Children work in their classroom in El Renacimiento school, in Villa Nueva, Guatemala. Photo © Maria Fleischmann / World Bank

CHAPTER 3

The World Bank in Expansion Mode

The World Bank dramatically accelerated its activities and global presence under President Robert McNamara, who was appointed in 1968.

The focus shifted from building infrastructure to alleviating poverty. McNamara set out his philosophy and goals in a remarkable address to the Board of Governors in Nairobi on September 24, 1973.[15] He reported that the World Bank had doubled its operations and nearly quadrupled net borrowing from 1969 to 1973 as compared with the previous five-year period.

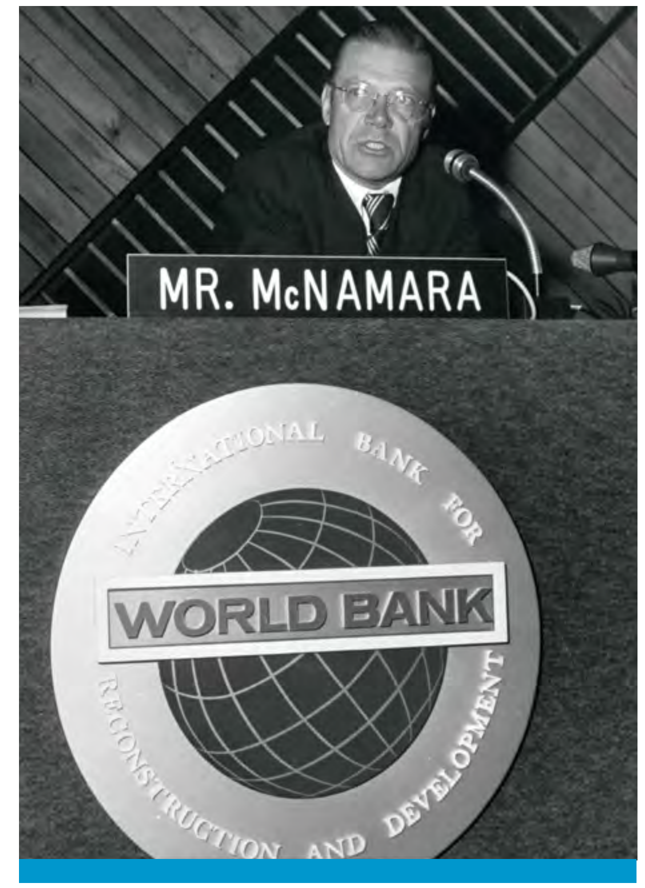
He posited that the fundamental case for development assistance was a moral one. "The whole of human history has recognized the principle—at least in the abstract—that the rich and the powerful have a moral obligation to assist the poor and the weak," he said. The World Bank's objective was nothing less than to end poverty McNamara said.[16]

The ambitious goal of tackling poverty and inequality head-on required a different order of investment and thus a rethink of the ways in which money could be raised. Eugene Rotberg, who became the World Bank's longest-serving Treasurer from 1968 to 1987, was the man for the job. As the World Bank's President ramped up loans, the Treasurer plunged into more innovative ways to raise money. To some

A Cambodian farmer Men Leng, 40, gets her first harvest in Prey Thom village, Reaksmei Sameakki Commune, Aoral district in Kampong Speu Province. Leng is one of 400 landless and land-poor families who received a social land concession from the government under the associated LASED project, funded by JSDF through the World Bank and implemented by Life with Dignity (LWD). Photo © Chor Sokunthea / World Bank

"In my view, the fundamental case for development assistance is the moral one. The whole of human history has recognized the principle—at least in the abstract—that the rich and the powerful have a moral obligation to assist the poor and the weak."

Robert McNamara, World Bank President, 1968–1981



World Bank meeting in Nairobi, Kenya, 1973, Robert McNamara World Bank President. Photo © Camerapix, Keystone Pictures USA / ZUMAPRESS.com / Alamy Live News

Robert McNamara
World Bank President
1968–1981
Photo © World Bank Archives

Robert Cavanaugh
World Bank Treasurer
1959–1968
Photo © World Bank Archives

Eugene Rotberg
World Bank Treasurer
1968–1987
Photo © World Bank Archives

extent, McNamara and Rotberg were building on the unrealized ambition of the previous President, George D. Woods, to make the World Bank more responsive to the needs of developing countries, especially in view of the large number of African nations joining the World Bank during the first half of the 1960s. The new leadership changed the look and feel of the institution as they steered more loans toward what Rotberg called "non-cash flow generating projects" in areas such as health and education.

