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CARLSON

Address, April 1, Southern Methodist Univ Conf.
Speeches - 1958
(also in Articles)

From Economic Development and International Trade - A Perspective
Edited by Paul D. Zook
Published by Southern Methodist University Press 1959

ROLE OF THE WORLD BANK IN LATIN AMERICA

by Reynold E. Carlson

The International Bank for Reconstruction and Development (World Bank) is primarily a lending institution making long-term loans for electric power, transportation, and heavy industry designed to further economic development. But to look at the World Bank purely as a lending agency would be to overlook the most important elements which it has come to represent over the last twelve years. The conditions under which loans are made are, in the long run, probably more influential than the actual capital provided.

As of December 31, 1957, total Bank loans authorized were $3,394 million, representing 189 loans to 46 countries. Of this total $497 million represented postwar reconstruction loans and the remainder, $2,897 million, consists of loans for specific development projects. The total investment in Latin America amounted to $720 million, or approximately 25 per cent of total development loans.

The loans to Latin America were principally for power (46 per cent), transportation, both railroads and highways (36 per cent), agriculture, including irrigation and mechanization (8 per cent), industry, including mining and basic industry (6 per cent), and finally communications (4 per cent). Power and transportation thus account for 82 per cent of the $720 million loaned to Latin America. This reflects the Bank's basic policy to invest in the infrastructure where capital is not apt to be forthcoming from private sources. But since power and transportation are the keys to economic development in any country, these sectors, once unlocked, will be able to accommodate large private investments in agriculture and industry. The loans for power have added 2.5 million kw to a previous capacity of 3.9 million kw in eight countries, an increase of 63 per cent. Investment in transportation is rather evenly split between railroads and highways.

In its role as a supplier of capital the Bank mobilizes capital funds in various markets of the world, which it then channels to countries and to projects within countries. Loans are made up of capital drawn from many different markets, in part by sale of Bank bonds, in part by utilization of the original Bank capital, and in part by promoting the participation of commercial banks and other financial institutions in specific loans. An analysis of the sources of funds is not available for Latin America alone, but for total Bank operations around the world, the breakdown is approximately as follows:

Original capital (paid in)	$1,320 million	39%
Bond sales	1,269 "	38%
Participations	368 "	11%
Operations (past earnings)	215 "	6%
Repayments of Principal	203 "	6%
	$3,375 million	100%

It should be noted that while the Bank has a total capital subscription of $9,333 million, 80 per cent of this is not available for lending and is subject to call only to meet obligations of the Bank. The portion of total capital available for lending includes 2 per cent of a country's subscription, paid in gold or U.S. dollars at the time of joining, and another fraction, equal to 18 per cent of the country's subscription, paid in its own currency. While the aggregate of this 18 per cent fraction is $1,680 million equivalent, only $1,136 million equivalent has been released by the individual countries, and then sometimes under restrictive conditions.

It is interesting to note that the total contribution of the U.S. government derived from taxpayers' money is $635 million, which includes the initial 2 per cent plus the 18 per cent portion of the U.S. subscription. This share represents 19 per cent of total funds available for lending, and this fraction will continue to decline as Bank operations expand with funds drawn from other sources, such as bond sales. Since most of the original capital available for Bank lending ($1,320 million) has now been committed, it is evident that the rate and scale of further lending will depend upon the Bank's ability to place its bonds in the private capital markets of the world.

The second principal source of loanable funds is the proceeds which the Bank receives from selling its bonds in various markets. As noted above, this amounted to $1,269 million, or an amount already equal to the paid-in capital subscription. The bulk of these bonds, amounting to $1,069 million or 84 per cent of the total, is in U.S. dollars and represents the proceeds of fourteen separate dollar issues sold between 1947 and 1957. Although these are dollar bonds, 47 per cent were purchased and are now held by investors outside the United States. Many of these bonds are 20-25 years maturity, which is compatible with the fact that 35 per cent of total Bank loans to borrowing countries are for terms of 20-25 years. In addition to the U.S. dollar bonds, another thirteen issues have been placed in other currencies such as Canadian dollars $36 million, Netherlands guilders $21 million equivalent, pounds sterling $27 million equivalent, and Swiss francs $116 million equivalent. The total of securities issued in currencies other than U.S. dollars thus amounts to $200 million, something like 16 per cent of total bonds sold.

