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Transcript of interview with

Gerald Alter

Harold Larsen

John C. de Wilde

Oral History Research Office

Columbia University

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PREFACE

This manuscript is the result of a tape-recorded interview conducted by Professor Robert Oliver with Messrs Gerald Alter, Harold Larsen and John C. de Wilde in Washington, D.C. during July 1961.

The persons interviewed have read the transcript and have made minor corrections and emendations; the reader is reminded, however, that he is reading a transcript of the spoken rather than the written word, and that several years elapsed between the recording and the review of the transcript.

Interview with John de Wilde, Harold Larsen & Gerry Alter

By Robert Oliver

July 21, 1961

Q: Now, Mr. Larsen, would you identify yourself and say a little bit about your background and position in the Bank?

Larsen: My name is Harold Larsen. I was in London after the war to get my Ph.D., and upon graduation I received an offer to join the Bank's staff and came here and joined what was then called the research department in January, 1948. I am now the economic adviser to the department of operations for South Asia and the Middle East, where I succeeded Mr. John de Wilde, who was formerly in that position.

Q: What various departments have you worked in with the Bank?

Larsen: I was in the research department, which became the economic department, and then upon the reorganization of 1952, I changed to the department of operations western hemisphere's economic adviser, and then came with South Asia and the Middle East two years ago.

Q: Mr. de Wilde?

de Wilde: I am John C. de Wilde, currently acting director of the economic staff of the Bank. I came to the Bank in the middle of

1950 after having served for about 20 years in the research department of the Foreign Policy Association and having served from 1942 until 1950 in varying capacities with the U.S. government--with the Foreign Economic Administration, the State Department and the Marshall Plan organization or ECA. I originally joined the Bank's economic department. When this was dissolved in 1952 I became economic adviser to the new Asian department, which was subsequently split up into two departments: the Far East department and the South Asia and Middle East department. I then became adviser to the latter department. In 1958 I was called to Pakistan to act as Bank resident adviser in Pakistan, with the primary responsibility of advising the Pakistan government on economic affairs or policy. I returned to the Bank early this year and became assistant director and later acting director of the economic staff.

Alter: My name is Gerald Alter. I came to the Bank in 1951 after spending ten years as an economist with the U.S. government in various agencies, including the Federal Reserve Board, the Bureau of the Budget, Department of Commerce, and Treasury Department. I came to the research department of the Bank in 1951 and stayed with the economic department when it was created upon the formation of the area departments. I stayed with the economic staff for about seven years, completing my assignment there as assistant to the director of the economic staff. I joined the western hemisphere department in 1957 and am now economic adviser

in the western hemisphere department.

Q: I wonder if a good place to start our discussion today mightn't be with the reorganization of 1952. Would you all one at a time speak on the reasons for this and subsequent relations of the economists in the various departments of the Bank?

Larsen: The reorganization arose from I think a fairly widespread feeling in the Bank that the previous organization was not working satisfactorily. The reason for this, I think, was that the operation of decisions and procedures at the staff level was in the hands of the so-called loan department, and the then economic department was only in an advisory capacity. And the relations between the then loan officers and the economists were far from satisfactory. To be fairly blunt about it, there was a good deal of jockeying for position and prestige; and at least some of the economists instead of doing their job were fighting with the loan officers about not being consulted, being kept in the dark and so on. Finally management decided that this was unsatisfactory and reorganized in the so-called area operating departments. It was rather like overturning a beehive. Nobody was completely satisfied at the time it happened. The loan officers thought that they were losing their priority in the Bank, their supremacy in the Bank. The economist was quite unhappy about being placed under a noneconomist boss, as the directors of the departments were. Mr. Garner, who at that time

was vice-president, devoted a great deal of his time to going around explaining to people why this was happening and how he expected it to work. He was quite prepared to bang heads together if it did not work. I think after the experience of a year or two, we all finished up quite happy and satisfied with the results. I myself think this was a much better system than formerly.

