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ORAL HISTORY PROGRAM

Transcript of interview with

EUGENE H. ROTBERG

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By: W. Becker & D. Milobsky

Eugene Rotberg
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Q: I'm William Becker with George Washington University and the Business History Group.

Q: I'm Jochen Kraske, the Bank's historian.

Q: I am David Milobsky, the assistant to the historian.

A: I'm Gene Rotberg, and I was at the Bank for twenty years, almost.

Q: Mr. Rotberg, it's a pleasure to meet you and to have the opportunity to talk to you this afternoon. First of all, we'd like to ask you to talk a little bit about your educational background.

A: I was born in Philadelphia and I went to Central High School. It was an all-boys high school. Then I went to Temple University. I studied mostly English and History. After I graduated Temple, I went to the University of Pennsylvania Law School, and I became a lawyer.

Q: Could you talk a little bit about your career before coming to the Bank? In particular, we are interested in what career options you had when you graduated from law school.

A: It was clear I was going to be involved in public service. I was going to go to law school, for the most part, because I was interested in civil rights public policy and other matters dealing with the social contract between the different groups in a society. Also, I'm reasonably sure that another reason I went to law school was because my

father is a lawyer. Almost immediately after law school, I went into the Army and, after that, I went to the SEC, and became a securities lawyer.

Q: How did you make that decision given your earlier interest in public policy?

A: There was this group out there called "Wall Street", and there was this other sector which was going to regulate the Wall Street types. I thought my role was to be one of the regulators--in this case, in the world of finance. That's how I looked upon myself in terms of being a liberal, young citizen. In the 1950s, you had a lot of people going into government service for that reason. I could have gone over to the Solicitor General or the Justice Department. I just happened to have a relative who knew a friend at the SEC, and the next thing I knew, I had a job. I ended up staying there for eleven years.

Q: What kind of responsibilities did you have at the SEC?

A: I was a trial lawyer, principally investigating fraud, manipulation and deception in the marketplace by corporations and investment bankers. I then became Chief Counsel of the Office of Policy Research. I was also responsible for some sections of what is now known as the "Special Study of Securities Markets," a large, extensive work which examined how the securities markets worked.

I then became the Associate Director for Market Regulation, and I was responsible for the de-regulation of the securities markets. At that time, there were fixed-commission rates. Stock exchange memberships were limited. There were constraints on the relationships between non-members dealing with each other. There was a whole set of rules which were designed to make sure that there was a securities industry--made up of members of the stock exchange--with whom each non-member would have to deal at fixed, non-negotiated rates to execute a transaction. I was, I guess, the person most instrumental in breaking down the fixing of commissions, instituting institutional volume discounts, and controlling the practice of rebating to favored clients. I tried to open up the market to institutions other than securities firms. Essentially, my colleagues and I attempted to bring some competition in the securities industry on behalf of the consumer.

I learned, for better or for worse, to have a grudging disrespect for economists and more respect for lawyers. I learned that the process of cross-examination to get at the facts was useful. The process helped me to understand the difference between reality and language. It helped me to find out what people do for a living; why they do it, and how they do it.

The SEC was a very non-bullying atmosphere. We permitted markets to work rather than insist on changes by fiat. We permitted competition to work by simply permitting people to compete with each other. That also became quite important at the Bank, particularly since there was no such word as a "global economy" and therefore little competition when I first arrived at the Bank in 1968.

Q: I'd like to know more about your knowledge of the securities markets. Which of your experiences at SEC gave you the most knowledge in this area? Was it in enforcement, or the policy studies area?

A: I worked in both areas at the SEC. My knowledge of the bond market was *de minimis*. I spent no time whatsoever on the operations of the debt markets. I suspect that I barely knew the difference between a bond and an equity. I had had only minimal training in finance. My SEC work was more on policy than on the operations of the debt markets. I was far more involved in learning how firms really operated. What did Morgan Stanley, First Boston, Salomon, Merrill Lynch, Goldman Sachs, do for a living? What role did they perform? Where was their marginal advantage vis-a-vis each other? Where did they fit into a society? Were they different from a telephone line, simply putting the real players or the end users together? What was their value-added?

I suspect that if you worked for as long as I did at the SEC, you'd begin to have a somewhat cynical attitude toward role of financial intermediaries, particularly their perceived importance to an economy or society. This is not to say that they are not important, but they all can't be performing marginally important things on relevant matters. If you had twice as many or one-fifth of the numbers, you would do very well in transferring savings between investors and savers, between borrowers and lenders. You'd also begin to get a sense of the relevance of banking institutions as distinguished from securities or investment banks. Furthermore, you would also recognize the different roles of pension funds and insurance companies. You'd see the structure of the world's wealth. You'd also begin to see who has wealth in the world. In addition, you'd begin to learn how a firm acts as an intermediary between those who have wealth and those who do not. That's what you'd learn. You don't learn about stocks and bonds at the SEC. You learn about the role of intermediaries. This was fortunate because, as it turned out, the Bank was also an intermediary, at least in the financial sense. It transferred knowledge on the lending side, and it transferred money on the financial side. In that sense I think that the work at the SEC was relevant.