In a further effort to mobilize capital in the private market the Bank invites the participation of commercial banks and other financial institutions in particular loans. Thus, the amount of $368 million shown above as "participations" provides 11 per cent of the Bank's loanable resources at the present time and is derived from commercial banks purchasing one or more of the early maturities in a loan which may run for 20 or 25 years. During the early period commercial banks could participate either with or without the guarantee of the World Bank; but in the last two years this practice has been discontinued, and the World Bank no longer offers participations on a guarantee basis.

In brief, the Bank serves as a bridge between the private capital market and the borrowing countries which--in the case of Latin America--have not yet been able to rehabilitate their own credit in the market. In the case of some countries outside Latin America, e.g. South Africa, Norway, and Belgium, the Bank has helped to introduce these countries to the private markets as borrowers in their own right for the first time since the collapse of the 1930's. The pattern, in each case, provided for a simultaneous operation in which a total loan of, say, $40 million would be financed, in part by the Bank and in part by the sale of the country's bonds in the private market. In 1955, for example, Norway borrowed $25 million from the World Bank with a final maturity of 20 years and, at the same time, the New York market absorbed $15 million of Kingdom of Norway External Loan Bonds with variable maturities up to 10 years.

Such operations have not yet been possible in Latin America, but it is not unlikely that at some future date the private capital market will be willing to make general purpose loans to Latin American governments. For the moment, however, there are no such prospects on the horizon. The only credit the Latin countries have been able to mobilize in the private market has been either medium term supplier credits or general borrowing, for say five years, fully secured by gold or by U.S. government bonds. One exception may be cited. In 1955 the U.S. market absorbed a secondary offering of $8 million Cuban government bonds entitled "Veterans, Courts and Public Work Bonds." These securities were given, in lieu of cash payment, to contractors working on Cuban projects. In the secondary offering the contractors got 90 and the bonds were offered to the public at 98 to yield 4.12 per cent. The final maturities on this issue run to the year 1983. This transaction should be considered an exception, however, for the bonds were secured by pledged tax revenues; to date no general obligation bonds of Latin American governments have been directly placed in the U.S. market.

The unique character of the World Bank role in Latin America lies, however, not in the mobilizing of capital sources but in the conditions under which loan operations are made. These conditions are of two types: (1) the general economic position and prospects of a country, and (2) the suitability of projects to be financed.

Before appraising the state of a national economy the World Bank has always insisted, as a prerequisite, that the country come to some understanding with its creditors on the old bonded debt of the 1920's which had been in chronic default since the great depression. Some resentment was encountered in a few instances on the ground that the World Bank was serving as a collection agent for operations long since discredited and forgotten. One by one, however, the necessary agreements were reached and only last year Bolivia, the last outstanding Latin American country, reached a settlement with its bondholders.

Once this step has been taken the Bank will make an economic appraisal of the country with a view to determining the amount of external debt that the economy can reasonably support. This is the concept of "creditworthiness" which is much misunderstood and involves a rather complicated balancing of past performance as measured by statistics, and of future prospects with many qualitative judgments being utilized. The principal sectors which are analyzed in this appraisal of a country are: (1) the structure of production, (2) the monetary mechanism, (3) the fiscal sector, (4) balance of payments and prospects thereof, (5) the exchange system and, finally, (6) the external debt.

In this process some characteristic questions are usually raised. What are the incentives to expand production? Is the price system reasonably free, or do administered price controls tend to choke off the producers' incentives? Are there bottlenecks, e.g. transportation, which inhibit expansion of production? A second line of inquiry relates to inflation, exploring all the obvious effects of inflation on the economy, including its ramifications in the monetary sector and the emergence of the usual camp followers, price controls and exchange controls. Next, the balance of payments sector is examined to discover what flexibility, if any, exists in the export and import prospects of the economy. In this connection due notice is taken of the climate for foreign private capital, especially where there are prospects for export promotion or import substitution in the internal market. Finally, the external debt is determined, noting the years in which the peak burden occurs, and the composition as between medium term supplier credits and long term obligations, noting any tendency to load the debt burden with short or medium term credit. The relationship between the debt burden and the balance of payments prospects is then analyzed to determine what margin, if any, is available for further borrowing. In a sense, all the elements mentioned hitherto--prospects for production, inflation, private foreign capital, and the exchange system--impinge ultimately on the balance of payments estimate which is then related to existing external debt. At this point the economic analysis of the national economy is concluded.