Q: Would either of you care to comment about the reorganization as such?

de Wilde: No. I think I have very little to add to this. Of course, at the same time that this reorganization took place, the component of engineers which had been part of the loan department were transferred to a separate department, the new technical operations department. I think that in retrospect must be regarded as a very sound decision in many ways simply because it was inevitable that the number of technicians that would be employed by the Bank, the number of engineers, etc., would continue to mushroom, and it would become a wholly unmanageable problem to have the loan operations and the analysis of projects all in one department. Inevitably, having created two separate departments, one in charge of loan operations in member countries and one charged with the analysis of projects, resulted in a certain amount of friction or potentialities for friction--just as there existed, let's say, earlier between the loan department

and the economic department. Although these frictions inevitably do exist and still exist, I think on the whole they have been manageable.

Alter: I have only one comment on that reorganization myself. I stayed in the economic staff on the reorganization, and I felt then and I still feel that a serious mistake was not made in not consolidating the operations of the technical assistance operation of the Bank with the operations of the economic staff. It always seemed to me--and I think experience since has indicated this to be the case--that a group of economists working on general subjects have a great advantage if they are drawn into technical assistance activities very heavily. And I felt that, at least for the first four or five years of the existence of the economic staff, that there was not a close enough working relationship. If these two activities had been consolidated, I think it would have benefited both the technical assistance activity and the economic research of the Bank.

de Wilde: Gerry, I would add one more comment to that. You remind me of one feeling that I had about the reorganization, certainly in retrospect. What you say, I think, about the link between technical operations and the economic staff is quite correct. I would even extend this to say that also the simple planning function of our present technical assistance and planning might have been incorporated in the economic staff. We

do have in the economic staff the only body of people who sort of have the leisure and the opportunity to look at the Bank's operation as a whole. At least potentially they have that opportunity. And having that opportunity, I think they have probably a greater opportunity to assess the operations of the Bank and to plan perhaps what these operations might be and how they might be changed in the future. It would have given the economic staff a good deal more focus than it has at present.

Alter: You're thinking of planning activity, not just economic programming.

de Wilde: I'm thinking, for example, of Bank planning. The technical assistance department was put in charge of planning for the Bank, of formulating, for example, the ideas for IDA, or those for an international investment guarantee program. It would seem to me that these kinds of activities might have been usefully integrated with those of the economic staff.

Larsen: My own view is that the fact that they were not is largely the fault of the economist himself historically. In the earlier days we were completely preoccupied with trying to do two things, I think: the first involved with the area countries and what we were supposed to tell the Bank about them, and secondly, the fringe of our attention was occupied with broader problems. The economist did not speak up in those early days about longer-



range problems and broad policy questions of the Bank. He would have been listened if he had. The gap was filled by the lawyer. It's extraordinary how in the early days the legal department produced broad concepts and ideas and suggestions, and gradually management began to expect the lawyers to have these ideas rather than the economists. It wasn't that we were excluded from contributing. We failed to contribute ideas.

de Wilde: I think that's true certainly to some extent.

Q: Well, do you feel that since the reorganization there has been greater use of economic analysis in specific project planning?

Larsen: Well, specific project planning is not the work of the area departments. But the observation that one has made of it is "no." I think the project planning has always been dominated by engineers and engineering concepts, and it's very difficult to get the economic contribution in there.

de Wilde: Wouldn't you say that it has not only been dominated by engineering concepts but also by financial concepts? In other words, the benefits and cost of the projects have been stated in largely financial accounting terms. I wouldn't say wholly, because I do think that progressively the appraisal of projects in the Bank has shown improvement. Yet there are many of us who

are not satisfied with this. But, as I explained to you the other day, I think one of the troubles has been (and I think here also the economist has been at fault) that the economist has not really expressed himself in very specific and practical terms to the economic problems involved in project analysis. Now, we know that many of the economic issues involved in project analysis are exceedingly difficult. And it has only been in relatively recent times that the economist as a profession has paid a great deal of attention to the economic problems of project analysis. They are progressively doing so more and more. But I think that all economists would be frank to recognize that many of the theoretical concepts of project analysis that have been developed over time by the economic profession are very often extremely difficult to apply to concrete projects. I wouldn't say that they are impossible to apply, and I think that a great deal more can be done than is being done today. For example, we are all aware of the fact that there is very often a marked divergence between the evaluation of costs and benefits at market prices and their evaluation at accounting prices which reflect the real cost or the real benefit to the economy. But having said this and having concluded that there is such a divergence, it is much more difficult to establish accurately what the divergence is in particular cases and to apply real costs and real benefits to the project analysis. This is just one illustration, I think, of the difficulty that we face.