The previous Treasurer, Robert Cavanaugh, believed that this approach would be resisted by bond-holders who would not "feel that this is a field in which we could prudently hope to lend and get the money back and, thus, be able to repay our bonds."[17] Rotberg noted, however, that "over time, the financial community came to accept the fact that lending to governments not supported by cash flow was okay, if it contributed to growth. They came to understand why we shifted to education, population, health, and later (as I believe these were precursors) to structural lending."[18]

Rotberg's energetic pursuit of ever-more sophisticated transactions heralded a revolution in development finance with innovations such as derivatives. Eventually, he was not only managing and investing over $20 billion in liquid assets in 20 different currencies, but also increased borrowing from $500 million to $10 billion a year. The amount of International Bank for Reconstruction and Development bonds outstanding increased by nearly 590%, from $3.29 billion at the end of 1968 to $22.6 billion at the end of 1978.

Rotberg was happy to shake things up. "There are traditional ways to borrow and there are untraditional ways to borrow. If you borrow in untraditional ways, you may end up upsetting people who you've grown up with, and people don't do things like that. I didn't have that problem. I eagerly sought out new sources of funds,"[19] he said.

"The more sources I could borrow from, the fewer problems there were. The idea was to always borrow when we did not need to, from people who had the money to lend," he said. In Germany, for example, the World Bank tapped into cooperative savings banks. "Traditionally, these institutions bought German government bonds, but we went to them directly and basically asked to borrow their excess savings. We offered them ten basis points more than government bonds. "Overnight we opened a brand-new market,"[20] Rotberg stated further.

"In Japan, we went to trust banks; then we went to insurance companies; then we went to what are called the regional banks; then we went to securities firms; then we went to the Bank of Japan," he said. "In other words, we looked for pools of accumulated wealth and tried to connect them with the World Bank. I didn't use traditional vehicles to approach them. We opened up ten discrete pockets of wealth in Germany, Switzerland, and Japan. That created an environment where they began to compete with each other."[21]

But never did the World Bank engage in any financial transaction with a country's private sector without fully briefing the finance ministry or the central bank first. "You could not go into Switzerland or Germany and say, 'I have an interesting new product here,' if that product was something which was anathema to government policy. For example, in Germany they never liked floating rate instruments, because they believed that weakened the nation's commitment to control inflation"[22] explained Rotberg.

"It's crucial to link development to capital markets because only capital markets can provide the volumes of funds that are needed in order to have an impact on development."

Jessica Einhorn, World Bank Treasurer, 1992–1995

The safety and liquidity in World Bank bonds also caught the attention of the official sector. The share of the World Bank's debt placed with central banks and other official institutions reached a peak in the mid-1970s, representing 80 percent of the total funding program in financial year 1974 and 76 percent in 1975. While the Bundesbank and the Bank of Japan remained the largest lenders to the World Bank in those years, the World Bank also borrowed from the governments of Abu Dhabi, Iran, Libya, Nigeria, Oman, Saudi Arabia, and Venezuela, tapping into the high reserve levels of these petroleum exporting countries.

Japan's Rise

The World Bank's relationship with Japan, which went rapidly from being a borrower to a critical source of funds largely because of its booming exports, reflected the country's remarkable economic recovery following its defeat in World War II. Between 1953 and 1966, the World Bank made 31 loans to Japan totaling $863 million. These loans funded important economic development projects across the country, among other things helping to rebuild Japan's electrical power capacity and develop its transportation network, including construction of the Meishin and Tomei expressways and the first bullet train (shinkansen) line.