Q: Did you have any international experience?

A: None.

Q: None at all.

A: Nor had I had any experience in accounting or finance. I was a trial lawyer. My job was to prove the existence of a whole range of price-fixing activities. It was not my job to ask, or even answer, the question of whether it was good or bad. Those were policy considerations which were set in the early 1900s and led to the U.S. anti-trust laws.

Q: Let's talk about how you came to the Bank.

A: It was the fall of 1968. I had been at the SEC for a number of years and I was fairly visible. There were newspaper and magazine articles describing the issues facing the SEC as well as my role, and my colleagues. I was conducting public hearings to describe to the outside world how the securities world operated. The securities firms' presidents and chairmen were the witnesses.

The 1968 election was closely contested, and a letter was drafted, I believe by Chuck Colson, to Wall Street. The letter said essentially that if Mr. Nixon were elected President, one of the first things that he would do would be to change the main thrust of the SEC and remove from authority those people who were causing Wall Street pain and stress. Although I was Civil Service, I thought that Colson

was talking about me. Such foolishness.

Coincidentally, Bob McNamara called some people on Wall Street and asked them who might make a good treasurer for the Bank. Wall Street spied an opportunity. One, they could make a good friend of McNamara by responding and suggesting someone who might be able to do the job, and two, they could use the inquiry to get me out of their hair. That happy circumstance ultimately led to an interview with McNamara for the Treasurer's job. I must tell you that I wasn't interested in the job at first. In fact, at that first interview, I wasn't really sure exactly what job I was being interviewed for. Nevertheless, it was an interesting combination of circumstances because I was ready to leave the SEC. The public hearings were winding down, and I didn't think I was going to have a very happy career at the SEC over the next several years anyway. Most of my close friends had already left. As for me, I had to decide whether or not I was going to follow my colleagues to Wall Street. At the time, I was offered two positions, one by the Chief Executive of Oppenheimer and Co., Leon Levy, who subsequently has formed the Odyssey Partners; the second was John Gutfreund, who is a very close friend, previously from Salomon Brothers. I was looking with my wife for housing in New York when I got this call from McNamara. It was a rather strange interview.

Q: This must have been in September, or October.

A: It was October of '68. Maybe a little later.

Q: Why was this a strange interview?

A: He started off by asking me if I had any accounting background. I told him I didn't. He asked me if I had studied economics. I told him that, as an undergraduate, I studied mainly history and literature.

Then he asked me why I became a lawyer. I told him I became a lawyer because my father was a lawyer. He also asked me how much I knew about international stuff? I said, "Nothing."

"What do you know about the bond markets?"

I said, "Nothing."

He said, "What do you think of investment bankers?"

I said, "Well, I'm trying to put most of them in jail for violations of the Sherman Act, or to prevent them from engaging in practices like price-fixing."

He said, "But you said you don't know much about what they do."

I said, "Right. But, I know they price-fix."

McNamara said, "Well, what do you think of commercial bankers? What is your attitude towards these people?"

I said, "I don't know them. I don't have much to do with them." At that time, the Glass-Steagall Act had a

fairly tough line between commercial bankers and investment bankers. I remember, though, responding that bankers, to me, were those people who wore white buck shoes on little boats sailing around Long Island Sound and holding martinis in the summertime.

McNamara looked at me and said, "So you don't know anything about finance or accounting or business or economics, and you really don't have a great sense of respect for the people who are operating in the financial markets?"

"That's right.", I replied.

He said, "What do you think of the problems of poverty in underdeveloped countries?"

I said, "Well, it's not a subject I know much about, but I think it's a subject worth spending one's life on." The next thing I knew, McNamara offered me the Treasurer's job.

Needless to say, I was a bit surprised. I asked McNamara why he offered me the job and he said, " One, because if it's good enough for me it's good enough for you. Secondly, it beats the hell out of selling automobiles."

Q: Did he say anything about the gigantic task that he had at hand?

A: Well, he told me that he wanted a Treasurer who wasn't beholden to the world of finance and its way of doing things. Up to this point, the Bank had been a minimal borrower. You

will find in the documents that the previous Treasurer, Bob Cavanaugh, had concluded that the Bank could not borrow very much. He may have been right, by the way. He was a good man. However, McNamara sensed that if he wanted to lend money, he would have to borrow. There was no other source of financing the Bank because its capital was *de minimis*. He wasn't about to come to the Bank and not be able to lend because he couldn't borrow. In our interview, he asked me if I could raise a lot of money. I said, "Why not?" I knew so little I did not know enough to say it could not be done. I think McNamara essentially wanted someone who would not start off with the premise that it was going to be impossible.

Q: What was your impression of him? You must have come to the meeting with some pre-conceived notions. He was very much a public figure. Had you ever met him before?

A: No. I had never met him before. I have always felt very comfortable with him. I always felt that his skills and his sense of self were such that they did not depend upon the powerful positions he had. I think his sense of self came from a basic belief that he was a rational man, and that he was on this earth to make a difference rather than to exercise authority and power. I found that very attractive.