Larsen: Not only is it difficult to do so among economists, but when you attempt to do so, it's almost impossible to make a noneconomist understand what you're trying to do. That's a problem of communication on many fronts.

Q: Does this imply that the benefit cost analyses done in connection with particular projects would tend to be of a rather narrower basis than if they were being done by economists, who would take into account such things as external economics, for example?

Alter: I don't think it's a question of people not wanting to take these things into account. I think even the engineers now in our technical operations department, who start from a somewhat different point of view, recognize that the Bank is interested in knowing what the broader economic benefits and costs of a project are. And they are being asked continually to appraise these costs of benefits. The difficulty is that it is extremely difficult first of all to identify in the case of many projects what external economies are really being created, and then after you have identified, to place an evaluation on this and to justify the evaluation as having some reasonable relationship to reality. Until the economist or someone can come forward with better procedures for identifying these external economies that are now available and for better measures of their magnitude, it's going to be extremely difficult to convince the practically

minded man that this is something that should be heeded.

Larsen: I'm not sure that I agree fully with that. I think the technically minded men that we have in the Bank do know that they should be heeded. I think that you will agree with me that, for example, in the staff loan committee discussions politicking gets into these things. Maybe it is agreed that there are some benefits that exist; we don't know what they are; but we feel it's enough to go ahead on.

Q: Have there been studies in the Bank of the very general process of development which might use information which the Bank has gathered from its own experience, for example, plus other studies that would suggest a way of going about establishing priorities for particular projects that would hasten economic development as such?

Alter: Are you talking now about methodological studies or are you talking about substantive studies?

de Wilde: How do we establish priorities? Is that what you're really stating?

Alter: It seems to me that every economic report that the Bank prepares on a country has as part of its objective to determine what is the nature of the economic development problem in this particular

problem in this country and what approaches seem to be most promising in coming to grips with this problem, either from the point of view of the Bank as a lending agency or from the point of view of the government of the country concerned to whom we're seeking to give some advice. The latter function, of course, is most comprehensively reflected in the Bank's general survey mission. And every survey mission is in effect a diagnosis of a country's economic problems and some indication of what it is important for that country to do and what appears to be most promising in the next few years at least in doing.

Larsen: In doing that work the Bank economist is not applying any particular economic theory of pure economics, applying tricks of some sort. What the Bank economists are presumably trained economists who are working in the field of applied political economy, and a great deal of intuition and visceral judgment is involved. We don't have a private set of economic tools which are applied.

de Wilde: Well, there are problems here involved at various levels. Mr. Alter was making a reference to the Bank's survey missions. The task of the Bank's survey mission is, of course, to develop at least the rudiments of a development program for a country asking for such a survey mission. And its job is to determine what resources can be mobilized to finance a development program, to identify the various-- shall we say--non-resource bottlenecks in the economy, the limitations of human resources, of technical capacity, organization and administration that place some limit on what can be done; to identify those economic activities which seem to have great potentiality for

development within the country; and on the basis of all this and related factors to build up some sort of a development program. This is one task and it's a manageable task.

Of course, the Bank faces a somewhat different problem as a financial institution. It has to determine what projects within, let's say, a whole range of possibilities it should finance. It can be guided by several things. First of all, the country economist in analyzing a country may come up with a conclusion that one of the bottlenecks of the economy, let's say, is power: that the development of power has been lagging, and that if one did develop the power resources of the country, it would give a powerful impetus to general economic development. On this basis one would be able to say that power has a high priority and that the bank should invest in power. Or they may come to the conclusion that the development of the economic potential would be greatly hastened if there were additional investment at a particular time in railway, roads or ports or other transport facilities; in which case they would emphasize the great importance of making some investment in this general field. This is the role of the area economist.

But even within this broad range of possibilities--it may be broad; it may be narrow--there is still the question of choice. We make a fetish here in the bank of saying, "We only finance high-priority projects." Of course, by financing high-priority projects--if indeed we do this--most of us recognize that implicitly we finance projects at the margin, since presumably resources are exchangeable. And there is a real question, of course, of determining in any country what should be the test of whether a project should be proceeded with

by the government or by the same token perhaps financed by the Bank or some other outside institution, and which should be regarded as basically sub-marginal. One of the great troubles is that we don't have a yardstick against which we can measure the return of the project.

