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CAVANAUGH, ROBERT W. - ARTICLES and SPEECHES (1948-1967)



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HOW MANY

ADDRESS BY ROBERT W. CAVANAUGH
TO BE GIVEN TUESDAY, JANUARY 6,
1948 BEFORE THE STUDY GUILD OF
ST. MATHEW'S CATHEDRAL

*Final draft
with final
changes.*



I wish to say, first, how much I appreciate the opportunity of being present and of speaking about the International Bank for Reconstruction and Development which is often referred to as the World Bank.

1. ORIGIN OF THE BANK: BRETTON WOODS

The International Bank for Reconstruction and Development had its origin in the Bretton Woods Conference of 1944. This conference of 44 nations was called together, while the war was still being waged with utmost intensity, to consider the economic and financial problems which seemed likely to be encountered after military victory had been secured.

It was recognized at Bretton Woods that there would be no considerable recovery of world production and world trade without international investment, but while it was clear that many countries would be in great need of money to repair the destruction of war or to develop their resources, it was also realized that the uncertainty which normally follows war and the enormous needs of those countries would be likely to deter private lenders from supplying sufficient money for this purpose. It was to fill this need that the International Bank for Reconstruction and Development

was established. For unless sufficient money was lent, and lent at long terms, to provide for basic reconstruction and development needs, recovery would be so delayed that economic and political stability would be endangered; and all countries would be losers.

2. THE BANK'S CHARTER - THE ARTICLES OF AGREEMENT

The Articles of Agreement of the Bank lay down the lines on which it must approach its task of assisting in the economic and financial recovery of the world. They may be summarized as follows:

First, the Bank is to assist in the reconstruction of economies destroyed or disrupted by war and the development of the less developed countries.

Second, it is to promote private investment whenever possible and supplement it when necessary.

Third, it must seek to promote international trade and the raising of levels of productivity, standards of living and conditions of labor throughout the world.

It also is laid down that the Bank must deal with the most useful and urgent projects first and that it must be satisfied that the borrower would be unable to obtain the loan elsewhere on reasonable terms and that he will be in a position to meet his obligations under the loan.

3. THE CAPITAL OF THE BANK

The authorized capital of the Bank is \$10 billion, divided into 100,000 shares of \$100,000 each. The total amount which has been subscribed is just under \$8-1/4 billion, of which 20% has been called. The remaining 80% is liable to call only if required to meet the obligations of the Bank. As regards the capital paid up, 2% was payable in gold or U. S. dollars and 18% in the currency of the Member country concerned. The whole of this 20% has now been paid up, with the exception of a small amount (about \$5 million), representing deferments, under a provision in the Articles of Agreement, by certain countries which have suffered enemy occupation.

The Bank, then, is a cooperative institution, whose Member countries have paid certain sums, proportionate to their resources, into a fund which formed the first working capital of the Bank; they have also assumed the liability for much larger sums in order that the Bank might be in a stronger position to raise funds for its purposes.

4. FUNDS AT THE BANK'S DISPOSAL

The funds at the disposal of the Bank consist in the first place

of its paid up capital and, in the second place, of such funds as it may borrow in the markets of its Members. As regards the paid up capital, although the 2% payable in gold or U. S. dollars is freely available for lending, the remaining 18% (which is payable in the currency of the Member country) may be used for loans only with the consent of the Member concerned. This provision was, of course, necessary since many countries would be in no position to extend immediate credit to others and could only afford to export in return for essential imports. So far, the United States, the only country which is in a position to supply goods on a large scale to other countries without requiring immediate countervalue, is the only Member which has given permission for the whole of its 18% to be used in making loans; Belgium has given this permission to the extent of \$2 million worth of its currency. Other countries can be expected to follow suit, but the amounts so made available cannot be great until more countries are able to export goods without requiring immediate countervalue.

The effect of the payment of the calls on the 20% paid up capital was to place at the disposal of the Bank U. S. dollar funds amounting to

approximately \$731 million and the equivalent of \$909 million of currencies other than U. S. dollars, the use of the latter for lending purposes being subject, as I have said, to the consent of the Member concerned.

As regards further funds for its purposes, it is clear that the Bank must chiefly depend in the immediate future on the markets of the United States, since countries which are unable at present even to allow the use for lending of the amounts of their currencies paid in as part of their capital subscriptions cannot afford to make funds available through their financial markets. The Bank made its first offering of bonds in the United States in July last. This offering, consisting of \$100 million of 10 year 2-1/4% bonds and \$150 million of 25 year 3% bonds, was heavily over-subscribed. I think it is fair to say that this was largely due to the fact that misunderstandings as to the Bank's policies and purposes which had been prevalent in its early days had been dispelled. It is now generally realized that the Bank may make loans only as investments which must be repaid and that it is in no sense a relief organization.

5. LOANS

The first applications for loans were mostly from European countries, and since the Bank is bound to deal with the most useful and urgent projects first, it is natural that particular attention has so far been given to problems of European recovery. Before the war, more than half the world's trade was done by European countries. These countries still have the productive capacity and the skills; to put them to work by furnishing the necessary machinery, materials and fuel presents a great opportunity to raise the level of world production with a minimum of outlay.

Disappointment with the progress already made in European recovery is natural, but it must be remembered that the principal reason why recovery is taking longer than was expected is that the effects of the war were deeper than had been realized. There is in fact no cause for despondency that, only two years after the conclusion of the most destructive war of all time, economic stability has not yet been achieved. Reconstruction and development take time; they require sound and detailed economic planning, the restoration of financial and monetary stability and the prolonged efforts of millions of human beings. Much has

already been achieved, and the picture is apt to appear less favorable than it actually is owing to the fact that the most acute shortages are in consumer goods: material and labor are necessarily being diverted to the reconstruction of the basic stocks of wealth - housing, transport, plants, tools, machinery and raw materials. The detailed investigation which the Bank makes of every loan application has generally revealed greater progress than would appear from a superficial review of the state of the country, in which attention is naturally attracted to deficiencies which still exist rather than to deficiencies which have been removed.

The Bank has granted four loans to date.

France:

The Bank's first loan was one of \$250 million to France. The importance of France in the economic position of Europe made it particularly fitting that she should be the first country in whose reconstruction the Bank should play an active part.

In spite of the gravity of the French situation ~~as it is~~ today, we must not overlook the tremendous progress which France has made in overcoming the effects of the War. By the end of 1946, her production

had been restored to approximately 90% of the 1938 level and the volume of exports to 75%. In spite of the difficulties and uncertainties facing France, therefore, the Bank believes that its loan to that country will hasten the progress of reconstruction both in France and in Europe as a whole, and that the risks involved are of the type which the Bank was designed to accept.

Netherlands:

The Bank's second loan was one of \$195 million to the Netherlands.

The Dutch people have displayed remarkable determination and energy and have achieved great progress in restoring output and combating inflation. But the abnormally heavy imports necessary to replace war damage and losses, the loss of Germany as the principal source of imports and as an important market, and the decline of supplies and revenue from the Dutch East Indies have placed a heavy strain on Dutch foreign exchange resources. This may be judged from the fact that 35% of essential imports in 1947 will have to come from the United States, as against only 11% in 1938. The excellent debt record of the Netherlands and its long tradition as an important creditor nation make it a good credit risk.

Denmark:

The Bank's third loan was one of \$140 million to Denmark. It was granted for the purpose of hastening economic recovery by the purchase of agricultural and textile machinery, machine tools, trucks, steel products, textiles and chemicals. Denmark has already taken effective steps to create the healthy internal conditions - a balanced budget and stable price and wage levels - which should result in the Bank's loan having the most rapid effects.

