

The new environment for World Bank borrowing

Even if its capital is cut, argues treasurer Eugene Rotberg, World Bank lending shouldn't suffer for quite a few years.

by James L. Srodes

Nearly everyone in the world of professional money applauds the way the World Bank has carried out its mission of funneling funds from the richer countries to the poorer countries. Since Robert McNamara took over as president in 1968, the total outstanding loans made by the bank and its affiliates have mushroomed from \$5.8 billion to \$34 billion — for projects ranging from birth control and mass transportation to highways and hydroelectric construction. To support that lending, it has lifted its annual borrowings from \$490 million to \$4.1 billion — never pressing the markets too hard on terms and always striving to protect its triple-A credit rating. And to increase its borrowing flexibility, and also reduce the cost of its loans to developing nations, the bank has run a highly aggressive money management operation that has grown from \$5 billion to \$9.4 billion and averaged an 8.42 per cent annual return over the past three years.

"One has to say that they are very conservative in their risk analysis and very professional in their money raising — particularly when compared with some banks," says no less an authority than John Gutfreund, Salomon Brothers' managing partner. Adds a veteran Eurobanker: "They don't throw their weight around, and that has earned them a lot of friends. They don't demand better than market for their issues, and bank policy is to rotate underwriters regularly so there are no favorites. This is remarkable in the Euromarkets especially."

But for all that, some clouds have begun to appear on the World Bank's financial horizon. One of them is that the burden of supporting the bank and its sister institutions has begun to weigh heavily on some of the industrialized nations, especially the U.S., as outlined in the preceding article. The others:

- Against the backdrop of more reluctant member-nation support, the bank is already bumping up against its lending



Rotberg: "We aren't changing our emphasis on where we get our capital, our rotation of underwriters or anything else of substance"

limit (its \$34.8 billion of capital and reserves) at a time when the needs of poorer countries for development money are expected to double by the mid-1980s.

- In this setting, the bank has already trimmed back its borrowing activities to well under its annual lending rate of around \$6.5 billion a year. It borrowed \$4.1 billion in fiscal 1978 (ended June 30) and has reduced its fiscal 1979 borrowing target by nearly \$1 billion to a total of \$4.2 billion — suggesting that it may soon begin cutting into its big cushion of liquid reserves.

- In addition, the bank has been conspicuous in its absence from the big U.S. capital market since mid-1977, doing all of its recent borrowings in yen, Deutsche marks and Swiss francs instead.

So what's going on? Has the outlook suddenly changed for one of the world's

biggest and most respected borrowers? And if so, in what ways and how much? To get the answers straight from the person who should know best, *Institutional Investor* recently interviewed Eugene Rotberg, the World Bank's 49-year-old vice president and treasurer. Rotberg, a former regulator at the U.S. Securities and Exchange Commission, joined the bank in 1969 and masterminded both its borrowing program and its huge portfolio of short-term securities. And, not surprisingly, he had ready responses to the questions that have been raised about the World Bank's lending and borrowing outlook.

Rotberg, for example, downplays the threat of declining member-nation support. "The issue of capital funding by our government members has nothing to do with the direct financing of the loans the bank makes," he says. "It is our lending program that determines how much we borrow. And we determine the lending program on the need of development assistance and on the integrity of these projects and their creditworthiness. If we do a good job of that, the financial markets that finance those loans will accept us."

To be sure, Rotberg goes on, the bank's articles of agreement "say we cannot have outstanding loans that are greater than our total capital and reserves. If we don't get the capital, we can't make an increasing amount of loans. But the important thing to remember is that even if we get no further increases in our capital, we can continue to make new loans of \$6 billion a year through the mid-1980s because we will be getting repayments of past loans all the time."

Keeping up

It's been estimated that the bank needs \$41 billion of additional loan capital just to keep up with the inflation and money demands of the really poor sector of the world. But the impact of that on the bank's lending activities shouldn't bother its cred-

itors, says Rotberg. "It doesn't affect our current financing efforts—because those are for commitments made years ago and just coming due now for disbursement," he says. "If we get no new capital, then we make no increases in our new lending plans, that's all."

For the buyers of World Bank bonds, he goes on, "it is a real non-issue. The only thing important to them is whether the bank keeps to its one-to-one ratio on capital to debt. With no new capital, our borrowings essentially will remain at a steady state. The fact that we have reduced our rate of borrowing from what we had originally planned is for a technical reason rather than from an anticipation of capital problems."

