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The World Bank and International Commercial Banks:

Partners for Development

Remarks by

A.W. Clausen

President, The World Bank

to the

International Monetary Conference

Vancouver, Canada

May 25, 1982

Thank you President Wauters, and Good Afternoon, Ladies and Gentlemen!

It is a great pleasure to attend this meeting and an honor to be the first President of The World Bank to address the International Monetary Conference.

These conferences have been distinguished, above all, by the vision and breadth of knowledge that has characterized the discussions. The themes of partnership and interdependence have repeatedly been at the center of our IMC meetings. Today, I want to build on these themes. I want to discuss the tightening interdependence between the developed and the developing nations.

And I want to focus especially on what I believe can be a new era of partnership between The World Bank and international commercial banks for helping the economies of the developing countries.

I intend to make four basic points. First, that the developing countries have generally been successful in coping with the difficulties of the global economy, at least until now. Second, that the international commercial banks and The World Bank have both been contributing to this dynamism. Third, that The World Bank's work truly supports and complements the work of the international commercial banks. And fourth, that The World Bank and the international commercial banks should cooperate and collaborate more closely.

In order to develop a closer partnership with you, we intend to expand the International Finance Corporation, to explore the possibility of a multilateral insurance scheme for private investment, and to develop new mechanisms for attracting commercial bank co-financing.

Our objective in taking these initiatives is not to help commercial banks make more money -- although we think they will. The fundamental objective of The World Bank is to help raise the standard of living of people, especially poor people, in the developing countries. And we are convinced that, at this juncture in history, people in developing countries will benefit from a closer partnership between The World Bank and international commercial banks.

Fortunately, the actions we can take together to benefit people in the developing countries stand to benefit the rest of the world, too. Prosperity in the developing countries means higher exports and value-for-money imports for the industrial countries -- more jobs and lower inflation. Prosperity in the developing countries also makes for more secure trade in crucial resources, and, in general, a stabler and less troubled world.

The joint action we are proposing today would help the developing countries cope with the current adversities of the global economy, and, at the same time, strengthen the international monetary system on which people in all parts of the world depend.

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The developing countries have, on the whole, been remarkably successful in dealing with the global economic difficulties of recent years.

Throughout the seventies, the developing economies (_excluding_ the capital-surplus oil-exporting countries) grew at an average rate of more than five percent per year -- about two-thirds faster than the average for the industrial economies.

Between 1960 and 1980, the developing countries, in aggregate, increased their share in global output by 21 percent. The industrial countries now sell a quarter of their exports to the developing countries, and the volume of these exports doubled in real terms over the 1970s.

The economic growth of the Third World has been uneven, however. The dynamism is concentrated at certain poles of development.

The OPEC countries and a group of about 20 newly industrializing countries -- countries like Korea, the Philippines, Mexico, and Brazil -- doubled their shares in global output from 1960 to 1980.

But other groups of developing countries have suffered slower progress or, in one case, economic retrogression.

Sub-Saharan Africa is the one region of the world where most countries suffered a fall in per capita income over the last decade. And without policy reforms by African governments and increased international assistance, the prospects for Sub-Saharan Africa in the eighties will be no better.

Poverty is also pervasive in the populous nations of South Asia, but their economic performance has been encouraging. In the early seventies, many of us were concerned that population growth was outstripping food production in these countries. But now population growth rates are declining in a number of countries, and food production is expanding more than 50 percent faster than population for the region as a whole. The challenges are still immense, but the South Asian countries have demonstrated promising economic vitality.

In summary, the economic performance of the developing countries has been varied but, in more places than not, it's been dynamic!

Just now, the economic resilience of the developing countries is being tested again -- perhaps as never before. Slow growth -- if not actually a recession -- in the global economy is costing them export revenues. The index of commodity prices fell last year to the lowest level in real terms since 1945.

Meanwhile, interest rates are still far too high by historical standards, and there has been some contraction of commercial bank lending to the developing countries. These factors are adding to their balance-of-payments disequilibrium and debt-servicing difficulties.

Government budgets are constrained in most countries, developed and developing. And the pressures for protectionism are rising. Increased trade restrictions would further retard world economic growth and, in the process, make debt servicing more difficult for many countries.

These current economic difficulties, together with the generally solid economic performance of the developing countries, provide the rationale and context of The World Bank's decision to strengthen its role as a catalyst for international investment.

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My second main point today is that international commercial banks and The World Bank have already both been contributing, in different ways, to the dynamism of the developing countries.