Luxembourg:

The Bank's fourth loan was one of \$12 million to Luxembourg. It was granted for the purpose of financing the purchase of equipment for the steel industry and of rolling stock for the railways. Iron and steel production is the major industry of Luxembourg and exports of metallurgical products in the years preceding the war comprised about 80% of all exports. Owing to under-maintenance during the war the industry now needs to be modernized and adapted to postwar market requirements. The railways also are of vital importance, particularly as international carriers linking the Ruhr, the Saar, Lorraine, Switzerland and the Low Country ports. The Bank's loan, by providing

the means for raising the volume of traffic of Luxembourg's railways and for expanding the country's capacity to produce the type of steel products for which there is a heavy demand, will contribute not only to the recovery of Luxembourg but also to that of her neighbors.

In addition to the four loans already granted for European reconstruction, the Bank has received and is examining applications for loans from Czechoslovakia for the reconstruction of war damage and losses and for the restocking of raw materials; from Poland for the purchase of equipment and materials for coal mining, the iron and steel and textile industries, electricity and transport; and from Italy for purchases of equipment necessary to restore the damage suffered by that country's industry and transport system during the war.

As regards applications from non-European countries, we have so far received one from Chile for hydro-electric, forestry, harbor, transport and railway projects; one from Mexico for irrigation, Hydro-electric, pipe-line, highway, railroad and harbor projects; and one from Iran for the development of agriculture and transport. All these applications are receiving the most careful and thorough study. Fact-finding missions have visited Denmark, Poland, the Ruhr, Brazil and

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Such a mission is now in Chile, and another is en route to the Philippines;

Italy; and invitations have been accepted to send a similar mission to Mexico. Discussions are also proceeding with other countries regarding their development plans.

The past year has been an important one in the development of the Bank's loan policies. It is a year in which there was built up a policy framework which will give form to its future activities.

The core of that structure is the continuing emphasis on the requirement that loans made by the Bank must be made productive and must relate to well designed projects of reconstruction and development.

This implies that the project or program financed must promise an increase in the level of industrial or agricultural output of the borrowing country. It implies that the proceeds of the loan must be utilized only for the productive purposes for which the loan was granted. It implies that the borrowing country itself must take effective steps, where necessary, to remedy any unsound monetary or budgetary practices which would threaten either the productivity of the loan or the prospects of its repayment.

In cooperation with the borrowing countries, mechanisms were established to assure that the proceeds of the Bank's loans are not diverted to purposes other than those for which the loan was granted. This includes not only the meticulous checking of documents of purchase and the like, but also checking on the end use within the borrowing country of the goods purchased with money advanced by the Bank. If the Bank lends money for a railroad, or a coal mine, or a power plant, it wishes to see that such money is used for that purpose.

But the technical investigations and supervision over the proceeds will prove of little value in assuring that loans will prove productive unless there is a reliable economic base on which to build.

The responsibility for making the political decisions required for the achievement of the necessary financial reforms rests with the appropriate officials of the individual nations. But it is believed that the Bank, precisely because it is a cooperative international agency, will prove increasingly useful as an influence to prompt and perhaps to facilitate the taking of the necessary steps to bring about economic stability.

It is impossible to place too much emphasis on the importance of productive loans from the standpoint of healthy international relations.

There are few things which place a greater strain upon friendship between nations than international loans which leave behind merely an obligation to repay, without corresponding benefits to those who must bear the burden of repayment. In such cases, and they have unfortunately not been infrequent, the people of the borrowing country are apt to regard the lender as a foreign ogre of whom the worst can readily be believed. The people of the lending country, on the other hand, when they discover that their own often quite generous instincts are being interpreted as avarice, are apt to become disillusioned and to look with disfavor upon further ventures in the international field. The sum total is impairment rather than improvement of relations within the international community.

6. THE ROLE OF THE BANK IN EUROPE

This brings me to the question of the role of the Bank in the affairs of the world today. Although the Articles of Agreement established the principles on which the Bank must operate, the role which it will play will clearly depend on the state of the world in which it has to operate.

We must face the fact that the economic state of the world today, two years after the war, is worse than was anticipated either at the time of the Bretton Woods Agreements or in the days immediately following victory. It has become clear that the effects of the war were deeper and of more profound significance than had been realized. The dislocations of industry, of trade and of human life have been greater and more difficult to remedy than had been foreseen and recovery has further been hindered by the rapid development of unforeseen political conflicts.

The situation in effect is this. It was known that immediately after the war it would be necessary to give short-range relief in the form of the basic necessities of life, such as food, clothing and fuel, in order that countries which had suffered devastation and impoverishment as a result of the war might be sufficiently restored to make a start on the rebuilding of their economies and on the turning of their human and material resources to productive use. Provision to meet these basic needs was made through UNRRA and formidable sums were disbursed by that body in the form of grants. But the needs were far greater than had been apparent, and the resources of UNRRA were not

suffic^{ci}ent to accomplish the purposes for which it was established. The stage of relief has not been quickly succeeded (as had been hoped) by the state of reconstruction; we have to face the fact that relief needs have not yet been satisfied and that many countries are not yet able to stand on their own feet or to carry their own burdens.

To the extent that relief is still necessary the International Bank cannot enter into the picture, for it is not a relief organization and can lend only after it is satisfied with the prospects of repayment. But the granting of relief can have the effect of restoring the vitality and energy of a nation to the point at which the Bank would be justified in granting a loan so that that vitality and energy might be turned to productive purposes. You have all been reading and hearing of the Marshall Plan and of the various estimates under it ^{ob} [that] the basic

needs of Europe from United States during the next four years. ~~the~~ *In his recent message to Congress, Pres. Truman set the figure at 17 billion dollars.* ~~require between 15 and 25 billion dollars.~~ You have also no doubt seen

the figure of three billion odd, mentioned as the sum set aside by the Sixteen Nation Conference in Paris and under the Harriman Report, as

the amount which the International Bank might be called upon to supply *additionally* for the financing of equipment in connection with the over-all European

Recovery Program. Many informed persons believe ~~these amounts to be on~~
in the earlier reports
~~the high side, particularly the three billion given for equipment~~
needs to be on the high side.

needs. Most of these individuals state that any figure used is largely
guess work and that an accurate equipment estimate can be made only
after specific projects are objectively considered and screened by an
organization equipped to examine such projects. Insofar as the
International Bank is concerned, it is believed impossible to complete
any accurate plans for large additional loans to European nations

until the Marshall plan has solidified. This will probably not be

until early spring. *Effective assistance under the Marshall Plan
furnished on a grant basis will be an
added equity base for future loans of the
International Bank.*

After the European countries have obtained the basic needs for

existence there will be a need for the development of productive

facilities to supply a better way of life. These requirements will

be almost unlimited and the International Bank and private investors

will find many opportunities in this area for productive loans with a

minimum of risk.

8. THE REST OF THE WORLD

The urgency of the recovery of Europe does not detract from the
importance of assisting countries of other areas of the world, such

as Latin America, Asia, Africa and the Middle East. Indeed, the Bank recognizes that the need for reconstruction loans will pass within a few years, and the financing of development projects will become the primary concern of the Bank. We must face the fact, however, that the Bank cannot possibly do the whole job of financing such development; this can only be done by the free flow of private capital. But the Bank can make a beginning and can give its attention to such basic things as the improvement of the credit position of the countries concerned. The removal of obstacles to the free flow of private capital is a matter of prime concern to the Bank.

Existing defaults are one of the most obvious obstacles to the restoration of credit. In some cases the basic causes of default were beyond the control of the borrowing country and it is not suggested that every country with outstanding foreign bonds in default could or should resume payment on all its bonds in accordance with their original terms. But in some cases the default was due to unsound financial and economic policies; in such cases agreement with creditors would inspire more confidence and go further towards re-establishing credit if it were undertaken as part of a program of financial reform.

In the case of applications for loans by such countries, the Bank takes the view that a program to deal with existing financial and economic problems must precede the consideration of a program for long-range development. The financial and economic stability of its borrowing Members is of the greatest importance to the Bank in raising funds for its operations; if this stability does not exist the funds will not be forthcoming. It is, therefore, essential that Members borrowing from the Bank should have a sound fiscal policy, a healthy balance of payments, and good relations with their creditors. The Bank cannot assist a country which neither has financial and monetary stability and credit nor the willingness to take action to achieve them. Such lending would be neither prudent nor productive. But given the willingness to take action to establish a sound fiscal situation, the Bank can assist both in obtaining the necessary technical assistance for this purpose and in the financing of a long-range development plan which can succeed only against a background of fiscal stability.