He also had been badly stung by the recent failure of a bond issue in Switzerland: there was quite a hostile comment

in the Washington Post editorial page about it. Perhaps that was the first transaction he had done. He also had made a statement to the press, I think, in that first Annual Meeting speech he made, where he said that if he wanted to be a banker he would not have come to the Bank. The Swiss did not take too kindly to that. The Swiss put those two things together and said the markets showed a lack of support for the institution; that they were concerned about bringing in some driven do-gooder; and that he had better understand that the Bank needed the support of the world's financial system. As it turned out, that was a misplaced criticism. The bond issue had failed because the pricing of it was set weeks before it came to market because of the awkwardness of the Swiss syndication techniques. (The market had changed, but the bond issue price had been set.) The bond issue was doomed to failure no matter who had been President. I think the whole episode bothered McNamara. I think he was also somewhat troubled by the fact that he felt that the previous Treasurer, in all honesty, felt that they could not pull off the size of the program which would have been necessary for McNamara to finance the Bank. It's not useful to comment or to speculate what would have happened had the German economy, and later OPEC and Japan, not generated these phenomenal financial excess reserves which the Bank could tap to finance

its development lending program. Did McNamara know that was going to happen? Did I know it was going to happen before the lending program escalated? Probably not, but the goal was worth finding out and taking the risks.

Q: You had to work very closely with him over the years.

A: Yes.

Q: His management style actually has become very much a matter of public record. There were books written about it. What was your management style like? Was it similar to his? Obviously, it was compatible.

A: I think he was the best manager and leader the Bank has ever had. I think he was a superb manager under any definition of a manager. Did he get "the best out of people," whatever that cliché means? The answer is yes. Did he motivate people? Yes. Did he cause people to tell him what they thought he wanted to hear? Yes. Let me talk a bit about that.

To work closely with him you had to have a very strong ego. I don't mean egotistical. I mean "ego" in the psychological sense. You had to have a strong sense of self, the same thing I've described about him. If you could not handle answering questions which you did not know the answer to, or indeed which were sometimes unanswerable, and did not know how to say in response, "That is an unanswerable

question"; if you could not take admitting to failure or admitting to a mistake or a lack of knowledge; if you ran your life, professionally or personally, covering up, you would not be comfortable with McNamara because he believed that the way you get at truth is to ask a lot of questions. To me, that was second nature. You just ask a lot of questions and you say, "I'm going to make mistakes or I'm going to fail, and I'm not sure and I don't know." But if those words can't come out of your mouth, you are in bad shape with McNamara. He knew certain questions were unanswerable, but he wanted to see how you were going to respond to the question. He wanted to see whether or not you were going make it up or confess to unsureness. He would accept the latter, not the former.

He did ask a lot of quantitative questions, but that was just to find out how rigorous your preliminary work was. He would often ask questions such as, "Gene, you say that government bonds trade at a yield of 7.12, and World Bank bonds trade at a yield of 7.62. That's 50 basis points difference. Tell me why we trade so much worse than government bonds?" And I'd say, "Well, Bob, one, the Fed doesn't do open market activity in our bonds, which means there's no buying power of the Federal government. Two, savings and loan associations who buy our paper cannot count

them against their reserve requirements because it's not an asset which is reserve-free. Three, commercial banks cannot take our paper and give it to the Fed as collateral against their borrowings from the Fed. Fourth, pension funds and insurance companies in sixteen states are not authorized to buy the paper of an international institution. Fifth, there are hundreds of investors throughout the world who know nothing about the World Bank, and what they do know is bad news. We lend to poor people. It's good money after bad. They don't want to lend to us. Sixth, the insurance companies are already filled up on what is called their "basket" of foreign debt, five percent, and can't buy World Bank paper. Seventh, our paper is not lendable, that is, you can't use it to collateralize borrowings in the Street. Eighth, we do one bond issue a year in the U.S. each of the last three years and there is, therefore, not enough liquidity. When there's no liquidity there's a big spread between buyers and sellers." I'd go on and I'd give him twelve reasons for why we were 50 basis points worse than the U.S. government bonds. He would then ask me how many basis points were attributable to each reason. At that point, I laughed. I told him that, I didn't know the answer. He said, "Oh, can you find out?" I said, "No. I can't conduct that experiment. It's unconductable. I can't control all

the other variables." That's the kind of talk we had back and forth.

Q: How knowledgeable was he about the financial markets?

A: He was the best financial analyst I've ever met, but he made it clear that he was not going to talk publicly on that subject, except on very rare occasions. His constituency, from the outside world's perspective, was the developing world. It was not the financial world, and it certainly was not going to be the industrialized world who provided most of the callable capital and guarantees behind the Bank. Although he had tremendous expertise on cash flows and present value calculations, which he could do in his head, that was not an image he wanted the public to identify him with.

He had very, very good skills. Most people like to look at charts. McNamara wanted the raw data because he wanted to manipulate the numbers and do sensitivity analyses. He was a fabulous financial person. He had, I think, little respect for most accountants. He would say, "I don't want you to tell me what the accounting implications of what you are doing. Tell me what the financial implications are, because accounting conventions often cover up real gains or losses." He would always say, "Gene, don't worry about the accounting."