Over the last decade, the commercial banks expanded lending to the more prosperous developing countries dramatically. Your banks helped to cushion their adjustment to the vicissitudes of the global economy. Commercial banks are now very much the major suppliers of foreign capital to the developing countries.

Your banks have also been widening your relationships with the developing nations -- from balance-of-payments lending into local currency lending, local branches, and investment in domestic business.

This audience knows what the commercial banks have done in the developing countries better than anyone. After all, you are the ones who did it.

Today's high interest rates and recession -- on top of the adjustments many countries must still make to the energy price hikes of the seventies -- mean that commercial banks will almost certainly face strong demand for further lending to the developing countries in the coming years.

The World Bank has been a friend and banker to the developing countries for more than 35 years now, and we intend to keep adjusting our approaches to help them cope with current problems. We must maintain flexibility in these difficult times.

Allow me a few minutes to explain what The World Bank is and how it normally operates in the developing countries. Many of you are familiar with The World Bank, but my own understanding of its development role has certainly widened from the impression my reading of the press as a private commercial banker gave me.

The World Bank's formal name is International Bank for Reconstruction and Development (IBRD). It lends to developing countries for projects and programs which increase production, or which expand and improve the efficiency of public services like water supply and education.

IBRD brings together, in a unique way, the industrial and developing countries, and the public and private sectors. The Bank is owned by 142 member governments, with the largest shareholders being the largest industrial nations. IBRD raises the bulk of its funds by selling bonds.

Its lending rates are high enough so that IBRD makes a modest profit each year. Notwithstanding the fact that the Bank does not reschedule its loans -- as a matter of firm and unexcepted policy -- no borrowing country has ever defaulted on a World Bank loan. By its basic articles of agreement, IBRD is not allowed to lend more than the equivalent of its subscribed capital and reserves -- a ratio of just one-to-one.

The World Bank has an affiliate that lends to the very poorest of the developing nations. This affiliate is called the International Development Association and is known by the acronym I-D-A or "Ida". It lends to nations which cannot, even with appropriate economic policies, afford to borrow on IBRD terms and are thus not creditworthy for IBRD lending.

The World Bank also has a second affiliate -- the International Finance Corporation (or IFC). IFC's purpose is to encourage productive private enterprises in developing nations. IFC is different from the Bank and IDA in two main ways: its loans do not have to be guaranteed by governments, and it can also take equity positions in corporations. IFC frequently supplements its resources by encouraging "parallel financing," principally by selling participations in its investments to commercial financial institutions.

The bulk of our work at The World Bank consists of two types of activities: project lending and policy dialogue with borrowing governments.

The Bank develops projects in nearly all sectors, according to the varied and changing needs of our borrowing countries. Together with IDA, The World Bank will lend a total of $13 billion to developing countries in our current fiscal year.

The World Bank continues to give high priority to projects that benefit the poor. Mainly because most of the world's poor live in rural areas, a high proportion of our lending is for agriculture and rural development. And energy lending is now another high-priority area. Energy and agriculture together represent over half of the Bank's and IDA's lending.

The World Bank's work is not measured in terms of loan volume alone, however. We also devote substantial efforts to economic analysis in order to advise governments on development issues.

In recent years, this policy work has become more important than ever. Many developing countries need to undertake basic shifts in their economic policies to adjust to changes in the global economy.

The buffeting that they are currently suffering makes such shifts even more urgent. And we are increasing the number of economists we employ in country economic work, so that we can give borrowing countries the best possible advice at this crucial time.

Most of the credit for the economic dynamism which the developing countries have maintained should go to the people who live and work there. But international commercial banks and The World Bank have both been providing essential assistance.

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The third main point I want to make today is that The World Bank's work supports and complements the activities of the international commercial banks in the developing countries.

At the global level, The World Bank (together with the International Monetary Fund and GATT) has helped to build an interdependent global economy. About a quarter of everything produced in the world is now traded internationally.

The Fund, GATT, and the Bank have served to encourage orderly monetary change, to reduce trade barriers, and to develop the weaker parts of the global economy. International commercial banking depends on the relatively integrated, dynamic, and peaceful world economy that these official institutions have nurtured.

At the level of particular developing countries, The World Bank's project lending is a strong complement to the lending which commercial banks do. The World Bank's loans are long-term, and thus add stability and balance to a country's debt structure. Even more important, The World Bank's projects involve it in all sorts of issues and activities in which commercial banks seldom get involved, but which are crucial to a country's overall economic development. And few commercial banks ever engage in policy dialogue like The World Bank routinely maintains with borrowing governments.