The help which the less well developed nations need for a full realization of their potentialities should not be limited to financial

advice and loans. Because these countries lack the advanced technologies and skills which characterize more developed nations, the Bank may be asked to cooperate more closely in the consideration and formulation of their plans, including the obtaining of the necessary technical assistance. Here again the Bank is in a position of exceptional advantage as a cooperative institution with no object but the good of its Members.

9. THE BANK AND THE REVIVAL OF INTERNATIONAL LENDING.

There was once a disposition to question whether the Bank would be sufficiently careful and prudent in the use of the funds at its disposal; whether, in fact, it would exercise as much prudence as would be exercised by private interests in such matters. I think it is now known that the thoroughness with which applications for loans are investigated and the responsibilities which the Bank accepts both for the use of the proceeds of a loan and for the loan itself during the whole time that it is outstanding are establishing a new standard of responsibility in international lending.

It is indeed important that there should be in the future a greater sense of responsibility both in borrowing and in lending than has frequently been the case in the past, which, as you all know, contains

the record of much bad borrowing and bad lending, particularly in the inter-war years. The investor should be interested in the welfare of the borrower and must be indeed in a sense his partner; a recognition of this principle both by borrowers and lenders would create a sense of cooperation and of mutual responsibility, in place of the unfortunate mutual antagonism which has often developed in the past, when the borrower has felt exploited and the lender has felt cheated. It is the hope of the Bank that, by virtue of its unique position as a cooperative institution, lending only to its Member countries or under their guarantee, it may be able to promote relations between debtors and creditors in the international field which will be greatly to the benefit of both. The restoration of confidence in international lending is essential to the revival of world trade and of world prosperity; to help in rebuilding that confidence is the fundamental purpose of the Bank.

Address by Mr. Robert W. Cavanaugh
of the International Bank for
Reconstruction and Development
at McCoy College, John Hopkins
University, Baltimore, Maryland

March 17, 1950

corrected



It is a distinct pleasure for me to be here with you to discuss the International Bank for Reconstruction and Development which is more often referred to as the "World Bank". I understand you have already spent five months studying the United Nations and its specialized agencies, and that last week Professor Fisher and Mr. Williams presented to you some facts concerning the International Monetary Fund which organization like the World Bank was founded at the Bretton Woods Conference in 1944. This conference of 44 nations was called together, while the war was still being waged with utmost intensity, to consider the economic and financial problems which seemed likely to be encountered after military victory had been secured.

It was recognized at Bretton Woods that there would be no considerable recovery of world production and world trade without international investment. It was further recognized that the uncertainty which normally follows war and the enormous needs of the world would be likely to deter private lenders. Therefore, to promote freedom and stability in international exchanges and to restore the flow of international capital investment, the International

Monetary Fund and the International Bank for Reconstruction and Development were instituted. The Fund was designed to promote international monetary cooperation through consultation and collaboration among its members on international monetary problems and also to assist its members in meeting conditions of temporary disequilibrium in their balance of international payments. The Bank, on the other hand, ^{was} intended to render long-term financial assistance to its members for the purpose of reconstructing or developing their productive facilities and resources.

The Bretton Woods Conference drew up a charter for the Bank which was called its Articles of Agreement. These Articles were to become effective when signed by nations participating in the Conference whose minimum capital stock subscriptions were not less than \$6,915,000,000 and after such nations had deposited, with the State Department of the United States, proof that their respective laws permitted them to join the Bank and to carry out their obligations under the Articles. This occurred on December 27, 1945. However, the Bank did not actually commence operations until June 25, 1946 as it required several months to recruit a small staff and develop organization plans and procedures.

All of the 44 nations participating in the Bretton Woods Conference have joined the Bank except Haiti, Liberia, New Zealand and the Soviet Union. Eight other countries who did not participate in the Bretton Woods Conference have received membership so that the Bank now consists of 48 member countries. I might mention that the staff of the Bank numbers approximately 400 and represents some 20 different nationalities.

The primary powers of the Bank were assigned to a Board of Governors composed of a Governor appointed by each member country for a five-year term. Each Governor also has an alternate who may act in the absence of the Governor. These Governors are for the most part the leading financial men of their respective Governments. For example, in the United States it is the Secretary of the Treasury. The Governors must meet annually and of course may meet more often if necessary. There are also provisions whereby the Governors may vote by mail. The Board of Governors, has delegated most of its powers to a group called the Board of Executive Directors. The Board of Governors has retained only the power to:

1. Admit new members and determine the conditions of their admission;

- (2) Increase or decrease the capital stock;
- (3) Suspend a member;
- (4) Decide appeals from interpretations of this Agreement given by the Executive Directors;
- (5) Make arrangements to cooperate with other international organizations (other than informal arrangements of a temporary and administrative character);
- (6) Decide to suspend permanently the operations of the Bank and to distribute its assets;
- (7) Determine the distribution of the net income of the Bank.

The Board of Executive Directors consists of 14 individuals, five of whom are appointed by the five largest stockholders (The United States, the United Kingdom, France, China, and India), and ~~see~~^{nine} other individuals who are elected by the Governors of the remaining members. As you can see, each of the elected Directors usually represents a number of countries. The Executive Directors or an Alternates^{their} spend their full time at the Bank and meet normally once a month.

The Executive Directors select a President for the Bank who becomes ex officio Chairman of the Executive Directors. The President is responsible for the conduct of the business of the Bank and for the organization, appointment and dismissal of its officers and staff.

The Articles of Agreement of the Bank lay down the conditions which govern its approach to the task of assisting in the economic and financial recovery of the world. They may be summarized as follows:

First, the Bank is to assist in the reconstruction of economies destroyed or disrupted by war and in the development of the less developed countries.

Second, it is to promote private investment whenever possible and to supplement it only when necessary.

Third, it is to seek to promote international trade and the raising of levels of productivity, standards of living and conditions of labor throughout the world.

The Articles of Agreement also provide that the Bank must deal with the most useful and urgent projects first and that it must be satisfied that the borrower is unable to obtain the loan elsewhere on reasonable terms and that he will be in a position to meet his obligations under the loan.

The authorized capital of the Bank is 10 billion dollars, divided into 100,000 shares of 100,000 dollars each. The total amount which has been subscribed is \$8,348,500,000. The Articles of Agreement specify that the capital stock of the Bank shall be in terms of United States dollars of the weight and fineness in effect on July 1, 1944 which for all practical purposes means \$35 per troy ounce of fine gold. As you will see later this ^a is/very important provision.

The provisions in the Articles concerning payment of the subscriptions of the various members are very unusual. In general they provide that each member shall pay 20% of its subscription for use in the normal operations of the Bank and that the remaining 80% shall be called and paid only if required to meet the obligations of the Bank on its borrowings and guarantees. Thus, you can see that the 80% of each member's subscription is not available for loans by the Bank but is held as a fund for the protection of those holding bonds issued by the Bank and those who have made loans directly to members of the Bank which loans are guaranteed by the Bank. I might mention that although this 80% has not been paid to the Bank it should be obtainable on short notice. For example, the Secretary of the Treasury is authorized by law to pay the United States 80% on demand and no further Congressional

action is necessary. Also, I might add that the 80% must be paid in gold, United States dollars, or the currency required to discharge the obligations of the Bank for the purpose for which the call was made.