The World Bank's final loan to Japan was signed in 1966, and by early 1970, the direction of the flow of capital between the Bank and Japan was reversed when the World Bank borrowed 72 billion Japanese yen (the equivalent of $200 million) from the Bank of Japan in two tranches. In making the deal, the Japanese central bank noted the World Bank's huge contribution to the development of the Japanese economy and expressed a desire to "help the World Bank's activities and thereby strengthen international monetary cooperation."[23]

Samurai Bond. Photo © World Bank Archives

The following year, the World Bank issued its first public bond to Japanese investors, an 11 billion Japanese yen (then equivalent to approximately $30 million) 10-year issue that paid a 7 ¾ percent coupon. The issue was managed by Nomura Securities, and the Industrial Bank of Japan (a predecessor of Mizuho) acted as the agent bank (commissioned company). That bond was one of the first "Samurai bonds" ever issued (a Japanese yen–denominated bond issued in the domestic Japanese market by a foreign issuer). The World Bank's inaugural Samurai bond helped to develop this new market and paved the way for the first sovereign Samurai bond (by Australia in 1979) and eventually the first corporate Samurai bond (by Sears in 1979). The World Bank would continue to be an active issuer of Samurai bonds for the rest of the 1970s and the first half of the 1980s (and still occasionally issues in that format on investor request).

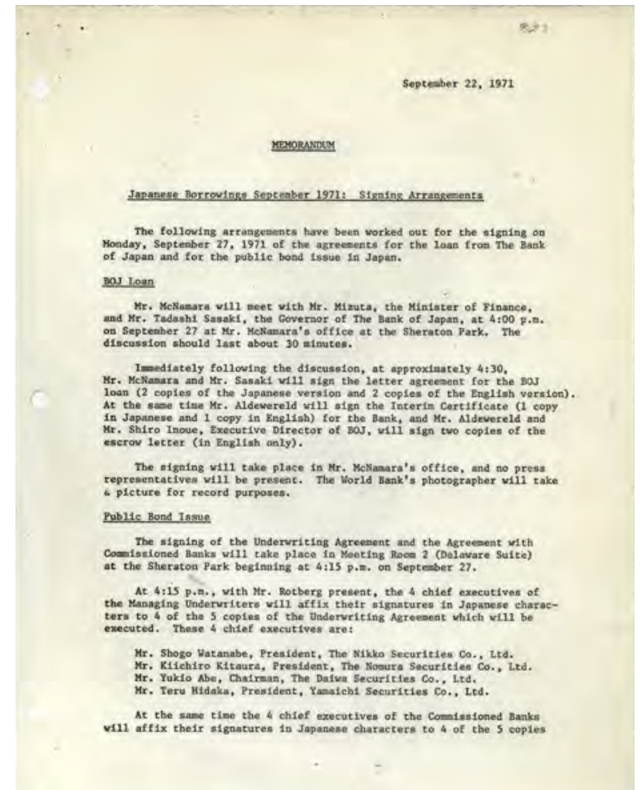
During the same period, the World Bank also regularly borrowed from Japanese commercial and trust banks in syndicated loan form. Syndicated loans were preferred by Japanese banks, because at that time they were prohibited from dealing in securities.

By the end of 1971, Japanese investors held 8 percent of the World Bank's outstanding debt (led by the Bank of Japan), while investors in the United States held 38 percent and those in Germany 27 percent. Japan was already a net creditor of the World Bank, with the amount of outstanding World Bank debt held by Japanese institutions and individuals exceeding the outstanding balance of World Bank loans to the country.

In 1985, following moves by the Japanese government to liberalize its capital markets and internationalize the Japanese yen, the World Bank issued its first "Shogun bond" (a foreign currency–denominated bond issued in the domestic Japanese market), a $300 million 10½ percent ten-year issue. The transaction was lead managed by Nomura Securities, with Daiwa Securities acting as co-lead manager. This marked the beginning of the practice by World Bank Treasury of providing investment products denominated in a foreign currency to Japanese investors, which continues today.

In 1987, the World Bank further built on its history of innovations for the Japanese market when it issued its first "Daimyo bond" (a yen-denominated bond that settles in a European clearing system) lead managed by Daiwa Securities. Five years after that, the World Bank issued the world's first Japanese yen-denominated global bond. "Japanese institutions learned a lot from the global approach of the World Bank," said Hiroyuki Tanaka, a Senior Financial Officer at World Bank Treasury in Tokyo during the 1990s. "So, the relationship with the World Bank was very important for them."[24]

Former World Bank Treasurer Jessica Einhorn explained the importance of the Japanese relationship



September 22, 1971

MEMORANDUM

Japanese Borrowings September 1971: Signing Arrangements

The following arrangements have been worked out for the signing on Monday, September 27, 1971 of the agreements for the loan from The Bank of Japan and for the public bond issue in Japan.