In the world of finance at that time, if you had unrealized profits or losses, you never showed them on the P&L statement. You do nowadays, but at that time only if you had a sale. You could have an asset that you bought which is at a profit, according to the current market price, or at a loss. I would sometimes say, "I don't know whether I'm going to sell an asset where I have a gain or loss." McNamara would never say, "Make the choice so that we can produce a given profit." He would always say, "Do what you think is the appropriate thing to do. Never worry about the accounting implications; about how it looks. Always make the financial/economic prudent decision."

Keep in mind the Bank's portfolio of liquid assets at that time was close to $20 billion cash. Mistakes were made. Good decisions, lucky decisions, and unwise decisions were made all the time. He would never, never say, "Can't you manage the money a little bit differently or better?" Never. He would never second-guess a mistake.

Q: Who else did you work with when you first started there? Who were your colleagues?

A: Well, I worked closely with Siem Aldewereld. He was the Vice President-Finance at the time. I worked closely with Aron Broches also. Obviously, I spent a lot of time with Burke Knapp, although Burke was purely on the lending side.

Keep in mind that McNamara immunized the financial operations from the rest of the Bank in a sense because he realized that its client base was outside the Bank. The outside world was going to have to finance this place. For this reason, the financial operations, to this day, have been fairly sheltered from some of the bureaucratic excesses and turf battles inside the Bank, because it had to borrow $10 billion a year from strangers who knew nothing about the Bank. These were the people who had to be convinced to buy the paper of the Bank. Therefore, I had very few relationships with the lending arms of the Bank.

The last thing I needed was some lending officer describe to the Metropolitan Life Insurance Company what he does for a living. It was the financial arm which explained the Bank to the outside world. Indeed, it was the financial arm which explained the Bank to the Finance Ministries of Western Europe and Japan, and to the Central Banks. For the most part, the Bank, as distinguished from IDA, was explained to both the political and private side by the financial staff.

Q: Let me talk about some of the people you had to start dealing with outside the Bank. You started, in December of '68, and McNamara tells you to raise more money. However, this is before the OPEC money started flowing. What did you

think you were going to do? Cavanaugh, a good and sensible man by your own admission, didn't exactly see this mandate as a great opportunity.

A: I don't think Cavanaugh was under any pressure to raise money because the previous President of the Bank didn't require it. Secondly, there are traditional ways to borrow and there are untraditional ways to borrow. If you borrow in untraditional ways, you may end up upsetting people who you've grown up with, and people don't do things like that. I didn't have that problem. I eagerly sought out new sources of funds. In Germany, we tapped the cooperative savings banks. They are like S&Ls. Shopkeepers put their money there. Traditionally, these institutions bought German government bonds, but we went to them directly and basically asked to borrow their excess savings. We offered them ten basis points more than government bonds. Overnight we opened a brand new market.

Making a long story short, we opened up many different sources written about elsewhere (the Bretton Woods Commission 50th Anniversary papers). In Japan, we went to trust banks; then we went to insurance companies; then we went to what are called the regional banks; then we went to securities firms; then we went to the Bank of Japan. In other words, we looked for pools of accumulated wealth and tried to connect them

with the Bank. I didn't use traditional vehicles to approach them. We opened up ten discrete pockets of wealth in Germany, Switzerland, and Japan. That created an environment where they began to compete with each other.

Q: So that they would start coming to you rather than you having to find them.

A: Of course. I've written a lot about how you negotiate in that environment. It isn't advisable to take advantage of that situation. I never asked for more than I deserved in terms of the rate the Bank had to pay.

Q: Did this new approach generate any kind of reaction inside the Bank itself?

A: The real reaction was outside the Bank. Suddenly governments and investment bankers approached McNamara and they said, "You know, don't you think that Gene ought to be doing business with us rather than so and so?" McNamara, I later found out, never told me. He would totally insulate me from the normal pressures that most CEOs would put on their treasurer.

Q: You did this more or less on your own?

A: I accompanied Siem Alderweld on the initial trips. I later worked closely with Joe Wood, John Adler, and David Bock, all very, very smart. The three of them provided a foil to test what we were going to do on a whole range of

financial policy issues. As for other divisions in the Bank, people basically left me alone. The people I really had to convince were the people who either worked for me or who were outside the Bank. If I couldn't convince them that what I was doing was right, then I knew there was a real problem.

Q: What about the Board? You had regular reporting responsibility to the Board.

A: Yes. Every week for twenty years I presented to the Board the state of the world's financial markets.

Q: But did you use members of the Board to help gain entre to certain people in different countries?

A: Not usually. However, it would be unthinkable that I would engage in any financial transaction with the private sector without fully briefing the Finance Ministry or, the Central Banks first. Although they did not give the entre, they could block whatever we wanted to do, and I did not want to do anything which would interfere with the monetary policy of the country. You could not go into Switzerland or Germany and say, "I have an interesting new product here," if that product was something which was anathema to government policy. For example, in Germany they never liked floating rate instruments, because they believed that weakened the nation's commitment to control inflation. They believed that if you gave a society a way to hedge inflation, then you give

a society the means to ignore inflation. The discussions were extensive with the Central Banks and Finance Ministries in all of the major countries, but that was rarely done through the Board. We kept the Board informed about our discussions.