The second broad aspect of Bank operations relates to the analysis of particular projects, assuming the economic report indicates some margin available for further borrowing. If the economic report be negative on this point the matter is closed and no projects, however high in priority they may be, can be considered. The analysis of the projects turns on four major points: (1) the economic prospect, that is, the degree of priority assigned to the project in competition with other projects; (2) the financial prospect, that is, whether the project can earn enough local currency to cover costs and leave a margin for amortization of its debt; (3) the technical prospect, that is, whether said project is suitably engineered and whether it may be expected to perform the job for which it is designed; and, finally, (4) the management prospect, that is, the quality of the management, previous experience, financial integrity, and so on.

If a project fails to meet the test on any of these four counts it is certain to be passed over or--and this is important--the Bank may make representations to the government on what must be done to make the project acceptable. The financial prospect question might be illustrated by the case of an electric power project where the question of rates comes into consideration. The Bank wishes to see a rate structure which permits the power utility, be it public or private, to earn enough to cover all costs including depreciation, plus some return on investment to generate new capital for expansion. On the technical side the Bank's engineers review the project to make sure that the equipment to be ordered is adequate for the task, and that specifications are written in such a way as not to favor any particular supplier and to assure ample provision for maintenance. If the project seems to be lacking in management the Bank will certainly insist upon strengthening this sector before proceeding with any operation.

It now remains to summarize some of the specific influences which the Bank has tried to exercise during its twelve years of loan operations in Latin America.

1. Old bonded debt. Refusal to make any loans until some agreement has been reached with former creditors has unquestionably had its effect in all the countries.

2. Inflation. On various occasions the Bank, after lending on some projects, terminated its activities on the ground that the accelerating rate of inflation, with all of its accompanying ills, was inhibiting the balanced economic growth of the country.

3. Medium term external debt. The emergence of Western Europe as a supplier of capital goods in the postwar period brought great pressures to pile up substantial amounts of medium term credits. Borrowing countries are often unable to resist the blandishments of manufacturers who have no interest in economic development but who offer to sell a piece of machinery on "painless" credit. The Bank has made representations to more than one country that further loans may not be possible unless steps are taken to reduce the total burden of supplier credits.

4. Electric power rates. There are instances where the Bank has insisted that the structure of power rates be modified to permit companies to cover costs and to generate, through depreciation reserves, the necessary capital for the local currency costs of further expansion. In inflationary conditions, flexibility of rate adjustments is particularly stressed.

5. Domestic capital. Since the Bank only lends the foreign exchange cost of any project, there is need for substantial amounts of local currency to cover domestic expenditures on labor, raw materials, etc. On occasion, the Bank has insisted upon delaying a project or upon cutting down the scale of the lending program until domestic resources could be mobilized from noninflationary sources. The expansion of the U.S. program

known as "PL. 480," disposing of surplus agricultural commodities, has proved useful as a means of generating local capital. The Bank has sought, wherever possible, to insure that the allocation of these counterpart funds be made to sound investment projects.

6. Competitive bidding. The Bank has a firm policy of requiring competitive international bidding on any projects. It also insists upon complete separation of the consulting engineers who design a project and the subsequent contractors who handle the construction. These measures assure each government a better chance of getting "its money's worth."

Apart from the specific points singled out above, the World Bank participates in a wide range of activities designed to assist the member countries in their progress toward economic development. In some cases general survey missions have analyzed a country's resources and recommended criteria to be used in determining priorities. These general survey mission reports have been published for Colombia, Cuba, Guatemala, Mexico, and Nicaragua, together with surveys made jointly with the United Nations Food and Agricultural Organization on Chile, Colombia, and Uruguay. The Bank has stationed resident representatives who have participated in the preparation and implementation of development measures in Colombia, Ecuador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Peru, and Paraguay. The Bank also participated in a study of power development in Mexico and occasionally sends special missions to assist countries in making regional studies such as that of the Cauca Valley in Colombia.

In short, the role of the World Bank in Latin America is not appraised solely in terms of the loan capital provided, however important that may be for development in basic sectors, but notice must also be taken of the many ways in which the Bank influences, directly or indirectly, the economic development of the Latin American republics.