BOJ Loan

Mr. McNamara will meet with Mr. Mizuta, the Minister of Finance, and Mr. Tadashi Sasaki, the Governor of The Bank of Japan, at 4:00 p.m. on September 27 at Mr. McNamara's office at the Sheraton Park. The discussion should last about 30 minutes.

Immediately following the discussion, at approximately 4:30, Mr. McNamara and Mr. Sasaki will sign the letter agreement for the BOJ loan (2 copies of the Japanese version and 2 copies of the English version). At the same time Mr. Aldewereld will sign the Interim Certificate (1 copy in Japanese and 1 copy in English) for the Bank, and Mr. Aldewereld and Mr. Shiro Inoue, Executive Director of BOJ, will sign two copies of the escrow letter (in English only).

The signing will take place in Mr. McNamara's office, and no press representatives will be present. The World Bank's photographer will take a picture for record purposes.

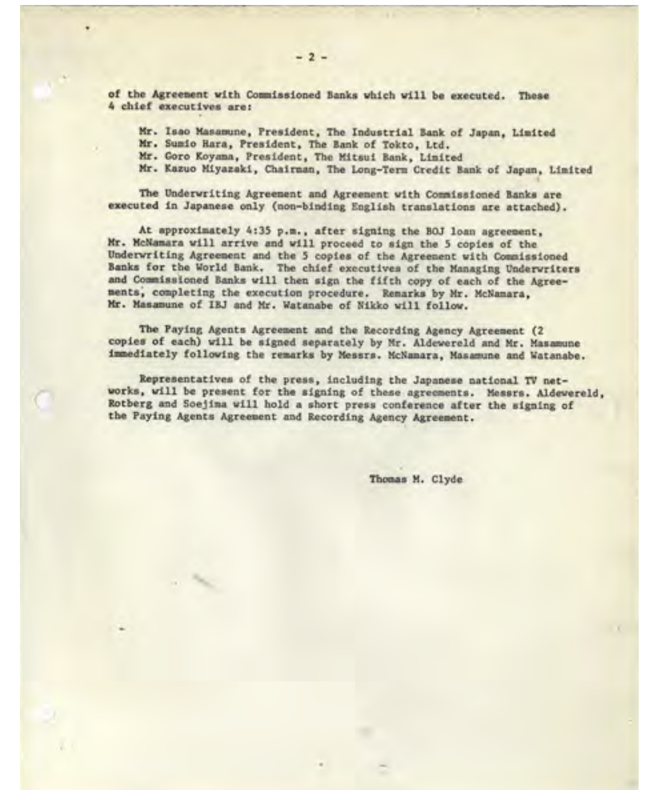
Public Bond Issue

The signing of the Underwriting Agreement and the Agreement with Commissioned Banks will take place in Meeting Room 2 (Delaware Suite) at the Sheraton Park beginning at 4:15 p.m. on September 27.

At 4:15 p.m., with Mr. Rotberg present, the 4 chief executives of the Managing Underwriters will affix their signatures in Japanese characters to 4 of the 5 copies of the Underwriting Agreement which will be executed. These 4 chief executives are:

Mr. Shogo Watanabe, President, The Nikko Securities Co., Ltd.
Mr. Kiichiro Kitaura, President, The Nomura Securities Co., Ltd.
Mr. Yukio Abe, Chairman, The Daiwa Securities Co., Ltd.
Mr. Teru Hidaka, President, Yamaichi Securities Co., Ltd.

At the same time the 4 chief executives of the Commissioned Banks will affix their signatures in Japanese characters to 4 of the 5 copies



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of the Agreement with Commissioned Banks which will be executed. These 4 chief executives are:

Mr. Isao Masamune, President, The Industrial Bank of Japan, Limited
Mr. Sumio Hara, President, The Bank of Tokto, Ltd.
Mr. Goro Koyama, President, The Mitsui Bank, Limited
Mr. Kazuo Miyazaki, Chairman, The Long-Term Credit Bank of Japan, Limited

The Underwriting Agreement and Agreement with Commissioned Banks are executed in Japanese only (non-binding English translations are attached).