For the last few years, we have been supporting this economic policy dialogue with what we call "structural adjustment loans." These loans, unlike the bulk of our lending, do not finance specific projects. Rather, they are disbursed as the country makes necessary structural adjustments that will reduce balance-of-payments deficits over the medium-term.

We are working very closely with the International Monetary Fund in this area. The Bank's structural adjustment loans complement the work of the Fund, in that the Bank's focus is on fundamental changes to prevent the recurrence of crises in the longer-term future.

Each structural adjustment loan is specifically tailored to the specific problems of a specific borrowing country. We understand that basic economic adjustments cannot be accomplished in one pass. We monitor progress and are willing to consider a limited series of follow-up structural adjustment loans to support what must be an ongoing process.

The international commercial banks have become the major suppliers of funds from abroad for the developing countries. And The World Bank's bread-and-butter tasks -- project lending and policy dialogue -- lead to precisely the sort of changes and long-term stability which the developing countries need to attract commercial bank investment.

This complementary relationship between The World Bank and commercial banks is a fact of global economic life.

Before I go on, allow me to add that IDA assistance to low-income countries is also in the interest of commercial banking.

Clearly, the benefits to commercial banking are not immediate, as they are in the case of our work in the middle-income countries where international commercial banks are also actively involved.

But IDA helps to keep lines open to half the world's population which is otherwise excluded from the international banking system. These poor countries have suffered most from the economic adversities of the last decade, and they have not been able to resort to commercial borrowing to give themselves time to adjust.

There is good evidence that IDA works! You can look at the record of 24 countries which used to be ineligible to borrow from the International Bank for Reconstruction and Development (IBRD) and were thus confined to receive credits only from IDA. These countries have now been "graduated" to The World Bank's normal programs. Some IDA graduates are now able to borrow from international commercial banks, too. IDA's first graduates included countries like South Korea and Chile, and they have recently been joined by countries like Indonesia, Honduras, and Egypt.

Or, look at what IDA is doing today in particular countries. IDA develops high pay-off projects in poor countries and allows the Bank to maintain a serious dialogue with these countries on economic policy.

It is necessary for me to mention IDA in particular, because just now -- when it is needed more than ever before -- IDA faces its most serious crisis since it was established over 20 years ago in 1960. In spite of efforts by the U.S. administration, the United States government has failed to meet its negotiated commitments to IDA, and many other donor countries decided this year to respond to the U.S. by cutting their own contributions proportionately. As a result, we have had to slash our planned fiscal year 1982 IDA program by nearly 40 percent. But we are glad to see that in recent weeks a number of governments are taking steps to salvage part of what has been cut.

Over the long-term, maintaining the effectiveness of IDA promises to be a solid investment. The returns will go, in the first instance, to the 2.2 billion people in the IDA countries. But, in the end, people everywhere will benefit by the integration of these countries as productive contributors to the global economy.

IDA is not, of course, the kind of investment which a commercial bank would be able to make. But it is an investment which bankers will recognize as prudent.

IDA is another way through which The World Bank complements and, in the long run, strengthens the commercial banking system.

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My fourth main point today is that we should now develop the complementarity between The World Bank and international commercial banks into a closer relationship of collaboration.

Current budget problems in many industrial nations make it unrealistic to assume that there will be a significant real increase of official development assistance in the next few years. Yet the needs of the developing countries for investment capital from abroad are greater than ever.

Fortunately, over the last generation, many of the developing countries have achieved resilient patterns of rapid economic growth. Some of their governments are solid credit risks, and nearly all of these countries are replete with attractive investment opportunities. The private sector, with the commercial banks at the fore, has the capacity to increase its level of investment in the developing nations.

Thus, we intend to strengthen The World Bank's traditional role as a catalyst for commercial international investment.

Let me be specific.

First, we can do more through IFC, the International Finance Corporation, the World Bank affiliate which I mentioned earlier. IFC has great potential for stimulating commercial investment in the developing countries, and we will make every effort to enlarge the scale of its operations in the next few years. To accomplish this, we need greater collaboration between IFC and commercial banks.

IFC offers profit-making ventures in private enterprises. Each venture is well-researched, and the risks are carefully calculated. IFC projects provide commercial banks with sound opportunities to diversify their foreign lending.

In the 25 years since IFC was created, its Board of Directors has approved nearly 600 projects in some 80 nations. These projects have established or expanded about 450 businesses and financial institutions. They involved \$2.5 billion of IFC funds and an additional \$1.6 billion of funds raised through IFC syndication.

IFC also helps to foster capital markets in developing countries. We want to help developing nations upgrade their expertise in international finance. And we are ready to exchange views with their central banks regarding global market conditions.