The provisions governing the 20% portion of the subscription are also quite unique. They provide that 2% of each members subscription shall be paid in gold or United States dollars and that 18% shall be paid in the currency of the respective member. In arriving at the amount of local currencies to be paid, the member uses the exchange rate between such currency and the United States dollar valued at 35 dollars an ounce. This means that should the United States Government devalue the dollar the amounts payable by other members would not be changed. The Articles also provide that whenever the par value of a member's currency is reduced, or the foreign exchange value of a member's currency has, in the opinion of the Bank, depreciated to a significant extent within that Member's territories, the Member shall pay to the Bank within a reasonable time an additional amount of its own currency sufficient to maintain the value of its currency held by the Bank as of the time of initial subscription. Thus, if the United States would devalue the dollar it would have to pay additional dollars to the Bank to maintain the value of its 18% capital subscription on the basis

of 35 dollars per ounce of gold. Other members also must maintain the value of their 18% subscription and thus when some of them did devalue their currencies last fall they paid additional amounts to the Bank.

One further important point I would like to mention concerning the 20% capital is that although the 2% payable in gold or United States dollars is freely available for lending, the remaining 18% (which is payable in the currency of the Member country) may be used for loans only with the consent of the Member country concerned. This provision was necessary since many countries would be in no position to extend immediate credit to others and could only afford to export capital in return for essential imports. So far the United States is the only Member which has given permission for the whole of its 18% to be used in the making of loans; Belgium has given this permission to the extent of 2 million dollars worth of its currency, Canada the equivalent of 10 million dollars, Denmark the equivalent of 125,000 dollars, and the United Kingdom 500,000 pounds sterling. Other countries can be expected to follow suit, but the amounts so made available cannot be great until more countries are able to export goods without requiring immediate countervalue.

The effect of the payment the 20% capital was to place at the disposal of the Bank approximately 733 million United States dollars and the equivalent of some 931 million of currencies other than United States dollars, the use of the ^{18% portion} ~~latter~~ for lending purposes being subject, as I have said, to the consent of the Member concerned.

To obtain further funds for ^{lending} ~~its purposes~~ in the immediate future, it is clear that the Bank must chiefly depend on the money markets of the United States. Countries unable to allow the use of their currencies paid in as part of their capital subscriptions cannot be expected to make funds available through their financial markets. The Bank made its first offering of bonds in the United States in July 1947. This offering, consisting of 100 million of 10 year 2-1/4% bonds and 150 million of 25 year 3% bonds, was heavily over-subscribed. I think it is fair to say that this resulted largely from the fact that misunderstandings as to the Bank's policies and purposes which had been prevalent in its early days had been dispelled. It is now generally realized that the Bank may make loans only as investments which must be repaid and that it is in no sense a relief organization. In addition the Bank sold an issue of 17 million 2-1/2% Swiss Franc Serial Bonds in August, 1948, an issue of 100 million

dollars of 2% Serial Bonds last month, and 28-1/2 million 2-1/2% Swiss Franc Serial Bonds on the first day of this month. The 100 million 2-1/4% Ten Year Bonds issued in 1947 were redeemed by the Bank simultaneously with the sale of the 2% Serial Bonds last month. Through the above operations the Bank has borrowed about 260 million dollars.

In addition to selling its own obligations the Bank has sold with its guarantee 28 million of the obligations of its borrowers. It is the usual custom of ^{the} Bank to provide in its loan agreements that the borrower will deliver bonds to the Bank evidencing the principal of the loan. By so doing the Bank has an easy means of selling all or portions of the loans - much easier than drafting complicated sales agreements to the satisfaction of the purchaser, the borrower and the Bank.

Taking into consideration the pertinent amounts above and approximately 23 million representing the net earnings of the Bank to date, we find that the total funds available to the Bank for loan purposes amount to the equivalent of roughly one billion 30 million dollars. Of this amount the Bank has committed \$744,145,000 on loans of which about 716 million is still owing to the Bank. Thus, you can see that the Bank has at this time approximately 314 million available for further loans.

I would^{now}/like to mention some points concerning the loan operations of the Bank. The Articles of Agreement restrict the total amount of the loans and guarantees made by the Bank to 100% of the unimpaired subscribed capital, reserves and surplus of the Bank which at the present time means approximately 8-1/2 billion dollars. The Bank may guarantee, participate in, and make loans to any member or any political sub-division thereof and to any business, industrial and agricultural enterprise in the territories of a member. However, when the borrower is not a member, the loan must be guaranteed by the member in whose territory the project is to be located. Before making a loan the Bank must be satisfied that in the prevailing market the borrower would be unable otherwise to obtain the loan under conditions which are reasonable for the borrower. Last, but certainly not least, is the requirement that the Bank shall make arrangements to insure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency.

These requirements have from time to time been subject to criticism by various people who felt that at least some of them were much too strict. We in the Bank believe it is impossible to place too much emphasis on the importance of productive loans from the standpoint of healthy international relations. There are few things which place a greater strain upon friendship between nations

than international loans which leave merely an obligation to repay without corresponding benefits to those who must bear the burden of repayment. In such cases, and they have unfortunately not been infrequent, the people of the borrowing country are apt to regard the lender as a foreign ogre of whom the worst can readily be believed. People of the lending country on the other hand when they discover that their own often quite generous instincts are being interpreted as avarice are apt to become disillusioned and to look with disfavor upon further ventures in the international field. The sum total is impairment rather than improvement of relations within the international community. The Bank must always bear in mind that for the most part any funds it has to loan have to be raised in the market of its members. I think it can be taken without question that should the Bank make a series of bad loans and thus become faced with defaults it would find it impossible to raise additional funds from private investors.

Because it is necessary that loans made by the Bank be productive, it is only logical that the Bank should not only investigate programs submitted to it prior to the time loans are granted but that it should

also follow up to ascertain that proceeds of the loan are utilized only for the purposes of the loan. In actual operation whenever a prospective borrower contacts the Bank concerning a loan, the Bank insists on receiving specific information as to the exact program planned by the borrower. For example, if the loan is for the purpose of constructing a hydroelectric plant, the Bank wishes to know not only how much electricity such a plant will produce but also whether there are reasonable prospects that consumers will be able to use all of the proposed current. The Bank will send a group of its own engineers, economists and other experts to the proposed location. These men will investigate the above factors and satisfy themselves that there is sufficient water power and that the estimated costs of the thousands of items necessary to build such a plant are in line with the amount of funds requested by the borrower. The economists will naturally endeavor to ascertain that the borrower will be in a position to repay the loan as it matures.

One of the main difficulties in making loans is often the lack of the local currency of the member in whose country the project is to be located. As you can realize labor, internal transportation, and

certain material costs will be incurred in the currency of the country where the project is to be developed. Under its Articles of Agreement the Bank can only furnish the foreign exchange needs of the borrower except in unusual circumstances. In building a hydroelectric plant approximately one half of the total cost would be for local currency expenditures. If this currency were not available it would tend to limit the rapidity of development regardless of the amount of funds the Bank might loan.

Once the Bank has decided that the project is practical and would be productive, it then becomes a matter of drafting the terms of the loan agreement. This is usually done in Washington on a working party level by 3 or 4 representatives of the borrower and a group of 4 members of the Bank. The Bank's group consists of a representative of the Loan Department who acts as Chairman, a representative of the Economics Department, a representative of the Treasurer's Department and a lawyer. The Loan Department representative insures that the necessary appraisals and investigations of the loan are made and prepares reports and recommendations concerning the loan request. The Economics Department representative is responsible for the creditworthiness of the borrower and the

economic factors which may affect the loan or the project. The Treasurer's Department representative advises as to the rates of interest and other charges, repayment terms, other financial conditions of the loan contract, and the provisions concerning the disbursement of the loan proceeds and the right of the Bank to supervise the end use. The Legal Department representative drafts the loan agreement and guarantee agreement, if any, and supplies legal advice. On the level above this working party group is a staff loan committee headed by the Vice President who decides most policy questions concerning the loan. After the loan agreement has been informally agreed to by both the staff of the Bank and the borrower, it is then submitted to the Executive Directors for approval and if approved it is then signed.