The relationships with the Board were excellent. To this day they are superb. If you talk to Board members about the Bank staff, they'll say that Finance gives them fabulous professional advice. We never gave them the run-around. We always told them the truth.

Q: What about those borrowing methods that were a little further out there, like the currency swaps?

A: Most people will tell you I invented the swap. That's not quite true. There was an ad hoc one, maybe two, done the year before. Although the World Bank didn't do the first one or two, it did the next and, more important, it institutionalized it. It built a staff around swaps. Within a matter of months, we were doing swaps that no one had ever heard of before. It took three months to get Board approval on the first one. They were afraid it would lead to something which is now called "derivative products." They were afraid that it could not be regulated. They were afraid that it was going to be opaque. They were afraid they wouldn't be able to set capital requirements. They were

afraid it was going to be too complicated. They were afraid this was going to put pressure on capital markets, which would lead to speculation.

Q: Did the swaps raise questions about Bank credit-worthiness?

A: No. The more sources I could borrow from, the fewer problems there were. The idea was to always borrow when we did not need to, from people who had the money to lend.

Q: I was curious about what you did with this money after it came in. I know that one of the big strengths of the institution was that you borrowed money when you could get it on favorable terms, and you kept it in reserve so that the Bank was never really desperate to borrow money. You also talked about how you've been able to keep these costs, I think you termed it "costs of liquidity," down to a minimum. Was that ever a problem? Was that ever difficult? How did you keep these costs so low?

A: All the people who did that are rather well-known figures now. They have almost, without exception, become multi-millionaires after they left the Bank. Before Wall Street took them from us, CEO's would go to McNamara and ask if he minded losing so and so from Finance. They were really asking if we would cut their underwriting if they stole our personnel, but we always let our people make the jump to the

private sector if that's what they wanted. These people, to this day, have always remained very friendly to the Bank.

Q: Who are these people?

A: Mark Winkelmann, who is on the Executive Committee at Goldman Sachs; Bill Michaelcheck previously at Bear Stearns; Morton Lane, the president of Discount Corporation, Hani Findakly. Lots more.

Q: Now, on the liquidity side, what kinds of devices was the Bank developing?

A: I can't discuss this here, but they were amongst the most sophisticated operations of the Bank. The Bank's Executive Directors were a little nervous. They were worried that we were making too much money and taking too many risks. I told them if I was taking lots of risks, I wouldn't have made all that money. We did it through financial engineering.

I have a whole bunch of articles on "financial engineering and derivative products" written ten years ago, that I can show you. Our staff invented them, and we used some rather complicated techniques. We assessed probabilities, evaluated choices, and took advantage of aberrations in the market where you could buy and sell something simultaneously and therefore have no risk, but make a profit in the transaction because of aberrations in the

market. After I left, I heard that the Bank is more cautious on how that money is managed now. What they really mean is that the aberrations have disappeared. They are right to be more cautious, because they can't make money as easily as we did, because, when we were doing it, there were a lot of easy ways to make money without risk. However, as the world of communications and financial sophistication increased, aberrations and "arbitrages" disappeared.

Q: Because these transactions are almost instantaneous.

A: They are instantaneous. The knowledge is more widely available, the mathematics are more widely known, the financial engineering skills are diffused, and aberrations don't occur. That's why the Bank is somewhat cautious nowadays.

Q: What about the decision determining the Bank's level of liquidity?

A: The Executive Directors would ask us why we were borrowing all this money simply to hold it in liquidity. I responded by telling them that they had already lent it. They just hadn't disbursed it yet. If we waited until we actually needed the money for disbursement on previously-negotiated loans before we borrowed it, what guarantee would we have that it would be available, or at a reasonable price? The answer is none. Suppose it wasn't there; suppose it was

in the wrong currency; suppose the rate was too high. It was better to take what we could get on favorable terms. Then we had the money on hand when we needed it.

One of the questions that you asked about liquidity also applies to borrowing. Identifying sources to borrow from isn't that difficult. It's how you treat the people who are lending you the money that's difficult. The Bank had the reputation of not bullying people, not driving a transaction down to the last penny so that the firm involved would lose money. We didn't threaten to cut off our relationship with them if they didn't do things our way. We didn't try to squeeze every last penny out of every transaction for several reasons: 1) because sooner or later someone else will be as strong as the Bank; 2) the Bank may lose favor because of something that happened at the Bank--the President may change; 3) markets could change, savings could disappear; and 4) the Bank can't raise ten, twelve billion dollars a year if people are always losing money when they deal with us, whether they are customers or intermediaries. In other words, we understood that there was going to be some tough times ahead, and we wanted to create an environment where any money in the world seeking a haven could come to the Bank. Creating that environment is difficult when you hire too aggressive financial people. I like to have people who have

studied History, English, and Physics; people who understand there's a complicated, vulnerable world out there.

The financial stuff we'll teach you overnight. The more subtle psychological ways to handle people in the world of finance are much more important. They don't teach you that in business school. They just tell you to get everything you can. You don't win that game very often, and when you do, you're sure to lose it later. Even if you win consistently, you are not going to get the volumes.