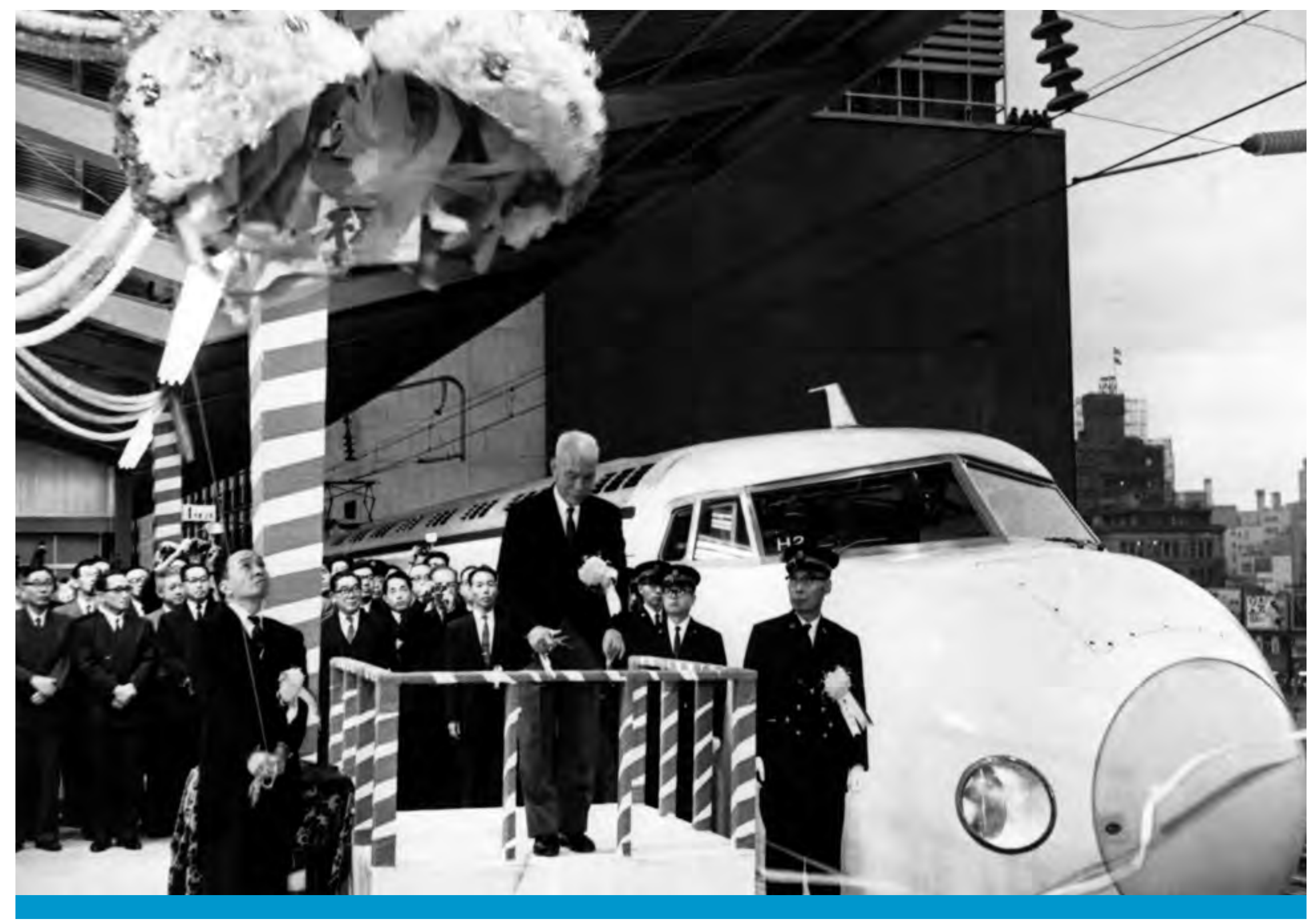
At approximately 4:35 p.m., after signing the BOJ loan agreement, Mr. McNamara will arrive and will proceed to sign the 5 copies of the Underwriting Agreement and the 5 copies of the Agreement with Commissioned Banks for the World Bank. The chief executives of the Managing Underwriters and Commissioned Banks will then sign the fifth copy of each of the Agreements, completing the execution procedure. Remarks by Mr. McNamara, Mr. Masamune of IBJ and Mr. Watanabe of Nikko will follow.