In connection with the charges the Bank makes for a loan the following has been developed. First, there is a commitment charge levied on the amount of the loan from the time the loan is effective until the funds are withdrawn by the borrower. Upon withdrawal of the money the borrower pays a full interest charge. Also upon withdrawal a charge of 1% is made on the amount withdrawn which is placed in a Special Reserve to be used only in the event of defaults on loans. The rate of interest

charged by the Bank is set a fraction above the rate it is estimated it would cost the Bank to borrow the necessary funds for the same length of time the loan is expected to run.

I would like to stress the fact that the Bank does not disburse the entire amount of the loan immediately upon the signing of the loan contract. Instead, the funds are normally disbursed only when the borrower submits to the Bank proof that the goods called for by the loan agreement have been purchased and paid for by the borrower and that they have been shipped. In some cases the Bank has advanced funds to the borrower prior to the final manufacture of the article to be covered. Here also, however, the Bank requires a copy of the contract or some other evidence that the proper goods will be acquired. Moreover on the basis of reports from the borrower and actual inspection by the Bank's staff, the Bank ascertains that the specific goods that were covered by the loan agreement and for which disbursements have been made by the Bank are actually received in the country and are put to the use specified by the loan agreement.

During the less than 4 years of our active life, the Bank has made 24 loans for projects in 13 different countries. As I said before,

these loans aggregated approximately 745 million dollars. Most of these loans have necessarily been in dollars - unfortunately we haven't had other currencies to lend except in quite small amounts - but the dollars have been expended in many different countries. Of the total disbursement of 567 million dollars made on Bank loans up to December 31, 1949, about 5 million dollars was spent in Asia and Africa, 27 million in Canada, 51 million in Latin America and 63 million in Europe, in addition to the 421 million spent in the United States.

Our first loans, in 1947, were, as you know, for the purposes of European reconstruction. But since the beginning of 1948, our principal business has been the making of development loans. During the last two years we have made loans for electric power development in Chile, Mexico, Brazil, Belgium, Finland and El Salvador; for agricultural machinery in Chile, Colombia and India; for timber production in Yugoslavia and Finland, and for the woodworking industry in Finland; for railway reconstruction in India; and for shipping in the Netherlands. That list covers a broad field, both geographically and functionally.

As a matter of fact, the actual variety of the Bank's loans is considerably greater than is indicated by the listing I have given. Take,

for example, the loans for agricultural machinery. The Indian Loan was made for very heavy tractors and auxiliary equipment needed to clear a large area of weed-infested land. In Chile and Colombia, on the other hand, the machinery was of a much more general character, part of which was sold to individual farmers and part put into equipment pools, where it could be rented by small farmers. As for the electric power projects, they range all the way from a central power station, using low-grade coal, in the heart of industrial Belgium, to a hydroelectric project in tropical and agricultural El Salvador.

Nevertheless, it is true--regrettably true--that the amount of loans made by the Bank has so far been limited. As Mr. Black, our President, has often said, the principal reason for this has not been the lack of money but the lack of well-prepared and well-planned projects ready for immediate execution. We hope, however, that no one will get the idea that we at the Bank are at all content with this situation. On the contrary, it has often given us a feeling of considerable frustration; it's only human that we should want the satisfaction which would come from being able to make a much larger volume of loans. But for the Bank to lower its standards to achieve this end would, in our judgment, be a disservice to our members and would impair our ultimate

effectiveness.

We
I do have high hopes, however, that the existing obstacles to a greater volume of Bank financing will, over the next few years, be progressively removed as a result of the technical assistance which is being provided to many underdeveloped countries by the Bank itself, as well as by other international agencies. I don't want to take the time to review in detail all the varied types of technical aid which the Bank has been called upon to provide, but I do want to stress that its scope is continuously widening. To give but a few illustrations, we have, upon request, sent irrigation experts to Peru and Iraq, a textile expert to Ecuador, an agricultural financing expert to El Salvador, a consultant on the financing of private enterprise to Turkey and an electrical and a railway engineer to India. We are also planning to send technicians to several of our member countries to help them in the development of a local securities market. In each case, it has been our effort to tailor our help to fit the needs of the particular country concerned. We have tried to avoid establishing too many ground-rules; in this still experimental field, we have preferred the pragmatic to the dogmatic approach.

Perhaps the most significant development in the Bank's technical assistance activities over the past year was the organization, at the request of the Government of Colombia, of a rather comprehensive economic survey mission, designed to help the Colombian Government to formulate a long-term development program for the country, and to make recommendations with respect to administrative measures and economic and financial policies essential to the success of the program. This mission, which was headed by Dr. Lauchlin Currie, has not yet completed its report so that I am not in a position to discuss with you the substance of the recommendations to be made. But I do want to say that, ~~in my judgment,~~ the provision of this type of assistance is a logical step in the development of the partnership relationship which the Bank has sought to establish with its member countries. We have already received requests to send somewhat similar survey missions to several other countries and are even now in the process of organizing such missions for Turkey and Guatemala.

We will have to wait for some years, I believe, before we can know with any certainty the real value of this type of work. We all know that the report of a mission, however brilliant it may be as an intellectual

exercise, is only of real use as its recommendations are adopted and put into practice. Nonetheless, ~~in my judgment~~, there are grounds for being optimistic about the effects of a mission such as ours to Colombia-- both because of the continuing relationship which exists between the Bank and the member country concerned, and because, if the country does its share in carrying out the mission's recommendations, the Bank is in a position to supplement its efforts with financial aid.

I would like to conclude this statement by reiterating that the Bank cannot and should not be expected to provide the answer to all or even a major part of the world's financial ills. It is beyond both the purpose and the power of the Bank, for example, to cure the "dollar shortage", or to assure the maintenance of full employment throughout the world, or to satisfy short-term budgetary and balance of payments requirements. Although our operations do contribute to the solution of these problems, our essential objective is narrower and more precise - to help raise production levels and living standards through financing long-term productive projects, providing technical advice and stimulating international investment from other sources. That, I think, is a broad enough field of activity for all the resources, ~~vigor~~ and imagination

which the Bank can possibly bring to bear. I believe that we have already made a substantial contribution in this field and I am confident that, as the seeds of our past work bear fruit, the Bank's contribution will become increasingly significant.



Address by Mr. Robert W. Cavanaugh
Treasurer
World Bank

To Washington Society of Investment Analysts
March 15, 1965

Mr. Chairman, Gentlemen:

I am delighted to have the honor of being here with you to discuss the activities of the World Bank. I am sure that as experienced investment analysts you are generally familiar with the World Bank. My remarks, therefore, shall be limited largely to current events.

However, may I first remind you that the main objective of our institution is to promote the economic development and growth that leads to better living standards and to broader opportunities for the peoples of our member countries. To carry out this objective the Bank has loaned about \$8.5 billion and disbursement of loan proceeds has reached nearly the \$6-1/2 billion mark.

Related to all this is, of course, the need for funds to finance the Bank's lending operations. To finance these operations we have a number of sources of funds. From capital paid in by our 102 member governments we have available some \$1.7 billion equivalent for lending. Loan repayments and sales of loans to investors have provided us with a replenishment of some \$2.7 billion equivalent; and roughly \$680 million in additional funds have become available from our earnings. Our largest source of new money for lending, however, has been the international sale of World Bank obligations to investors by means of both public offerings in various markets and private placements.

On a net basis we have raised, or soon will have raised, nearly \$2.8 billion equivalent through the sale of the Bank's bonds and notes to investors in about 40 countries. Included in this figure is over \$2 billion in U.S. dollar obligations of the Bank, and the equivalent of nearly \$700 million of bonds and notes denominated in six European currencies and in Canadian dollars.

Of this funded debt about \$1.4 billion is held by institutional investors in the United States which, as a group, constitute the largest supplier of long-term borrowed funds to the World Bank. It is in this area of our operations that your interests and those of the Bank coincide. It is also the reason why I am especially pleased to talk to a group of distinguished investment analysts at this particular time.