Assuming for a moment that we know fully how to evaluate the economic costs and benefits, that is, that we can project, and put a value on all of the costs and benefits over a period of time..

Alter: Of a particular project.

de Wilde: Of a particular project. And, let's say, we go through the sophisticated routine of discounting these costs and benefits to present values, the real question then is: What is the rate of return or the interest rate at which, for example, you should discount? In other words, you might ask: What is, for example, the opportunity cost capital under these conditions? Well, this is a concept that we in the economic staff are beginning to try and deal with. But it's a very difficult kind of concept--to try and develop a yardstick by which you measure whether or not you proceed with a given project or whether you reject it.

Q: But this sort of analysis that you're now talking about is more likely to be done on the economic staff than by economists of the area departments, I take it?

de Wilde: The study of some of the concepts involved, yes, I think is appropriately a function of the economic staff. The application of the concept, of course, would have to be and presumably some of the responsibility of the area economist and the TOD.

Larsen: In its present work the economic staff is trying to produce the concepts and the various measures which might be applied in operating their concepts for the use of somebody else. In the staff economic committee, however, they will always be looking over our shoulder.

de Wilde: Yes. This would perhaps be a useful opportunity to indicate that the economic staff has an importance in that it does help to elaborate some of the economic concepts through a process of joint discussion with the area department economists and the TOD economists, concepts that can be applied by the area department or might be applied by the area department and the TOD in their work; and also plays, I think, a useful role through the staff economic committee, which is chaired by the director of the economic staff and which includes all of the economic advisers of the various departments, including the technical operations department, by providing a certain measure of uniformity in the analysis of a country's economy. Obviously, as Mr. Larsen has said, a good deal of judgment always enters into the economic appraisals. Well, the moment judgment enters in, of course, there is always the danger that the standards of judgment are not uniform; that what one would expect are the standards that apply to one country are not the same standards one applies to another country,



taking into account, of course, such differences as inevitably have to be taken into account. The staff economic committee does, I think, play a useful role in trying to bring about a measure of uniformity in the standards of appraisal. And I think over a period of time, this has improved--the standards of our economic appraisal--because all of us economists sit around a table and ask each other or ask a person who has come there to defend, as it were, his report the kind of critical questions which presumably should be asked. Gradually this has been a process of mutual education. We've all learned something from this exchange of ideas. And I for one certainly believe, looking back in retrospect, however bad we may think some of economic work still is, and I think we're all pretty critical about it still, that it has considerably improved. Wouldn't you agree?

Alter: Yes.

Q: I take it that a very large portion of the Bank's loans have gone for very heavy capital using operations, such as power, transportation facilities and things of this sort; and very little, if any, of the Bank's lendings have been for manufacturing or for agriculture--some for agriculture although not as much as these other two--and almost nothing for projects dealing with education, let's say, or housing or public health, things of this sort. What would happen if an economic study suggested that a real bottleneck in the economic development process occurred at the education level, let's say? Would the Bank be apt to consider that this is an area of lending that it might get into, or might it try and find ways of getting more deeply involved in the

development process of a country itself? These are a lot of issues that I've thrown out here. Perhaps you can comment.

Alter: It seems to me that the distinction between economic overheads like power, highways, railways, ports, a distinction between these economic overheads and the commodity-producing sector, projects in the commodity-producing sectors, manufacturing and agriculture, is an extremely important one from the point of view of understanding the Bank's operations. It seems to me that the Bank has always recognized that the economic priority of the commodity-producing sectors is no less, perhaps even greater, than the priority of projects on the economic overhead front. And one of the things that I think the Bank economists are always trying to determine in a particular country is whether the economic overheads, so to speak, at this particular moment in time are somewhat more developed in a sense than the commodity-producing activities that they are designed to support or whether the opposite situation prevails. After having appraised the relative abundance or paucity of economic overheads in a particular country at the present stage of its economic development, the question then is what should be done about it? And I had the feeling myself that the Bank has always had as part of its basic philosophy emanating, I suspect, from the character of the management of the Bank, the idea that the governments and agencies such as the Bank which lend financial support mainly to governments and to government-created institutions have a very limited role to play in the direct commodity-producing field. This is partly I think resulting from observation by the Bank on how poor a job governments have actually done when they have assumed