The Paying Agents Agreement and the Recording Agency Agreement (2 copies of each) will be signed separately by Mr. Aldewereld and Mr. Masamune immediately following the remarks by Messrs. McNamara, Masamune and Watanabe.

Representatives of the press, including the Japanese national TV networks, will be present for the signing of these agreements. Messrs. Aldewereld, Rotberg and Soejima will hold a short press conference after the signing of the Paying Agents Agreement and Recording Agency Agreement.

Thomas M. Clyde

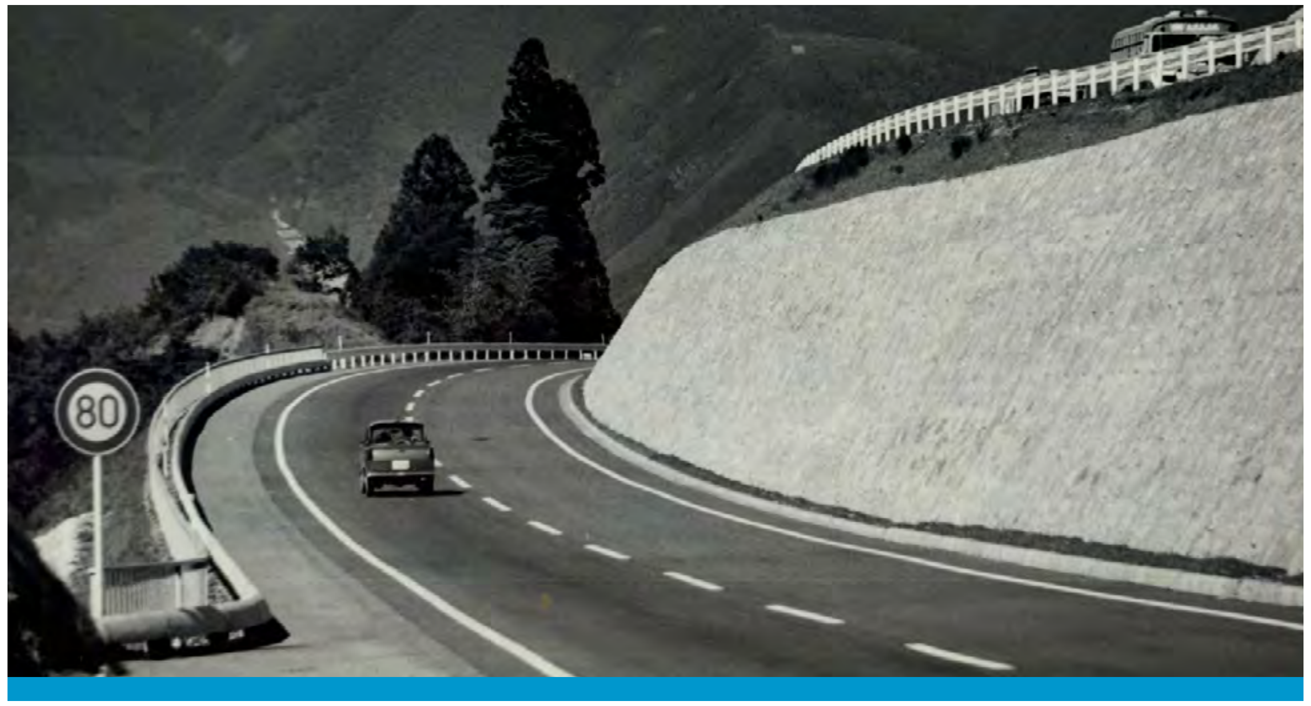
Japanese Borrowings September 1971: Signing Agreements. Photo © World Bank Archives



A World Bank loan of $80 million in 1961 helped finance the new Tokaido Shinkansen (bullet train line) in Japan. Photo © World Bank Group

"IBRD has been instrumental in facilitating and expanding the Uridashi market since its inception in the early 1990s. IBRD's exceptional credit and name recognition helped broaden the product's appeal to the retail investor. IBRD was one of the first in the structured Uridashi note market in the 1990s with their dual currency offerings, and as a result, MUFG sought IBRD's help to meet investor needs via new yield enhanced structured Uridashi products."