Currently the Bank is carrying on an intensive fund raising campaign through international marketing of its bonds. This is a major effort that, to date, involves public offerings of nearly \$300 million equivalent of long-term bonds on the markets of three countries. I might add it is the first marketing we have undertaken in the United States in three years; and the hiatus between marketings in the other two countries is longer still.

Today, for example, we are announcing that on March 23, subscription books will be opened on an offering of DM 250 million of 5-1/2% 20-year Bonds. This, our first public offering in Germany, since 1959, is being handled by a syndicate of German banks headed by the Deutsche Bank and the Dresdner Bank. Incidentally this issue will carry the highest coupon placed so far on a World Bank bond.

In the United States, on the other hand, 186 commercial banks and investment banking and dealer houses offered, in mid-January, \$200 million of

World Bank 4-1/2% 25-year Bonds to the public at 100-3/8 to yield 4.475%. These were the first World Bank bonds offered here since January 1962, and, by itself, the issue was the largest we have yet offered. It was quickly oversubscribed and about \$180 million of the bonds were purchased by pension funds and other institutional investors in this country. The remaining \$20 million was bought by investors abroad.

Canada, in mid-February, was the next market for a long-term World Bank bond issue; the first such offering there in nearly ten years. A group of Canadian investment banking and dealer houses underwrote Can\$ 25 million of 5-1/4% 25-year Bonds, priced to the public at 99-1/2 to yield 5.28%. Initially this issue sold slowly, but later picked up as substantial European investment interest developed along with institutional demand in Canada.

On completion of the offering in Germany the Bank, in just about two months, will have sold the equivalent of over \$285 million in new long-term bonds. Two-thirds of the total will have been purchased by investors in the United States and the remaining third by investors abroad. Given reasonably good market prospects the Bank may raise additional funds outside the United States by means of one or two modest public offerings in the balance of the calendar year. Most likely candidates would be the markets in Switzerland and the Netherlands both of which we have tapped with some frequency in the past.

You have undoubtedly noted that I have stressed the Bank's continuing interest in marketing its bonds and notes outside the United States, despite the higher costs of funds abroad. As an international lender, owned and operated for the benefit of 102 member countries, the Bank has a natural bias for internationalizing, as far as feasible, the sources of its funds, borrowed or otherwise. More pragmatically, the Bank as a continuing borrower must not be

in a position of undue reliance on a single market, however, favorable money costs in that market may be.

Consequently, we take advantage of opportunities to borrow non-dollar funds despite the differential in costs, so long as the differential is not unreasonably large. The relatively small size of our non-dollar borrowings plus the fact that the Bank has some \$2.4 billion equivalent in free funds from capital and earnings, has made it possible to absorb these additional costs, for the present, without increasing the 5-1/2% standard rate currently in effect on our lending.

Two principal factors have joined to require the Bank to resume large-scale marketing operations. One, a negative factor, has been the very sharp drop in the sale from the Bank's portfolio of obligations of its borrowers. For several years sales of loans to other investors, including participations, have supplied the Bank with between \$200 million and \$300 million annually in relendable funds, and, thus, reduced materially our need to raise new money in the market.

After reaching a peak of about \$300 million in each of the fiscal years 1962 and 1963, loan sales declined in fiscal 1964 to \$173 million and have dropped off still further with sales of less than \$75 million reported for the first seven months of the current fiscal period. The proposal for and the ultimate enactment of the Interest Equalization Tax by the United States and rising yields in Europe acted to dry up this replenishment for our funds. Now with the voluntary program for commercial banks to reduce or stabilize their foreign commitments, prospects for a substantial revival in loan sales appear, for the present, to be rather dim.

The more important factor that has necessitated increased borrowings by the Bank, has been a resurgence in our lending operations in fiscal 1964 that has continued on into the 1965 fiscal year. In the first eight months this year the Bank made 23 loans totaling \$575 million, and, based on present indications, lending for the fiscal period should exceed \$800 million, equal to or higher than the \$810 million reported in fiscal 1964. Accompanying the growth in loan demand has been an equally great demand for our technical assistance services.

The expansion in operations reflects the increasing scope of the Bank's activities arising in part from a larger membership and in part from a broadening of the purposes for which we will lend. In the last several years -- principally between 1962 and 1964 -- we have acquired 35 new members, the bulk of them being African republics in the early stages of development.

It is true that some of them are not candidates for Bank loans but rather for credits from our affiliate the International Development Association. IDA, as you know, assists, on very easy repayment terms, those of its members whose development is hampered by a limited ability to service foreign debt incurred in financing economic growth. Yet, a number of these new countries are eligible for Bank loans as is illustrated by our lending about \$40 million in the last 12 months in Algeria, Liberia, Gabon and Sierra Leone.

Whether or not eligible for Bank or IDA financing all of these new members add heavily to the work load of the Bank's staff, since it too administers IDA. In addition, the Bank's technical assistance services are under constant pressure to help these countries. So urgent is their need for such help that we are opening an advisory office in the Ivory Coast to service West Africa and are planning a similar office to serve East Africa.

Our long established members also exert heavy demands on the lending and technical services of the Bank. Many of them, with the help of our loans and other sources of funds, have made very substantial progress over the years; and have reached a point where sizable additional financing is needed to carry them through further development stages. Two loans in Europe in the current fiscal year illustrate this point. Yugoslavia borrowed \$70 million for railway modernization and improvement -- its second loan for this purpose -- which raised to \$260 million the total of our lending in that country since 1949 for industry, power and transportation. In Finland, on the other hand, we lent \$28.5 million for improved roads to service the country's burgeoning economy in which we have invested an aggregate of nearly \$190 million over the last 16 years.

As to the broadening purposes of our lending two loans in the Philippines and one in Malaysia illustrate how we are moving, on a modest scale, into new forms of assistance. In the Philippines, one of these loans amounting to \$20.2 million was made to help finance improvement of the Manila Water System, while the loan to Malaysia, some ten days ago, is supplying about \$7 million for improvement of the water system in Singapore. These were the first loans we have made to assist major cities in this regard. Our second loan in the Philippines this year, amounted to \$6 million to help pay for 16 new buildings and renovation of other buildings at the College of Agriculture of the University of the Philippines, at Los Banos.

This project is part of a five-year program to improve the quality of agricultural research and education in the Philippines. This was also the Bank's first loan for education. In making these three loans we used the same care in assessing the creditworthiness of the borrowers, the feasibility and

economic worth of the project and its urgency in the over-all development requirements of the country, as we would have employed in say a loan for power or industry. No doubt we shall make further loans for water supply or education or some other vital project in similar fields, but their volume will be quite modest in relation to our over-all lending. In fact much of this type of financing is most urgently needed in countries in the less developed or IDA category, which is indicated by the fact that IDA has lent over \$46 million for educational programs in Afghanistan, Nigeria, Pakistan, Tanzania and Tunisia, as compared to a mere \$6 million for the Bank. As to water supply IDA has made credits available in China, Jordan, Nicaragua and Pakistan totaling nearly \$63 million, or more than twice the amount of similar lending by the Bank.

I hope in this brief description of some of the factors affecting the Bank that I have given you an idea of what lies behind both the increase in our lending and in our borrowing. Before closing, I should like to touch briefly on a few policy changes -- actual and proposed -- that affect our financial position.

Effective last July 1, we dropped the policy of treating a portion of our loan charges, amounting to 1% of outstanding loans, as commission and then automatically allocating it to a liquid "Special Reserve." After giving due consideration to the reserve position of the Bank, our directorate decided that all loan charges will be treated as part of regular income, and that net income will be increased by the equivalent of what formerly would have been commission. At the end of each year the directorate of the Bank will decide on how "net income" will be allocated to reserves or other purposes. The objective of this change was to give the Bank fuller and more flexible control over

its earnings and apply them to its general operations. In the event you are interested, may I add that net income of the Bank for the first six months of the current fiscal year totaled \$66.6 million which compared with a net of \$62.6 million in the same period last year. Reserves of the Bank on December 31, 1964, aggregated over \$894 million, a sizable sum indeed and a record of many years of satisfactory earnings.

