ADDRESS to

THE BOND CLUB OF NEW YORK

BY

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New York, N.Y.—May 14, 1989
Because this is the center of the financial community of a nation which holds nearly 50% of the funded debt of the World Bank, I am delighted to have this opportunity to discuss with you our plans for the future lending operations of the Bank, and the relationship between those plans and our borrowing program.

I want to begin by emphasizing a point that my predecessors Eugene Black and George Woods made over and over again: the World Bank is not only a financial institution—it is a development agency. I accepted my present position with the Bank because I believe that the development of the emerging world is one of the biggest and the most important tasks confronting mankind in this century.

But having said that, I must make equally clear that the World Bank is a development investment institution, not a philanthropic organization and not a social welfare agency.

Our lending policy is founded on two basic principles: the project must be sound; and the borrower must be creditworthy.

We simply will not make a loan unless both these criteria can be met—and met completely.
We insist that the investment project itself have a demonstrably high economic return and be directly related to the development of the country in which it is located. And we insist further that the total economy of the borrowing nation be capable of repaying our loan, and meeting the interest and other charges—on-schedule, and in full.

These have been the World Bank's criteria from the very beginning. They are its criteria today. They are going to remain its criteria in the future.

The fact is that with more than twenty years of accumulated experience, the Bank's appraisal of the technological feasibility and the economic value of new investment projects is today more sound, more searching, and more sophisticated than it has ever been.

As for the creditworthiness of our clients, I am fully aware that certain countries face mounting problems of debt management. Past burdens can tend to depress future ability to meet new obligations. We have initiated, therefore, a special study of this problem to ensure that we lend only where there is a firm basis for repayment.

Our studies of creditworthiness are not just passive examinations of how a country is managing its economic affairs. They are increasingly designed to make specific suggestions on how policies and programs can be improved. As you well know, changes in economic policies—once accomplished—can work near miracles in improving the creditworthiness of a country.

But although the World Bank will continue to lend only on the financial principles of sound projects and creditworthy clients, I am convinced that within the limits of those principles we can and should greatly expand our lending program, if we are to fulfill our obligations to our member states.

Let me explain why.

First, I want to emphasize that what I am discussing here is the IBRD arm of the World Bank Group. It is essentially a "hard
lender.” There are, of course, countries that are in desperate need of development capital, but which simply cannot qualify for “hard” loans. As far as the World Bank Group is concerned, their capital requirements must be met by our International Development Association.

But that is not what I am describing here.

I am talking about our “hard-loan” operations and the issue is this: do the developing countries need more of these hard loans, and is the Bank able to make them?

Based on the most careful analysis, my colleagues and I are convinced the answer to both questions is yes.

If one looks around the globe today, it is obvious the world is characterized by an expanding economy. The industrially advanced nations are, of course, the leading edge of this surge of progress. But there are a number of developing nations as well—countries such as Malaysia and Mexico, for example—which are experiencing dramatic economic growth under the infusion of modern management, new technology, and development capital.

In the field of agriculture, we have the beginnings of a revolutionary breakthrough on our hands. The massive improvement in wheat and rice cultivation in Southeast Asia is momentous. It is no mere freak of good weather or lucky conditions. It is a carefully planned program of new seeds, intensive use of fertilizer, and modern soil and water management. The green revolution is not simply a grab bag of miscellaneous farm techniques. It is a complete and coordinated agricultural technology. If we can succeed in marrying this technology to new programs of agricultural credit and marketing, we can definitely arrest the spread of famine that threatens the world’s exploding population.

Nor is it in agriculture alone that economic opportunity is strong. Both Taiwan and Korea, for example, have recently achieved annual increases in industrial production of 15%, and in industrial exports of 25%. This is economic expansion at an extraordinary rate, and suggests that the modernization of Japan over a few decades may not have been an isolated phenomenon.
These nations, and many others like them, all require development capital: capital to expand the irrigation systems, capital to build the fertilizer plants, capital to construct the storage facilities—capital to turn the immense agricultural potential into a self-sustaining reality. And they require comparable capital to stimulate and bring to the takeoff point their indigenous industrial production.