What technical reason? Rotberg explains that the bank's liquidity has gone from \$5 billion to \$9.4 billion in recent years. That is in excess of what it needs to meet already-made commitments, and so there is no need for massively increased borrowings. "We have a formula," he says, "that says we must have in liquidity about 40 per cent of our borrowing requirements for the next three years. At the moment our liquidity approaches 60 per cent of our next three years' lending plans. This has nothing to do with our capital problems. We had planned to borrow \$5 billion this year, but we aren't going to because it turns out that the loans already committed and ready for disbursement are

taking longer to pay out than we thought. We planned to pay out over five years on most loans, but frequently we find it takes six or seven years for borrowers to absorb all they need."

Dollar denouement

As for the absence of dollar borrowings, Rotberg is not particularly worried. "If we borrow D-marks, Swiss francs and yen, they are fully convertible to buy the goods and services our clients need," he says. "We don't need dollars for everything we do." For example, he says, "If we finance an electric power project and the borrower selects a French supplier, we will sell the currencies in our inventory, buy the French francs we need and pay them to the supplier and then charge the borrower's account in that amount of Swiss francs or yen that were used on that day. Since we deal only in the world's convertible currencies, we buy and sell them every day."

The case for non-dollar borrowing is strong, Rotberg argues. "Right now we are borrowing in Swiss francs, yen and D-marks because we believe that the low nominal interest rate is the better borrowing approach—even assuming the devaluation potential. We would rather borrow Swiss francs at 4 per cent than dollars at 9.5 per cent. It's that simple. Stated another way, we think our borrowers are better served by the bank having liabilities in Swiss francs

at 4 per cent than in U.S. dollars at 9.5 per cent. The nominal interest rate differential of 5.5 per cent over fifteen years, we think, is far greater than the revaluation potential of the Swiss franc against the dollar. What isn't understood by everyone is that if you borrow in those three currencies, there is an implicit decision that you believe the dollar is *undervalued*. We would rather have liabilities in those others, given the large differential between them and the dollar."

Rotberg acknowledges, however, that the bank's Euromarket borrowings have grown a bit stickier lately because of rising interest rates. "On the Dm 200 million issue we just did in Germany, we decided to come to market at 6 per cent at a 98 per cent price, which I suspect is very tight," he said in late July. "We'll know in a few weeks whether the yield will go to 6.25 per cent or better. If you see the next guy offering a price that is 25 basis points more, then prices are very tight. That's what's happening now in Germany and Japan, but not at the moment in Switzerland. There is no question that what's happening on the interest rate front in the United States is having an effect all over."

But Rotberg, again, says he is not overly concerned: "We have had no trouble with our underwriters. It is true that in the huge issues we've had in Germany and Japan we have paid more than we would have three months ago. But is AT&T in trouble because it is paying 1 per cent more? In fact, we at the bank are actually paying less than the market even now. What is happening is that while the market is going up rapidly, we are still paying less than market even now. Period."

Rotberg, moreover, sees a day when the bank will come back to the dollar. "We expect to be major borrowers of dollars in the future," he says, "and we aren't changing our emphasis on where we get our capital or our rotation of underwriters or anything else of substance. We are merely taking advantage of a large source of capital, and we have diversified the way we borrow into co-financings and private placements. But we have been doing all of that for some time now. We first borrowed Swiss francs 25 years ago."

In the final analysis, then, Rotberg feels that any decrease in World Bank capital will damage only the scope of its activities, not its basic financial strength. "Obviously, if we don't get the capital increase, we can't make the commitments at the level we think is appropriate. Therefore, we will have to borrow less. But we are talking about what happens in the mid-1980s. We are borrowing *now* to meet disbursement obligations from past commitments. Those patterns will not change until or unless our lending program changes. The decision as to what we borrow and how we manage our portfolio will continue to reflect interest rates, maturities and exchange risk potentials. The only losers will be the underdeveloped countries that have to borrow project financing from us." ■

International Investment Banking

Kidder, Peabody & Co.
Incorporated

NEW YORK • BOSTON • PHILADELPHIA • CHICAGO
SAN FRANCISCO • LOS ANGELES • ATLANTA • DALLAS • KANSAS CITY

Subsidiary companies in
LONDON • PARIS • GENEVA • HONG KONG
CAIRO • TOKYO