important roles in the direct commodity-producing fields. However, this does not mean that the Bank itself in its operations is not interested in giving substantial support, even direct support, to the financing of commodity-producing operations. The interest which the Bank has had for a long time in the establishment of local financial institutions such as development banks through which our loans could be channeled into manufacturing activities, for example, with the use of a more simplified administrative mechanism within the Bank, using a local institution in which we presumably had confidence, I think is an indication of the Bank's interest in providing more finance for the commodity producing sectors, particularly manufacturing.

Similarly, we have in many countries--in Latin America, for example--tried to initiate or lend support to the establishment of specialized agricultural credit institutions through which we could give support to the private agricultural sector of the economy. We have also, of course, made loans for irrigation and other things which are more closely related to even though not directly commodity producing in a sense.

I feel myself, however, that this effort to set up development banks and make loans through development banks through agricultural credit institutions within the country has been, if not a failure, not a brilliant success. We have not succeeded in extending our activities in this field to the extent that I personally feel we should have done. We have been faced with difficulties in the sense that in many countries where agricultural credit institutions, for example, have been set up by the governments, they have been operated on a straight political basis, and it is extremely difficult to get economic or

commercial criteria employed by such institutions, to get their managements and staffs selected on a nonpolitical basis; and this has in several concrete cases, limited, I think, the confidence that the Bank had that it could use such institutions as a means of getting finance into the commodity-producing sectors of the economy. But I do not believe that the relatively small proportion of Bank resources that have gone to what we might call the direct commodity-producing fields is any indication of a judgment on the part of the economists or anyone else in the Bank that these fields are of less importance. It's really a question of what it is possible for a government to do and a Bank to give support to and whether a mechanism which is adapted to the problem, whether such a mechanism exists in the country through which the Bank can give assistance.

Larsen: People criticize the fact that the Bank has not lent for what you might call the social sector--health, education and housing and the like. This doesn't mean that the Bank doesn't think these are important. It's only that it thinks that its funds are not appropriately put into that sector. You will observe that the survey missions have almost universally included specialists in the social sector. We have been frequently criticized by our friends for not directly lending in the social sector. To which I reply that it has always been that our funds are substitutable.

I recall specifically that in one of my missions to a Latin American country, the Minister of Finance requested specific finance for housing and for hospitals. I asked him what his own government's investments and expenditures were, and he said they were putting it

into power and roads, and they were satisfactorily taken care of, but he was now short of money for these other purposes. We pointed out to him that we would finance the roads or power, which would release his money for financing the social sector. He very quickly granted that point.

Q: Did he follow up then?

Larsen: Typically, no. Very frequently things do not come to fruition. He did follow up in about three years' time.

de Wilde: I think that one should keep in mind also not only what it is desirable to do but what it is practical to do. An institution like the Bank has not got a vast staff. It can't get a staff including experts on every conceivable aspect of what might be regarded as legitimate development activities by a government. Now, we could finance education, we could finance health, we could finance housing. But if we did so on any considerable scale, we would have to recognize that we would either have to have on our staff or include from the outside on a special consultant basis experts on these particular fields. In many ways it's more much more practical to concentrate on a limited number of fields and staff ourselves to screen investment propositions in these fields than to work all the way across the board, particularly since, as Mr. Larsen has said, resources are fungible and by financing something in one field, one does in fact release certain resources for another field.

