the Bank operates would not take well the idea that directly or indirectly we would provide cash transfers so that indebted countries might either meet their obligations to the IMF or to the commercial banks - even if it were explained to them that that it is all in the public good since it might provide a catalytic movement to trigger new flows.

. Those from whom we borrow are not in the business nor do they perceive that it is their or our capacity to save the world's financial system or to promote increased commercial bank lending. They are harder and tougher and with more alternatives than those who deploy savings as deposits in commercial banks.

. The markets would question why lending not targeted to projects or sectors but rather for the purpose of providing quick cash transfers, neither targeted nor escrowed, to facilitate debt servicing to others or even to encourage increased commercial exposure was a wise path for the World Bank. The use of a "guarantee" for the same purpose, i.e., to encourage commercial banks to increase their loan portfolio exposure in order to provide the funds necessary to pay them back interest, is of course simply the same process but in

more acceptable (less obvious) dress. And markets will "look through" language designed to call cash transfers something else.

- Governments must know that the constituency not at the table - the financial markets, essentially are hostile towards, or at the least nervous about, banks. But they are not hostile to the way we have conducted our business. They are supportive. That constituency can be turned off very quickly, - an event I cannot look forward to given the fact that the World Bank, has a $10 billion plus annual negative cash flow (and rising) to be filled from a cynical market place.

- I know full well that money is fungible; that to some extent programs, sectors, projects are fungible and that it is not easy to "trace" where funds obtained from the World Bank (or from commercial banks) are being deployed. It is not so hard to make that determination however, when resources are made available in connection with debt restructuring and during a period of negative transfers from indebted countries to industrialized countries. We have heard my distinguished friend from Mexico tell us that it is likely that not just principal but also interest payments may have to be incorporated into future debt restructuring agreements because of the negative transfer from indebted countries to industrialized nations. Given that environment, since the interest payments cannot be made other than by the extension of new funds from commercial banks,it hardly takes any great perception to realize that a World Bank guarantee of such funds, in effect, simply reduces the negative transfer

through a guarantee of the increased exposure - which in turn is being used to pay back interest that is owed.

. Markets that I know about will treat us, should we act as an intermediary in that process, much the same way they treat commercial banks - provide short term money and keep your fingers crossed. That is no way to start upon a borrowing program projected to reach $16 billion a year in a few years.

. I also suspect that once that road is travelled any astute commercial bank would insist that any increased exposure, beyond what was needed to repay interest, if not a part of that interest, should be covered by a World Bank guarantee. And conversely, the more the World Bank is prepared to guarantee, the less the commercial banks by definitiion will be prepared to lend. It is a zero sum game. And, for what purpose? And at what loss of leverage? The fact is that commercial banks, over time, will probably have to increase their exposure by lending new funds in amounts approaching the full interest rate burden - if they want to maintain their own viability. And if that is imprudent, I question whether it is the World Bank's capacity or mandate to solve that problem.

. And if banks do not lend, despite the consequences to them, I simply do not believe we can solve the problem of LDC exposure to banks and banks reluctance to lend. Not all problems can be solved. Not all mistakes corrected. Certainly not by an institution which has no taxing power, no <u>right</u> to borrow, no lender of last resort and no natural deposit base.

But I must admit that mine is a minority view. Ultimately, after all, if I am correct that the markets will not accept the risks involved in our guaranteeing increased commercial bank lending, then the callable capital of industrialized countries would sooner or later meet the World Bank obligations both to those it guarantees and to its other creditors. One way or another therefore governments would stand behind their commercial banking institutions and protect "the system".

Let me conclude by noting that I question the wisdom of the World Bank being used as the intermediary player in this scenario. That wonderful institution has developed credibility - great expertize, in the appraisal, supervision of projects and the quality of the development dialogue, - areas hardly touched by the private sector. I would hope that we would not use our scarce and shrinking legal power to increase our lending by providing untargeted cash either to comfort regulatory agencies who would like to point to the receipt of interest payments to their financial institutions, or to provide comfort to other entities who are constrained in lending, or to satisfy governments who might find it politically easier not to face up to a problem. In short, I think it would not be an efficient use of our capacity, skill and expertize but rather would be a response of superficial convenience and one which the markets in which we operate would not find appropriate or acceptable. Finally, I believe we would lose leverage in the maintenance and accept-

ance of our development advice, not increase it if we were perceived as the lender of first resort.