I'll give you a quick anecdote. I once went to Belgium to negotiate a private placement with the Banque Generale, the biggest bank in Belgium. This was a bank loan, at a fixed rate. Now banks don't normally lend at fixed rates. Because banks take deposits at floating rates, they don't want to lend at fixed. Nevertheless, this Belgian bank felt that it had enough fixed-rate long-term deposits and it was prepared to lend to us at a fixed rate. I've forgotten what the rate was, maybe seven percent. Upon my return, the Board had to approve of the transaction. The papers went up to the Board, and then there was an announcement after I got back from Belgium that the Central Bank had raised the interest rates to nine percent, and we had just done this borrowing at seven. The Banque Generale had agreed and signed the papers subject to our Board's approval. I told McNamara and

explained the situation to him. He told me to cancel the transaction. He didn't give me authority to go to the Board. He said that there was no such thing as a transaction where one side knows, up front, that they are going to lose money. And the Belgians were going to lose money.

I called up the Bank. I spoke to Paul Emanuel Jannsen, who is now the chairman of the Bank, and he said, "Gene, a deal is a deal. Sometimes it'll move in our direction, sometimes in your direction. Suppose it were to happen a month from now. It's a seven-year loan. Would you give us the money back? It just so happened that you are the borrower. We have struck the deal. A deal is a deal."

I go back to McNamara. I said, "They say a deal is a deal." You had these two stubborn guys.

Q: A Calvinist and a Lutheran, probably.

A: That's it. One of them said, "I don't want to take the money because I don't deserve it." The other one said, "I insist you take it, and I lose money on your behalf."

Q: What was the upshot of it? The deal didn't go through?

A: The deal went through. I finally said to McNamara, "They say if you don't do this transaction, that means that if the break goes the other way, you would expect us to break the transaction. We are not going to break it. Secondly, a deal is a deal. Sometimes we make money and sometimes we

lose money."

From that day on, you can't imagine the quality of the transactions that Banque Generale offered to us because we offered to break that transaction. Goodwill like that doesn't go away overnight. It lasts for decades.

Q: Could we move on to the debt crisis? What was the impact of this event on the Bank?

A: There was a concern that if the debtor nations were not paying interest or principal to the commercial banks, maybe they wouldn't pay the World Bank. Thankfully, this did not happen. When we presented the Bank to the outside world during this period, I could say that the debtors were taking the money they did have and making sure that they paid their debts to us. Our status as a preferred creditor set us apart from the commercial banks. The commercial banks, however, soon became quite upset. They felt that the Bank should accept defaults and moratoria, and that the Bank should refuse to lend any funds to the debtors unless they paid the commercial banks first. As a result, there was a lot of tension between the World Bank and the commercial banking sector.

The commercial banks, of course, had extensive discussions with the IMF who had quick, fast money available. As you know, the IMF does not borrow in the capital markets.

It gets money from governments. It took the pressure off of us. However, it did cause some tension between the Bank and the Fund.

Q: Did the Bank ever reschedule any of its loans?

A: I remember a situation with Nicaragua where the Bank had to make some provisions. I believe that this action reassured many commercial banks because it showed that the Bank was a real institution dealing with real people. Bear in mind that a provision is an accounting entry which simply says, "You aren't paying us. We can't force you to pay. We are going to take part of our profits and put that aside." I never objected to that. That's conservative, prudent banking. Indeed, if you think about it, it's making a provision for a future adverse event. A future adverse event is the non-accretion of income and the non-payment of principal.

However, I could not accept any moratoriums on payment or any forgiveness of debt. If they are not paying, they are not paying. I can't help that. But the idea that we should "forgive" them for it sets a bad precedent. Where would we draw the line? If we rescheduled Mexico's debt, how could we refuse Argentina, or Brazil, or Nigeria? How would we explain that to our creditors? Rescheduling debt was something commercial banks did, and commercial banks didn't

get long term loans at fixed rates in the bond market like we did.

Q: If you'd rescheduled, would the Bank have lost its status as a privileged creditor?

A: By definition, it would lose its preferred creditor status because it would do what everybody else does. That's where the big banks lost money. I had a responsibility to the bond buyer. We told them we were not going to reschedule. Rescheduling is an act where the lender throws away a contract. I didn't want us to take that initiative. If one of our debtors decided not to pay us, so be it. We would stop further disbursements on all not yet disbursed loans to that country after thirty days.

When the outside world saw that we did not participate in either debt rescheduling or moratoria, the banks were upset that they had to and we didn't. But they weren't in the long-term bond markets. They were in the short-term depository markets. Besides, they had support for their depositors from FDIC insurance.

In the end, we held the line, and that, I believe, enhanced our reputation. In short, when someone didn't pay, rather than forgive the debt, we took the loss provision, which basically was a reduction of net income.

Q: Let me ask a question about IDA. Did the Bank's

creditors see IDA as a means to bail out the Bank?

A: I hope so.

Q: You hope so?

A: Ask yourself what would happen if there were no IDA. Just think about it. There's no IDA. What do you do for Bangladesh?