But there are several other difficulties that have stood in the way of our financing social sector investments. One is undoubtedly the difficulty one has in making judgments as to standards. After all, when you set up a factory, there is really not a great deal of choice in the kind of equipment that one puts into that factory. A factory that produces nuts and bolts, or whatever it is supposed to produce, has to have a certain amount of machinery. There may be some very limited choice as to the kinds of capital equipment that you put into the factory, but it is a manageable choice. Whereas, for example, if one starts financing housing, obviously one gets involved in the question of what is the appropriate standard of housing for a country at this particular stage of development with these and these income levels; what, if any, subsidies should be extended by the government to housing. Similarly, with questions of education: What should be the standards of education? What should be the standards of school buildings and equipment? And the same with health. What should be the standards of hospitals? What the nature of equipment? And these all create areas of choice which are far bigger and which raise very important political issues and political difficulties. The financing institution may feel that the standard should be lower than the government has in mind. Obviously, there would be a great outcry if the Bank should insist on lower standards than the government has in mind. These are politically very hot issues that by and large can be avoided, particularly when there are so many other things that can be financed just to get away from them. Nonetheless, of course, we have now declared in principle that at least through IDA we might be prepared to look at some investments in these fields. Whether in fact

you'll be able to do this effectively and without getting ourselves into undue difficulties still remains to be seen. I think we're making an attempt now to see whether this works out. Many of us have our fingers crossed as to what we can do in this field.

Larsen: We're going to try and find out quite quickly in the educational field. This is for the international development Association, not the Bank. We now have under consideration one proposal for Tunisia and one for Pakistan for technical education, and we're in the process of scratching our heads and wondering how we'll handle that.

Alter: I wonder if we shouldn't turn to this whole problem of credit worthiness analysis, which we really haven't touched upon.

Q: This is the other major topic. I wonder if you couldn't just make a topic on this proposition: I've heard it said in the Bank that it hasn't been limited in its lending by its own resources, but only by the available projects which were suitable for Bank financing. In other words, it's a lack of projects rather than a lack of funds which has limited the Bank's ability to lend. Is there a comment that any of you would make on this?

de Wilde: I think this is certainly true to some extent. I think many countries are lacking in the organizational, technical and administrative capacity to produce the kind of projects that meet the standards that the Bank has set up. One of the great problems, I

think, that many of these underdeveloped countries have today is to get the right kind of assistance in enabling them to identify and to develop and to appraise projects in such a way that they can be sent to institutions like the Bank or the DLF or other governments that are engaged in the foreign aid business.

Q: I take it that the Bank staff itself is undertaking more and more of this particular stuff. In other words, instead of waiting for projects to come in from the prospective borrowers, the Bank staff more and more attempts to seek out projects.

de Wilde: We do try to seek them out, sometimes quite actively. And, of course, incidental to the examination of projects, very often the project undergoes very considerable change as a result of this examination. In other words, technical assistance is given in the formulation of the project in the process of its examination from beginning to end.

Larsen: But the Bank's lending has been limited. Well, in some countries the lack of projects has been a limitation on their planning. But there is another limitation also in other countries: namely, the inability of the Bank to lend for credit worthiness reasons. A country may have borrowed heavily and unwisely from other sources, which we feel prevents us from coming in. Yet that uncredit worthy country may have excellent projects.



Q: Well, let's discuss the question of credit worthiness then. Perhaps you could say what you were about to say about this issue.

Alter: It seems to me that the Bank's own evaluation of credit worthiness over time has changed. I don't know whether these gentlemen would agree with me on this. But if I recall how we approached this problem 10 years ago when I first came into the Bank with the way we approach it today, I have the feeling that we are giving more attention now to an evaluation of the country's economic growth prospects as a factor determining credit worthiness to a much greater extent than we did before. There's always been a feeling among some of us in the Bank that the capacity of a country to repay a debt, particularly when it becomes a fairly substantial borrower, is greatly dependent upon the general economic health of the country; and that as the country's external indebtedness rises, its, so to speak, further capacity to borrow is to an increasing extent a function of its general economic growth prospects.

This means that the credit worthiness analysis of the Bank merges very closely into the general economic analysis, in which we try to appraise the country's economic growth prospects, its capacity to manage its affairs well, to adjust to changing external conditions, its capacity to identify the bottlenecks to its own economic development and to do something about solving them.

The problem of credit worthy analysis in the Bank has, I think, been in a sense complicated by the fact that the Bank as a public institution is not only trying to appraise the capacity of the country to service debt, but it is also trying to influence the country to

adopt the right kind of policies so as to permit it to borrow more and to develop in a more reasonable and more satisfactory way. Frequently from a tactical point of view, the Bank in its desire to induce a country to adopt proper policy may withhold lending on the grounds that the country's credit worthiness is being damaged or impaired by certain policies even when I think in fact the Bank is fairly confident that over a somewhat longer term the country will adopt the proper policies and will open the way for further lending. But the Bank may hesitate, may slow down its lending, may stop lending for a time, in order to make sure that the country is adopting the right kind of policies or correcting certain defects that have appeared in its economic operations.