IFC is set for expansion. This will take place not only in the more advanced developing nations, but also in some of the poorest nations -- where private enterprise also has a major role to play. IFC is determined to expand its work in Sub-Saharan Africa, for example. Last year it invested about $100 million in countries such as Burundi, Somalia, Congo, and Zimbabwe. And this $100 million helped to mobilize another $600 million for these countries from IFC's investment partners.

A second way in which The World Bank might help to mobilize commercial investment in developing countries (in addition to expanding the International Finance Corporation) might be through promotion of a multilateral insurance scheme for private investment. We will present some options regarding this possibility to our Board of Executive Directors within the next few months.

A multilateral insurance agency would complement the various national schemes in the industrial countries which already support foreign trade and investment. One could envisage these national schemes working directly with the multilateral agency and private insurers.

Finally, a third way in which we hope to attract more commercial funds to the developing countries is through co-financing.

Commercial bank co-financing of World Bank projects has already increased from roughly \$200 million a year in the mid-seventies to about \$1.7 billion a year in the early eighties. Co-financing in our current fiscal year will exceed two billion dollars.

Yet commercial bank co-financing with The World Bank still amounts to only one percent of all commercial bank lending to the developing nations. There is surely scope for expansion.

The main attraction of co-financing with The World Bank is its unique expertise in project lending. The World Bank has a proven track record of developing attractive investment opportunities in many different sectors throughout the world and then ensuring that these projects are well-managed.

All World Bank projects are required to show an estimated economic rate of return of at least 10 percent in real terms, and most of our projects yield much higher returns to the countries in which they are situated.

Commercial banks are not equipped to develop and supervise projects around the world in the way that The World Bank does. Through co-financing, commercial banks can take advantage of a capability which The World Bank has built up over the last 35 years.

Because World Bank participation means added security, some commercial banks are placing loans co-financed with The World Bank in a special category when they set their country lending limits. Amsterdam-Rotterdam Bank is one prominent example.

We are hopeful that co-financing with us will also be viewed in a special way by bank supervisory authorities -- based on The World Bank's close relationship with borrowing nations, on its analysis of creditworthiness, and on the thoroughness of its project work. The Bank of England, for instance, has indicated that its assessment of a bank's risks in lending to foreign countries would be favorably influenced by loans co-financed with The World Bank. And the U.S. Treasury has asked the Comptroller of the Currency to reexamine, for the case of loans co-financed with multilateral development banks, the present interpretation of the ten percent legal limitation on lending to one borrower.

In order to get more co-financing underway, we have first listened carefully to the views of many international bankers about how we could and should modify our approaches in order to attract more co-financing. We are evaluating a broad array of new co-financing techniques and will be asking our Board of Executive Directors for approval of some of these within the next few weeks.

Different nations and different banks may have different requirements, so we are developing a range of co-financing instruments. At one end of the spectrum, a borrower may wish to keep the association between The World Bank and commercial banks loose, but coordinate the use of market borrowings with a World Bank project.

At the other end of the spectrum, The World Bank might find it appropriate to participate in a commercial bank syndication, providing the borrower with longer maturities and grace periods than it could otherwise obtain. This type of arrangement would also allow the terms of loans to be more closely tailored to the payback periods of different parts of a project, for the convenience of the borrower and to provide additional security to co-lenders.

There are various ways in which The World Bank's participation in syndicated project loans could be structured. The World Bank might fund the later maturities on loans or, alternatively, guarantee or accept the contingent financing obligations for them.

Co-financing offers The World Bank an opportunity to leverage its capital and professional expertise and attract needed additional funds to its borrowing countries. Participating banks would benefit by the new types of foreign assets which our presence in syndications would create. And borrowers would obtain more financing and terms better suited to the payback periods of their projects.

An expansion of IFC, multilateral insurance for private investors, and co-financing -- these are the specific ideas we have in mind. But these new initiatives cannot be successful without the collaboration of the international commercial banking community.

If you agree that direct collaboration with The World Bank is an interesting prospect for your banks, please lend your good counsel -- and then some of your money -- to convert these ideas into realities.

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The World Bank is first and foremost a development agency. Its mission -- its mandate, if you will -- is clear: to do all it can to assist poor nations to better manage their economies through the establishment of economic policies which are conducive to economic growth and development . . . thereby bringing them fully into the global economy.

Clearly, there is an urgent need for a greater flow of investment to the developing countries. The international commercial banks, the developing countries, and The World Bank, all acting in their own vested interests, should strive to find new ways to cooperate and work together in partnership . . . thereby strengthening the international monetary system . . . and thus securing a more stable and prosperous world for the benefit of all.

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