The facts, then, are clear. Capital requirements throughout the developing world have not diminished; they have expanded. The opportunities for high-return investment have mounted almost everywhere. As in the past, 85% of the new capital required will come out of the savings of the developing countries themselves. But that 85% will remain ineffectual without the other 15%, which is the irreducible foreign-exchange component these countries must borrow from abroad.

The irony is that just at the very moment when the opportunities for productive investment of external capital are expanding, the flow of that capital—particularly from the United States—has begun to shrink.

Why it is shrinking is a complicated story which we need not pursue today, beyond noting that there are two important assumptions at work here which are clearly erroneous. One is that the richer countries can no longer afford to supply capital abroad; and the second is that even if they could afford it, it would be unwise, since the overall record of developmental investment is a dismal picture of waste, incompetence, and failure.

These popular conceptions are simply not factual. But the more important point is this: how can we deal with a paradoxical situation in which significant opportunities for prudent investment in the developing world have increased, and yet in which the flow of investment funds has flagged rather than quickened.

The World Bank, just over a year ago, initiated a series of studies to determine what ought to be done about that paradox. When all the data had been sifted and thoroughly examined, the conclusion was compelling.
Our studies demonstrated beyond any question that over the next five years the demand of the developing countries for hard loans—on standards as high, or even higher than in the past—would expand substantially.

Though one could not predict with absolute precision what the new investment opportunities—when matched against the Bank’s lending criteria—would justify in total lending year by year, the estimate was that it would warrant an increase, for a five-year period, of at least 100%. It seemed reasonable that the Bank could and should embark on such a course.

This is a lending program which is specifically designed to help countries improve their economic performance. Indeed, it is a program designed to improve the economic performance of the world as a whole.

But the lending program is, of course, only one side of the coin. If we were to double our lending, we clearly had to borrow more. Further, we wanted to try to improve our liquidity. In recent years the Bank’s balances of cash and liquid securities had been drawn down by about $400 million, because of the difficulties of borrowing in world capital markets. To increase the flexibility of our operations, we needed to reverse that process if possible.

Was the five-year target of a 100% increase in loans, plus the desired increase in liquidity, practical in terms of our bond sales?

In broad terms, what we were proposing to do was to increase the lending of the IBRD from an annual average of some $800 million to over twice that amount, and add, in addition, a half billion dollars to our cash reserves. This would require net borrowing of about $600 million a year, which—even if it were all in long-term securities, and it is not—would amount to less than 1% of the long-term funds raised in the capital markets of the industrialized countries.

That did not seem to us then—and nor does it seem to us now—an unrealistically large amount of borrowing on the worldwide capital market.
What is important to remember is that one of the principal advantages of the World Bank is that it can raise money in any member country which can provide convertible currency. This means the Bank can spread its financing throughout a large number of nations.

What we have done in recent months is to look for new sources of funds. And we have found them. We have found them, for instance, in Saudi Arabia and Kuwait. Even more importantly, we have found them in the one country with a burgeoning balance of payments surplus: The Federal Republic of Germany.

Within Germany, we have tapped a totally new source of finance for the IBRD. It is the Westdeutsche Landesbank, a clearing institution for more than 250 savings banks, with nearly 3000 branches. This is now the largest bank in the Federal Republic. It has assets of approximately $7 billion. Moreover, this institution places our bonds in other savings banks in Germany. The deposits of all these institutions total some $26 billion. During the last nine months we have placed $200 million of our bonds through the Westdeutsche Landesbank while continuing to market public issues through the syndicate managed by our longtime underwriters, the Deutsche Bank.

In the same period we have made increased use of the Central Banks of the world. Sixty-five of these institutions hold over $1 billion of our debt—approximately 25% of the total. They have increased their holdings during the current fiscal year, and there is every indication that they will continue to increase them in the future.

It should not be surprising that our securities enjoy so high a rating. The combination of assets and guarantees which provides their intrinsic strength is wholly unique:

- A portfolio of loans for projects which bring high economic returns to the borrower—returns which can run as high as 100% and which average well over 10% per year;
- A guarantee of 100% repayment of each loan by the government of the country in which the project is located;
• Cash and liquid security balances, in fully convertible currencies, equal to about 45% of the outstanding Bank debt;

• Paid-in capital and retained earnings amounting to 90% of our debt;

• All this, plus uncalled capital subscriptions backing the debt and equal to some 500% of the amount outstanding.