Another interesting development affecting finances was the decision of the Bank's directorate -- later approved by the Board of Governors -- to transfer \$50 million from fiscal 1964 earnings, to the International Development Association in the form of a grant. The Governors also approved a policy statement that "any transfers to the Association will be made out of (Bank) net income which accrued during the fiscal year in respect of which the transfer is made and is not needed for allocation to reserves or otherwise required to be retained in the Bank's business and, accordingly, could prudently be distributed as dividends."

In making this grant to IDA the Bank acted in concert with the Association's developed members who, over the three years beginning November 1965, will make available an additional \$750 million to its financial resources. IDA has been a most useful complement to our own activities. It can and does make development credits available in countries, whose credit is such that we cannot lend to them on conventional terms; it supplements our lending by entering into joint financings with the Bank; and in a number of instances it has supplied continuing financing for development programs in which initially the Bank was the lender. To the present IDA has made more than \$1 billion available in 27 less developed member countries to finance a wide range of projects. All of its credits have had similar terms designed to relieve the

balance of payments stringency of the borrowing country: 50 years to final maturity; grace period 10 years; no interest and service charge of only $3/4$ of 1% a year.

You probably are all aware that we have another affiliate, the International Finance Corporation, whose function is to assist in financing the development and growth of private industry in the less developed member countries. The World Bank has always felt restricted in its ability to help finance private industry, because of the requirement that private companies must obtain government guarantees on our loans to them. IFC, happily, suffers from no such inhibition. In addition, it can more readily vary its investments in private industry to the needs of each particular case, as under its charter it can and does make equity investments, mixed loan and equity investments and investments in loans with equity features. It also can and does supply to its clients many of the services of an investment banking institution.

With this background, IFC could serve as an excellent vehicle for channeling funds of the World Bank into industrial lending; and it has been proposed that the Bank be permitted to lend to IFC without guarantee and that IFC be enabled to accept such loans. In turn IFC would re-lend the loan proceeds to private industrial enterprises without guarantee. These proposals, requiring an amendment to the charters of both institutions are now under consideration by the membership. If adopted the World Bank would be able to lend, without guarantee, to IFC up to four times the latter's unimpaired capital and surplus, or up to about \$400 million under present circumstances.

In addition to trying to spur private industrial growth by means of loans to IFC, the Bank is also deeply immersed in attempting to establish a

center for conciliation and arbitration of investment disputes between foreign investors and governments. A "Convention" has been prepared by the Bank's directorate; and a group of legal experts met in Washington to consider it. The experts submitted a report to our Executive Directors and work on the proposal is continuing. With these comments on our efforts on behalf of private industry and private investment, I had better come to an end to permit your questions.

SPEECH TO WASHINGTON CHAPTER NATIONAL ASSOCIATION OF ACCOUNTANTS
BY ROBERT W. CAVANAUGH - NOVEMBER 15, 1967



1. I am most grateful for this opportunity to talk with you about the World Bank. The Bank's history started with the Bretton Woods Conference of 1944. Out of that meeting came the charters of two agencies: The International Monetary Fund, with responsibilities for the short-term financing of balance of payment problems; and the "World Bank" with responsibility for assisting in the long-term financing of economic development.

2. As you know the field of economic development is full of frustrations even in the United States. However, the developing countries have problems we are most unlikely to anticipate. For example, several years ago the President of one of the Central American countries came to see the President of the World Bank. Our President proceeded to give his guest quite a lecture on the lack of financial discipline in his country. Our guest listened for some time to the recitation of the faults existing in his country but finally interceded. He agreed that the troubles did exist and that many of the reasons given for such troubles were correct. However, he said "you don't fully understand the difficulties. For instance, you have a staff of very competent people and when you are faced with a financial or economic problem, or even an administrative problem, you can press two or three of the buttons on your desk and in will come some of your competent staff. You need only describe the problem to them, perhaps with a few suggestions, and they will go away and

come back with some well-reasoned solutions. Now consider my situation when I have a problem to be solved. I press two or three of the buttons on my desk but nothing happens. The buttons won't work."

3. When the World Bank started in 1946, it was viewed as a curiosity and with suspicion. It is still a curiosity but, fortunately, most of the suspicion was unnecessary. The World Bank has become a viable institution.

4. The Bank has made some 500 loans totaling over 10 1/2 billion, in 82 of its member countries. It has had no losses on loans, and retained net earnings aggregate \$1 1/4 billion. Net earnings for last fiscal year were \$170 million.

5. But the figures do not indicate why the Bank has been successful. I think the "good character" of the Bank was moulded by its charter. The founding fathers could have provided that the Bank serve as a multilateral pool of government funds that it would dole out to the developing member countries. Instead they hit on the idea of requiring the Bank -- an inter-governmental agency -- to rely for funds primarily on the sale of its obligations to investors.

6. Reliance on the capital market for the funds which we lend, has exerted a major influence on the way we do business. It has meant that, though our lending may go beyond the ordinary bounds of the private market, the Bank must employ lending and administrative standards that are acceptable to the marketplace.

7. We are, perforce, most careful in our lending. There are three major considerations involved in our approach to lending. First, since the borrower is also an owner of the Bank; will the loan contribute to

the true economic interests of the country. Second, will the borrower be able to repay the loan. Third, is the project sound and is it likely to be carried out properly.

8. Consequently, our first step in a country is to survey its economy and the magnitude and types of its resources. We assess fiscal policies and practices, the rate of savings, the tax system and overall capacity to earn foreign exchange to service external debt whether private or governmental. This latter point is of vital interest, as the Bank lends only foreign exchange and is repaid in kind.

9. Having sorted out these matters, we gain a good idea of how much we can reasonably lend in a particular country and of its broad development prospects. We are then faced with the question of how we can most effectively help in its development.

10. In the developing countries there usually is a very limited supply of internal and external capital for investment, and the skills needed to prepare and carry out development programs are equally in short supply. Yet there may be dozens of proposed development projects laying claim to a share of these slender resources.

11. It is in helping to decide which projects deserve immediate priority, which should be put off for a time, and which should be turned down completely, that the World Bank supplies large doses of technical assistance services to its member countries. In establishing priorities we often survey the various economic sectors of a country, such as electric power, transportation, industry and agriculture, and then try to arrive at some conclusions as to the order of priority of individual projects within the sectors.

12. These judgments are not easy to make, nor can we compartmentalize one sector, or the projects within it, from judgments affecting another sector. For example: the sector most deserving of development may be industry, but the key to its development may be increased sources of electric power; or development of an agricultural area may be pointless unless adequate roads are provided.

13. Most less developed countries lack the basic services essential to a modern economy and most private money is not available for them. As a result more than 70% of our loans have been made to assist electric power, transportation and communications projects. A further 25% is financing basic industry and agriculture; and the small amount remaining is divided among general development, water supply and education.

14. Our borrowers include governments, government agencies and private enterprises, with the last two having to obtain guarantees of the member governments concerned.

15. Frequently, we have found it impractical for us to lend to the ultimate users of the loan proceeds. The Bank is able to lend directly to industry and agriculture where the project is large and a management organization capable of handling the project is in existence. But the major part of industry and agriculture in the developing countries consists of a myriad of small businesses and land holders for whose development the Bank, located in Washington, could not possibly lend. Yet development of the small businesses and farms is essential and we have turned to industrial and agricultural credit institutions to act as intermediaries.

16. The Bank and its affiliated International Finance Corporation, for example, have helped to establish privately owned development finance companies in 21 countries -- with the Bank usually making loans to them in foreign exchange and the IFC supplying equity capital. The companies retail the proceeds of the Bank's loans to local entrepreneurs to enable them to import goods necessary for their development. These finance companies also invest funds in local currency. They act as bridges between local business and sources of financing and "knowhow" in the more developed countries. They become focal points for local capital formation and advise on managerial and technical problems. The Bank itself has lent about \$600 million to private development finance companies, which equals more than a third of our total lending for industry.