William Mansfield, President and CEO, MUFG Securities Americas Inc.



A view of the expressway between Kyoto and Hikono, part of the Tokyo-Kobe Expressway. The World Bank made several loans to the Nihon Doro Kodan (Japan Highway Public Corporation) to help finance the construction of the 335-mile toll express highway between Tokyo and Kobe. Photo © United Nations / World Bank Archives

at that time for the World Bank: "It is not that the Japanese invested in our bonds—we had investors all over the world—it was that the Japanese gave us so much access to their capital market, preferential access, until capital markets really opened."

Over the past two decades, the World Bank has been one of the largest issuers of Uridashi bonds (bonds issued overseas and sold to Japanese retail investors). Because of the extraordinarily low Japanese yen interest rates during this period, Japanese investors were attracted to Uridashi bonds denominated in higher-yielding currencies. The currencies that have been popular with Uridashi investors have fluctuated over time and have included (among others) U.S. dollars, Australian dollars, New Zealand dollars, South African rands, and Brazilian real.

The World Bank has also been an active issuer of structured notes in Japan. These structures have permitted Japanese investors to take views on a variety of economic variables, such as equity index levels, foreign exchange and interest rates, and the slope of the yield curve. Moreover, Japan has been a very active market for the World Bank's sustainable development product innovations, such as the creation of the World Supporter Fund and carbon emission reduction linked bonds (described in Chapter 7). "The Japanese structured note market has been an important source of funding for the World Bank for decades and has also been the launching pad for some of our most innovative structures—from carbon emission rights linked bonds to dual currency structures to equity linked notes," said Michael Bennett, Head of Derivatives and Structured Finance in the World Bank Treasury.

In addition to becoming an important market for World Bank bonds over the past five decades, Japan also became the World Bank's fifth-largest shareholder in 1970 and its second largest in 1984 (a position it retains today) as well as one of the largest contributors to International Development Association. Japan therefore, has a truly special place in the history of mobilizing resources for the World Bank. Andrea Dore, Treasury's Head of Funding, noted, "Japan is a very important market for the World Bank bonds. From Hokkaido in the north to Okinawa in the south, one can find investors—institutional and retail—who support the World Bank's mission and recognize the high quality and safety of World Bank bonds through their investments."

Treating People Right

Eugene Rotberg, World Bank Treasurer from 1968 to 1987, explains the World Bank's approach to markets in the expansionist 1970s which is still valid today:

"Identifying sources to borrow from isn't that difficult. It's how you treat the people who are lending you the money that's difficult. The World Bank had the reputation of not bullying people, not driving a transaction down to the last penny so that the firm involved would lose money. We didn't threaten to cut off our relationship with them if they didn't do things our way."

"We didn't try to squeeze every last penny out of every transaction for several reasons: 1) because sooner or later someone else will be as strong as the World Bank; 2) the World Bank may lose favor because of something that happened at the World Bank—the President may change; 3) markets could change, savings could disappear; and 4) the World Bank can't raise ten, twelve billion dollars a year if people are always losing money when they deal with us, whether they are customers or intermediaries."

"In other words, we understood that there was going to be some tough times ahead, and we wanted to create an environment where any money in the world seeking a haven could come to the World Bank. Creating that environment is difficult when you hire too aggressive financial people. I like to have people who have studied History, English, and Physics; people who understand there's a complicated, vulnerable world out there."

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

Transcript, interview with Eugene Rotberg on April 22, 1994 for the WBG History Program archived by the WBG Historian's Office, Page 25. Online.

"Over the years, the professionalism and utmost dedication of the World Bank Treasury team has allowed us to collaborate on innovative funding and hedging solutions that have supported IBRD in obtaining efficient funding and effective balance sheet management."

François Pérol, former Chief Executive Officer, Groupe BPCE