No other bond in the world offers that kind of security. And it is precisely because of the strength of that security—and our stated determination to maintain that strength—that we have been able to place our recent bond issues at extremely favorable rates. An issue of World Bank bonds, with 8 to 15 year maturities, was sold in Germany a few months ago at a cost to us of 6.52%. By comparison, an issue guaranteed by a major European government, of comparable maturities, was sold in the same market at a cost of 6.92%.

In essence, World Bank bonds are backed by the full faith and credit of the strongest industrial nations on earth. And yet, we have always proceeded as if this outside protection of our bonds did not in fact exist. We have sought so to conduct our business that the Bank need never call on that security—and we have succeeded.

In my view, the most persuasive guarantee of our bonds is the day-to-day prudent operation of the Bank by its experienced and expert staff. I am determined to make certain that this guarantee is the only one we will ever have to exercise.

The record of the Bank’s operations under my predecessors is excellent by any standards. Profits have been good and have risen steadily in recent years. In fiscal 1969, they will approximate $170 million, compared to average annual profits during the past five years of $145 million. We fully expect them to continue to rise in the future. This is true even though Bank interest rates in the future will be set at concessionary levels as they are at present.
Today a typical 24-year Bank loan, which carries an interest rate of 6.5%, contains a grant element of approximately 20% of the face value of the loan. The combination of concessionary interest rates to our borrowers and operating profits to our stockholders is made possible by our high ratio of interest-free capital to funded debt—a ratio at present of nearly one-to-one.

Currently, the average cost to the Bank for all its funds—that is, its total funded debt, plus its paid-in capital and retained earnings—is only 3.1%. Essentially, it is the difference between this 3.1% and the Bank's lending rate, now 6.5%, which enables us to cover all our administrative costs, grant reasonable concessions to our borrowers, and continue to earn substantial profits.

But, though profits have been good, there is a far more fundamental basis on which our reputation rests. And that, of course, is the choice and supervision of our overseas investments.

I have been immensely impressed by the professional competence with which our staff analyzes both the specific project and the economy of the borrowing country, before a loan is made—and by the careful scrutiny and supervision of the project, after the loan is made.

Such deep involvement in the domestic economies of independent—often newly independent—countries is possible only because the borrowing nation understands and appreciates our genuine dedication to its development. They see us for what we in fact are: an international agency, specializing in development, with no political axe to grind. The security of our investment depends on our borrowers' development and hence their interests and ours coincide.

It is on these strict standards of appraisal and supervision that the reputation of the Bank rests. And these standards will be continued in full force during our projected expansion. That is possible simply because in twenty-two years of experience we have learned a great deal about the techniques of realistic development planning, and the successful supervision of projects in distant and often primitive surroundings.
This accumulated experience now allows us to cope efficiently with a much larger volume of work. It is, however, clear that if our work is to increase, our staff must increase. Consequently, we have set in motion a worldwide recruiting drive to find and hire economists, engineers, financial analysts, and other specialists in our field. We plan to expand our staff by about 20% this fiscal year. This will not be easy since our standards are very high. But the Bank's reputation is equally high, and this attracts the caliber of professionals we need. Our results in recruitment so far have been very promising.

As we expand, we must remain sufficiently flexible to change our emphasis as the needs of development itself change. It is no longer enough to invest in traditional infrastructure: in power, transport, and communications. Both the needs and the opportunities in the developing world now point unmistakably to such fields as agriculture, education, and population planning. But let me make it clear that in these relatively new areas we will apply the same rigorous standards of both economic profitability of the project itself, and creditworthiness of the country in question.

It is not as easy to quantify the economic benefits of a technical school as of a hydroelectric plant. Similarly, on the surface, it may appear that you have something more impressive and solid to show when you build a high way than when you simply sink a lot of tubewells. But the whole point is that a surface impression is not a sound economic analysis. A good irrigation system, for example, when combined with the use of new strains of seeds, can result in an economic return of 100% a year. That is in fact an actual case that occurred in Pakistan.

And when you reflect that the less developed countries now require $4 billion a year of food imports, it is obvious that a broad expansion of their agricultural production can have an immensely beneficial effect on their balance of payments situation—and thus enhance their overall creditworthiness.