Q: A question that I think you have touched upon, but perhaps I might ask anyhow: Are the standards of credit worthiness that the Bank has adopted designed primarily to protect the Bank against financial loss in the case of loan defaults, let's say, or do set standards of absorbed to capacity for the borrower country which will help guide it in its own development process? In other words, does the Bank look at this primarily from its own standpoint or from the standpoint of the borrower?

de Wilde: Well I think it's very difficult to distinguish between the two. I think the Bank was primarily motivated, particularly initially, by a desire to protect and reinforce its own credit standing. The idea of the Bank has always been that while the loans made by our institutions were in essence backed by the guarantees of the various

member countries in terms of that portion of their capital subscription which was subject to call that had not in fact been called up, nevertheless a banking institution of this sort should never really have to invoke this guarantee. It should operate on the basis of its own credit standing. In other words it wanted to make sound loans; it wanted to make loans under conditions which insured the repayment of these loans; so that it would never really have to call upon the member governments to cover any losses. We wanted to build up out of our income a certain amount of reserves. These reserves, of course, might be used to cover losses under certain loans, but we didn't want to have to call upon governments to produce any portion of their un-called capital to cover these losses. At the same time, I think we've also been conscious of the fact that in the interests of these developing countries themselves it was important not to burden them with too large a debt. They would get into very serious difficulties if they had an excessive debt that would involve too much of a sacrifice on their part to honor this debt service. Under such circumstances they would then have to default on their debt to the prejudice of their ability to get further external resources for their development in the future.

You spoke of the question of the absorptive capacity, that is the capacity of the country to make effective use of capital, whether domestic capital or external capital. Now, there are certain countries that you might regard as credit worthy on the basis of development potential or growth potential but which can only use at a given time a certain proportion of capital unless one wants to take the risk of a good deal of waste and inefficiency in the use of its capital.

Q: I'm wondering if these questions aren't related. Let me pose the question this way. If it were thought that a country could usefully, in a sound way from the standpoint of the borrowing country, use additional funds, might the Bank still be reluctant to make loans on some other grounds, alleging that the country was not credit worthy?

Larsen: It's very closely related. If a country has low absorptive capacity, either for its own capital or for external capital, it has very little growth potential. The two are related in that way. But there are other grounds on which the Bank might not lend. They are almost universally rare. The one I had in mind that we battled with in the early days was the widespread default on government bonds resulting from depression and the war, which awaited negotiations. We were severely criticized in our early years for refusing to lend to any country with a defaulted external debt which it was not negotiating with the creditors. But we were adamant on that, and I think were instrumental in obtaining almost universal settlements.

Alter: Of course, you can always argue that the country appraises certain risks somewhat differently than we do. I will illustrate for you right now. One of the big risks which we face in many of the Latin American countries was a possible collapse of the coffee market. There is a large surplus production of coffee right now, and it looks as though for the next four or five years there's very little chance that prices can be maintained at present levels unless there's a very successfully operated coffee agreement, or unless two of the major

countries, Brazil and Colombia, on themselves undertake major responsibility to keep supplies off the market.

Now, one could understand the Colombians deciding that we must expose ourselves to the danger of over indebteding, of assuming too much debt, because what is the alternative that we as a country face? In order to diversify our economy and in order to be in a better position to face such a catastrophe if it should occur? On the other hand, one can understand an outside institution looking at this situation deciding that we as a creditor institution do not have the same kind of an attitude toward this risk that the country has, and we would much prefer that a very substantial part of the capital which that country secures be obtained on terms which would not impose an immediate obligation to repay. Now, in actual fact, I think this is the way in which that particular dilemma is being resolved. The Bank has been instrumental, I think, in getting the governments to recognize that more assistance must be made available to countries which have this problem on terms which will not impose immediate repayment obligations in foreign exchange. The Bank has probably been more insistent upon this than some of the debtor countries themselves, who would have perhaps been willing to a greater extent than the Bank wanted for loans to be made available on conventional terms.