Q: You don't participate.

A: What do you do for Bangladesh or Upper Volta?

Q: Well, you can't do anything.

A: You think that's what the institution would do? What would inexorably happen if there were no IDA is that, one way or another, the Bank would try to find a way to lend to countries at, say, three percent below market. Indeed the EBRD is now discovering that a lot of the ex-Soviet states are not credit-worthy. They are very poor, yet that institution is under pressure to lend those countries. That's what happens to institutions. IDA doesn't "bail out" the Bank. It's more of a safety valve to permit economic and financial support to countries which are not credit-worthy but, if it were not available, would probably get some Bank lending at the margin and, in so doing, I believe jeopardize the financial credibility of the Bank.

In short, I suspect that if there were no IDA, perhaps there'd be no lending to Bangladesh or Upper Volta. However,

there would be lending to the upper level IDA countries, and that would damage the credit standing of the Bank. IDA fills that role instead.

Q: You obviously decided to stay on after McNamara left. Could you say a bit about the two other Presidents you served with?

A: McNamara left the Bank because (again, this is typical of his personality) he believed that what had to be done at the Bank would take five to ten years. He knew that the Bank's lending and financial operations were practically on autopilot. He said that he saw the Bank as an institution which could provide "Nobel Prize" quality advice to developing countries. He wanted to use the lending and the financing arms of the Bank as a lever to implement the highest quality economic and financial policies in each individual country. He also wanted the Bank to be a massive supporter of economic development research from all over the world, and to use the findings of that research for the good of its member countries. That would take ten more years.

(As an aside, I basically believed that he could not pull that off without commercial banks locked in step with it. Indeed, that was one of the reasons I wanted to form a separate institution which would bring commercial bank-type depository funding into the Bank.)

But back to McNamara, he basically felt that he needed five to ten years to turn the Bank into a quality research delivery institution. I think that's one of the reasons he left. He didn't have that much time, and he'd almost reached retirement age. I also think he felt that, at least, a financial person, who had run a big organization, and who was not hostile to the Bank, would not destroy what he had begun. And since the new President had to be a Republican, Clausen was an appropriate choice.

I would say that during the Clausen years the Bank continued to move forward on the financial side. The financial structure of the Bank, thanks to Joe Wood and David Bock, changed the way it intermediated the funds that were lent to the borrowers. As a result, the Bank became a rather risk-free institution in terms of its financial strength. It had enormous leverage and financial power in the world's markets. Although at the beginning of the period, there were 20 percent interest rates, we got through that with hardly a scrape. While the rest of the world was falling apart, we had built up such financial strength, it didn't affect our profitability.

When Clausen came, the whole infrastructure of what McNamara had developed in terms of schedules, data, and reporting dissipated. He didn't use it. He didn't, I think,

feel he needed it nor did he feel comfortable with it. That's not where his head was. He ran a Bank. (The World Bank, by the way, is not a bank. It doesn't borrow like a bank; it doesn't lend like a bank; it doesn't have capital like a bank. It's more like a venture capital firm, except that it's not financed by equity.)

It took Clausen a while to get a hold of how the Bank operated. He'll tell you, if you interview him, that he never knew what buttons to push. He was not a businessman who had grown up in a half a dozen corporations like you see nowadays, moving from one to the other. He was the Bank of America. They hired him when he was very young.

At the Bank of America, he knew where every skeleton was buried, not at the World Bank. He says it was not apparent who to call to get change done, or who to encourage, or who to blame, or how to find something out. There were too many buttons and he didn't know where skeletons were buried. He didn't know where the problems were, and no one was prepared to tell him. That was unfortunate.

Tom basically left me alone. There was mutual respect. In the years that he was there, I don't think I had three conversations with him about finance, the balance sheet, the P&L statements, the reserves, the loss ratio, or liquidity management. He had enough other headaches to deal with

anyway. Ernie Stern wanted to fill every vacuum, sometimes even if one didn't exist. Ernie is the best development economist in the world, but there was this tension between Clausen and Ernie. (This was the major reason why we had the reorganization later. Conable needed a way to reduce some of Ernie's authority, although their relationship later changed when he (Conable) saw how valuable Ernie was.)

Clausen didn't have a precise idea of what he wanted to accomplish at the Bank. If you asked McNamara what he wanted to do, he'd draw you a chart with power on the vertical axis and time on the horizontal axis. According to McNamara, when you start a job you have a lot of power. By the end of his tenure, he didn't want to have any power left. McNamara wasn't looking for consensus, or compromises. He was there to do his job--development--not win friends and influence people. He saw the Bank as a vehicle to combat malnutrition, unemployment, and infant mortality. If, at the end of his time, he didn't have any authority left because he created so many enemies, that was fine, as long as he helped to make the world a better place.

Clausen, on the other hand, wanted to leave the Bank as strong and as credible a financial institution as when he came in. This was understandable because he arrived at the Bank during a period of great stress. The Administration was

dumping all over the Bank as were the politicians. The Debt Crisis was creating aggravation. Meanwhile, the Bank management refused to bail out the commercial banks. Elections were coming up, the banks were hurting, and the Republicans didn't want it to be said that the World Bank was bailing out the commercial banks at the behest of the Republican Administration (rich lending to rich, that sort of thing). Clausen didn't want to create problems for the Republicans didn't want to have banks badly hurt, yet, at the same time, he didn't want the Bank's reputation to be hurt by bailing out the commercial banks. Essentially, he was caught in the middle, and he just wanted to get out of there with the place and his reputation still intact.