The economists at the Bank have been working on methods for quantifying the economic returns derived from social investment—such as education. Their conclusions demonstrate that
the benefits can vary enormously. A liberal arts college in a primitive underdeveloped area, can be a dead loss. But a technical high school—in an expanding economy where the available capital is not matched by the requisite skilled manpower—can pay huge dividends. One such project in Latin America brought an annual return of 50%. It is the World Bank's task to determine, in a given situation, precisely what sort of education contributes most to solid economic growth, and to invest accordingly. We have not financed in the past, and we will not finance in the future, any education project that is not directly related to that economic growth.

In developing countries with excessive birth rates, loans in the field of population planning have perhaps the highest economic benefits of all. The blunt fact is that unless the rampant rate of population growth is reasonably moderated in many of these nations, not only will their developmental projects be finally overwhelmed, but their capability of repaying foreign loans will simply be eroded within a decade or two.

Gentlemen, let me summarize the World Bank's situation.

As I have said, we conduct our affairs as though the only security behind our bonds were the technical and financial soundness of the projects themselves in our loan portfolio. But the fact remains that behind that assurance stands our very favorable ratio of equity to debt. Last month our total debt amounted to some $4 billion, compared to paid-in capital and retained earnings of roughly the same amount.

And beyond that lie two further assurances: two unique guarantees by the governments of the world. First, that each loan is the primary or guarantee obligation of the country in which the Bank's investment is made. And second, that the total of all Bank debt is backed by the uncalled capital subscriptions of the member governments—capital which can be used for no other purpose.

In the twenty-three year history of the Bank, there have been no losses on its loans—no government has failed to honor its obligations. The Bank has not been a target for debt repudiation
as have bilateral aid agencies and private credit corporations. The reason is obvious. Developing nations are convinced that it is in their own best interest to keep impeccable relations with the Bank.

Even in extreme situations, such as the latter years of the Nkrumah regime in Ghana, or in the period when the U.A.R. defaulted on obligations to bilateral creditors, neither of these governments defaulted on World Bank loans. As we expand our operations and become a more and more important source of development capital, the advantage to borrowing countries of continuing to meet their obligations to us will increase.

The final security behind our bonds is represented by the uncalled subscriptions to Bank capital. These amount at present to $20.7 billion—roughly five times the total of our funded debt. That $20.7 billion includes a U.S. share of $5.7 billion and a Common Market, U.K. and Canadian share of $6.6 billion.

The guarantee represented by the uncalled subscriptions cannot be eroded. By the provisions of our charter, these uncalled subscriptions may not be drawn upon for loans or administrative expenses. They can be used solely as a protection for the obligations of the Bank.

Moreover, the uncalled subscriptions are expressed in U.S. dollars, of the weight and fineness in effect on July 1, 1944. Thus they are not subject to deterioration as a result of changes in the value of currencies.

Similarly, because the loans of the Bank, made out of borrowed funds, are disbursed and repaid in the same currencies, the Bank faces no devaluation risks on its borrowed funds: its obligations to its creditors are matched by the repayments due from the borrowers.

It is, then, not too much to say that the World Bank is an entirely unique financial institution.

It is unique in its security and strength.

And it is unique in its purpose and program.
The World Bank was founded twenty-three years ago to reconstruct and develop a smashed, war-ravaged world. The reconstruction was a success. In the years since then it has turned increasingly to the developing world. And there the task is changing. What I have described to you today is our response to that change.

Our new program has begun well. It is on schedule. To date in this fiscal year we have borrowed more than in any previous year of the Bank’s history. Two-thirds of our borrowing has been outside the U.S. market. Our lending operations, both in number and in amount, are up substantially over last year. And, at the same time, our cash and liquid security balance has increased. It now stands at $1.7 billion—up $400 million over the level at the beginning of the year.

I believe you will agree these are signs of a vigorous and expanding organization—strong and secure in its financial base, prudent and precise in its decisions, and realistic in its goals.

In the business of development, hardheaded realism must be the guide. Neither a naive optimism, nor a despondent pessimism will do.

The simple fact is that in the last third of the twentieth century the underdeveloped world will either develop—or it will be caught up in catastrophe.

The one thing it will not do is stand still and wait.

You gentlemen—at the center of the most enormous and active capital market in the world—are not accustomed to standing still.

You act.

We at the World Bank propose to do the same.
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