de Wilde: Yes, I think the Bank has performed and is performing an extremely useful service in calling to the attention of many of the governments, both in the developed countries and the less developed countries, to this problem of credit worthiness, particularly as it relates to the total amount of external capital that these countries

will continue to need for development at an adequate rate. Now, we have hammered home again and again the proposition that these countries do need to develop at an adequate rate. For many countries this is a sine qua non. But they cannot be expected to borrow on conventional terms by and large all of the external resources that they need over time. If they did so, they would be saddled with an impossible debt burden, and the inevitable result would be a very large scale default. This is, of course, a generalization. There are still countries which have very substantial margins for the contracting of conventional debt. But there are many other countries which already have a very substantial debt service burden even in the in the light of their expected growth potential, and particularly bearing in mind the continued large volume of external resources which they have to have access to if they are to develop at an inadequate rate--countries like India and Pakistan. Through the consortia technique we have hammered home continually not only the fact that these countries need external resources in very substantial magnitudes, but that in large part the external resources will have to be made available on very lenient terms.

Q: Might a situation developed where the Bank staff decided that a country had a very heavy external debt and could not therefore stand external debt increase unless this resulted directly in the stimulating of exports? Does a question of this sort arise? Did this influence the Bank in the sort of projects it might finance?

Alter: I think that the Bank economists generally are very conscious of the important role that exports play in the economy, not only from the point of view of servicing debt, but also from the point of view of being one of the underpinnings of the economic growth in general in the country. There are very few countries that are members of the Bank where you had any reasonable expectation that in the next 15 or 20 years their economic growth is not going to be very heavily dependent upon their capacity to import capital goods and other products which they are for the moment at least in a poor condition to produce for themselves and they must engage in international trade. So I think most of us feel that one of the very important indicators in judging credit worthiness in most of the countries or in judging the economic growth potential of a particular country is its capacity over the next five to ten years to enjoy an increasing volume of exports at a fairly fast rate. This does not mean that we think that in order to have a five percent growth in income, you have to have five or ten percent growth in exports. The relationship is not that close. But there is an important relationship. In some countries, the more diversified larger countries, in countries which have developed an entrepreneurial group and a capacity to produce in the manufacturing field particularly, it may well be that you can have a rate of growth of income which is substantially in excess of the rate of growth of exports. In other countries which are smaller, which haven't reached a stage of growth that is as advanced, it's probable that the rate of growth of income is unlikely to exceed the rate of growth of exports. These are questions that you have to examine in the individual case,

and our judgment of the economic growth of a country I think is heavily influenced by this type of analysis.

Now, when it comes to the particular kinds of projects which this analysis leads us to, what kinds of projects we want to lend our financial support to, I think the relationship is more indirect. In many countries we seek a project, we look for projects, to which we can give our support, which would have a substantial effect upon exports. But I think that because of what I said before about the difficulties the Bank has in lending in the direct commodity producing fields, we have not really been doing that to any great extent. And I personally feel that this has been one of the limitations which the Bank has encountered in its own work. It has found it extremely difficult to develop a way in which it can give direct financial support to productive operations which will have a clear and identifiable impact on exports.

de Wilde: One of the great difficulties has been the fact that we cannot do very much with respect to what you might call the traditional exports of these countries, the exports of primary products, products of the extracting industry, agriculture or mining. These will go ahead generally as rapidly as they can without any particular assistance from the Bank. Now, obviously one of the problems that many of these countries face is that the market for these primary products is not growing as fast as the world economy or the economies in the advanced countries are growing or certainly as manufacturing production is growing--for various reasons, technological and other. So that there is a great problem now that many of these countries are facing, which



is to develop other exports, supplementary exports, in which they have hitherto not had any comparative advantage, as in the case of primary products.

Now, basically, it is very unlikely except in very few cases, that investments in industry in a less developed country, will from the very beginning have the comparative advantage which will enable it to export. There may be a few cases, but these are isolated and exceptional by and large. Thus the main focus will have to be on developing manufacturing industries which in the first instance will serve the domestic market and some of which will ultimately, when the requisite experience has been acquired in the field of manufacturing or labor productivity has gone up, may develop a comparative advantage and a capacity to produce competitive exports.