Conable never interfered with the Treasurer's department. We never discussed any of the financial stuff. If you had asked Barber Conable what he wanted to accomplish as Bank President, he would have told you that he wanted to reach a consensus within the institution. When he took over, there were bureaucratic conflicts throughout the Bank. I think that Conable's primary goal was to pull together a lot of disparate constituencies and issues which were once not reconcilable. He also got caught up in the huge reorganization, much of which was his own doing.

I am afraid that neither of Conable's or Clausen's basic

goals related to the LDCs. Both men focused on internal issues--perhaps because of the rather stressful environment. I think that Lew Preston's primary goal is to leave the Bank a better managed institution than when he arrived. In my view, the last three presidents have looked at the LDCs as their core constituency.

Q: You mentioned that the Bank's failure to face up to the Debt Crisis had something to do with the reorganization. What else was involved?

A: One of the reasons for the reorganization was to dampen the criticism from the U.S. Treasury that the Bank was inefficient. The commercial banks told that to the Treasury in response to the Bank's failure to "bail them out." The second reason was they were trying to figure out a way to move Ernie off to the side somewhere. Conable realized, however, that Ernie had more friends at the Bank than he had, and that he wasn't about to move Ernie out of the Bank. Third, I think he realized that he needed Ernie, which was a wise and accurate assessment. So, instead of removing Ernie, Conable decided to give him Finance. I think that the reorganization, therefore, was meant to move Ernie out, or to Finance.

I would have had no trouble at all working for Ernie. It didn't bother me. I would basically do what I wanted to

do anyway. Ernie, since he was totally disinterested in Finance, could not have cared less. As for me, I was ready to relinquish my position as Vice President and Treasurer for reasons having nothing to do with Ernie. I didn't want to continue to do the same thing I had been doing for twenty years. The Bank indeed was on financial autopilot. Making a long story short, Conable asked me to be the Bill Rhodes of the Debt Crisis, the coordinator of the Bank's response to the Debt Crisis. That meant that I would liaise with the IMF, the commercial banks and the developed world to create an environment that would encourage a prompt resolution to the crisis. In other words, I had to keep score of some very complicated issues involving loan guarantees, World Bank lending, IMF lending, Brady bonds, and Baker paper. It was exciting.

I agreed to be the debt crisis "czar." I met with Conable, and I laid out a little plan of what I intended to do. During that conversation, he asked me whom I expected to report to. I told him that I expected to report directly to him. I couldn't talk to Miyazawa, Stoltenberg and Paul Volcker without the strength of his authority. It was possible that I would recommend things that the Regions wouldn't like. Therefore, I felt it necessary to report only to Conable. My title was not the issue. I had to speak for

Conable. Conable however, could not accept direct responsibility for the Bank's handling of the Debt Crisis, so he asked if I would report to one of the two Senior Vice Presidents. I said no, and resigned the next day.

I think Conable, for understandable and appropriate reasons, could not take responsibility, in an extremely contentious era, for something that would place the Bank in a highly activist role in the Debt Crisis. In the end, he did little. Meanwhile, Merrill Lynch called me--I was getting job offers from Wall Street firms virtually every month in my life for ten years--and they wanted me to construct a risk management system for their derivative transactions. I accepted their offer. Soon thereafter, I left the Bank. Ernie took over Finance (it didn't miss a beat), and Moeen took over Operations.

I am not one of those who believe that the World Bank has changed over the last twenty years. I think the rhetoric has changed, the talk has changed, and maybe, at the margin, the lending has changed. However, most of the staff are not doing things differently than they did twenty or thirty years ago. It may be that the way they write about it is different. They may take a little bit more time on the clearances, but I do not think the Bank lends in a different way, nor uses a different discipline. It has always been a

rather meticulous, conservative institution. Its major problem has been that the staff tends, at time, to be arrogant and self-centered. They think they are the fount of wisdom. They are very smart, but they are also very motivated to do the right thing. However, I've been told recently that they tend to shy away from new initiatives.

Q: In your paper you talk about the reasons that led to the flattening out of the Bank's lending. Do you think there's anything the Bank can do to get out of this posture?

A: It's very easy to lend. Just lend--easiest thing in the world. It's harder to tell whether the flatness has been caused by a lack of drive or interest, or by a lack of credit-worthiness. Is it true that the countries simply aren't credit-worthy or cannot come up with good projects and good loans? Or they don't need the Bank anymore. Another possibility is that the Bank has an awkward, constrained, financial product, and, until it loosens it up, it will remain unattractive. Countries can do all kinds of things they couldn't do ten or fifteen years ago. The Bank claims that it can't give the LDCs too much flexibility because then they will make the wrong choices. It's a very paternalistic institution, and things are not likely to change anytime soon.

Q: Thank you very much.