17. We have also been institution building in other fields than industry and agriculture. We have assisted, and sometimes insisted, on the establishment of autonomous authorities to act as responsible and continuing managers of public power and transportation projects. The Bank has found that the best power or transport project imaginable from a physical and engineering viewpoint, is not truly a project unless there is an efficient and stable organization responsible for preparing and supervising the project's construction and for administering it after completion. Where management is political and is changed every time the party in power changes, inefficiency is an almost certain result.

18. Having devoted all this energy to the "loan making process," we do not stop there, and over the years have developed a comprehensive procedure

of administration for our loans. Before we disburse loan proceeds, the borrower is usually required to contract for goods and services, to be financed by us, through international bidding by appropriate suppliers. Disbursements, for the most part, are made only after receipt of documentation attesting that the items to be paid for are those agreed in the loan contract and that prices are reasonable.

19. Also, the Bank receives periodic reports from borrowers and sends specialists to examine the progress on projects and review the accounts. The purpose is to insure that borrowers are abiding by the loan contracts and that the project is moving forward at a reasonable rate. Furthermore, if difficulties arise we are apprised of them at an early date and acting jointly with the borrowers can move quickly to overcome them.

20. Perhaps of particular interest to you is the fact that we require independent audits of all revenue-earning projects before we make a loan and annual audits thereafter. The borrower is responsible for selecting an auditor but the Bank satisfies itself that the auditor is qualified and is given the necessary authority.

21. Often we are asked; is all this care in making and administering loans worthwhile. The answer is "Yes." All our projects have been successfully completed or are well on the road to completion. The Bank has had no losses on loans and borrowers have paid to the Bank almost \$5 billion as interest and principal. Another proof is that the Bank has been able to sell more than \$2 billion of its loans to other investors, including the sale of nearly \$700 million to financial

institutions in the United States. I doubt that this record would have resulted without the careful preparation and supervision of loan projects.

22. Perhaps I might now say something about the impact of our loans. There are many facts available to measure the impact, such as the fact that in Latin America the World Bank has helped to finance a three-fold increase in power capacity over that existing in the region in 1948. Also, we have helped finance the construction of some 30,000 miles of highways in the region. However, to me, such facts are too large to be meaningful.

23. One example of the grass roots impact of development is what happened to The City of Carmen, a small gulf port in Mexico.

24. Carmen was a dull, sleepy town with little to offer in the way of life's amenities and few prospects for improving conditions in the future. It had no road or airport connecting it with the rest of Mexico and, except for two ancient shrimp fishing boats, industry was non-existent. Some enterprising citizens looked into the possibility of increasing the shrimp catch and exporting it, but the electric plant then in operation could at most supply power for ten tons of ice weekly. Obviously this plan was impossible under the circumstances.

25. Things in Carmen have changed. Now there is plenty of ice. More than 200 shrimp boats operate out of Carmen and thousands of tons of shrimp are exported annually. A new highway and street system have been built along with a new airport. There is a new town hall, two new hotels and two new movie houses. Retail stores and small businesses have blossomed, as well.

26. Behind these happy developments was the introduction of a new, and relatively small, diesel electric power plant -- which was financed by the Bank as part of a national electrification program in Mexico.

27. These impacts of development financing give us heart. When you see the vast multiplying effect of small investments such as this, the work seems more worthwhile. Perhaps of more importance is the new hospital, new school and new public library that also resulted.

28. Let me now turn to a problem common to most of us -- Money. We have had a great deal. We still have some. But we want more. If you don't have this problem, I would very much like a word with you later this evening.

29. The first source of funds for the Bank is its capital. 107 countries are the stockholders of the Bank and have subscribed to nearly \$23 billion of its capital stock. However, only 10% of this is paid in and available for operations. The remaining 90%, equal to more than \$20 billion is callable only to meet the Bank's obligations to its investors. Consequently, this huge sum -- including over \$5.7 billion of the U.S. subscription -- comprises a pool of inter-governmental credit that forms the credit base of the World Bank. It makes World Bank bonds the safest in the world and is the main reason why the Bank has been able to sell some 100 bond issues totaling almost \$6 billion. Such issues have been the largest single source of funds for the Bank.

30. The World Bank moved early to establish its obligations in the United States investment market and in other countries. Within two months after it had made its first loan and well before full disbursement of then available capital funds, the Bank entered the U.S. market with a \$250 million bond issue. The market in the U.S. is the largest supplier of borrowed funds to the Bank but, overall, we have raised substantially more funds from a variety of markets abroad than we have in this country.

31. From the beginning the Bank's management was aware that the Bank would be a continuing borrower of funds for relending internationally, and that it would have to establish a broad international market for its securities. At the time we were working on the sale of our first issue in the U.S., in 1947, we were planning for issues in other capital markets. Our campaigns to market the Bank's obligations in the U.S. and other countries fortunately have been successful and, aside from U.S. Government securities, our securities are the most widely held issues in the world.

32. Ownership of the Bank's bonds in the U.S. is largely in the hands on institutional investors such as pension funds, insurance companies, savings banks and other fiduciaries. The establishment of such a market, as I said earlier, has been due in large part to the security accorded our issues by the 90% uncalled capital. However, credit must also be given to the hard work both by our own people and the syndicates of investment banking firms that have been responsible for underwriting and distributing our issues. Also, I am sure that the reputation of the

Bank for following sound business practices has had much to do with winning it a triple A rating and in keeping the cost of its borrowings relatively low. We estimate that U.S. investors hold approximately 42% of the total of our outstanding funded debt.

33. The remaining 58% of our issues are held in some 60 countries and consist of U.S. dollar bonds and notes and of issues denominated in Belgian francs, Canadian dollars, Deutsche mark, Italian lire, Netherlands guilders, sterling and Swiss francs.

34. To give you some idea of the frequency and size of our marketing activities; since June 30 we have sold a 150 million dollar issue to the public in this country; in Sweden we similarly offered a 75 million kroner issue through a syndicate of leading Swedish banks; we placed a 100 million U.S. dollar issue entirely outside this country with central banks and governmental accounts in 43 countries. We sold notes totaling 16 million dollars and 64 million Deutsche marks to the central bank of Germany and this morning we sold 5 million of U.S. dollar notes to the central bank of Austria.

35. The third basic source of funds for the Bank is its profits. To date the net earnings of the Bank have totaled more than \$1.4 billion. Approximately \$300 million of this has been set aside in a special reserve which, like the uncalled capital of the Bank, can be used only if needed to meet the borrowing and guarantee obligations of the Bank. Also, \$210 million has been given to an affiliate of the Bank, the International Development Association. The balance amounting to some \$900 million has been retained in the Bank for use in its operations.

As I mentioned earlier, the net earnings of the Bank are now running at the rate of about \$170 million a year.

36. In addition to the three basic sources of funds, the Bank has also sold parts of its loans and has received principal repayments and has been able to reuse such funds in its operations. To date the Bank has sold some \$2 billion of its loans to investors. About 2/3 of these sales have taken place outside the United States and about 1/3 inside the United States. Finally, borrowers have made principal repayments amounting to about \$2.7 billion, of which approximately 1/2 has been passed on to investors who have purchased portions of Bank loans and the other \$1.3 billion has been retained by the Bank for relending.

37. There are many aspects of the Bank that, for lack of time, I have not tried to cover. Also, I have not covered the three other members of the World Bank family - namely, the International Development Association, the International Finance Corporation and the International Center for the Settlement of Investment Disputes. However, I would welcome any questions you might have concerning them. In any event, I hope in my description of the Bank I have left the impression with you, of an international institution that is performing professionally a useful and necessary function in spurring economic development in the free world. That it has been and is a sound business organization. However, most of all, I hope you feel that something has been and is being accomplished and that it is worth your while to assist the developing peoples of the world and that you will use your tremendous power and talents to this end.