SOME CONSTRAINTS ON INTERNATIONAL BANKING

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Address to the Annual General Meeting
of the Caribbean Association of Industry and Commerce

Roseau, Dominica

October 21, 1972

Uploaded: September 8, 2014

The Caribbean Development Bank is moving swiftly towards its first crisis, namely that we shall have spent all our money by the end of next year. The coffers will be empty. The original commitment to the Bank was EC$50 million of hard resources and EC$50 million of soft. A substantial part of the hard resources was in regional members' notes which we cannot spend; allowing for this our original spendable money, to be paid in over five years, was about EC$90 million.

By the end of this year, 1972, the Bank will have committed about EC$45 million. And we are already investigating good proposals for 1973, which come to about EC$58 million, with more still coming in. So by the end of the year, we shall have to close the shop unless we get more money.

Why is the money going so fast? One reason is that the Bank swung into its stride very swiftly. Normally, an international development bank does not make any loan during its first two years; that time is spent recruiting staff, making rules and regulations, and studying the projects put up to it. But, knowing the urgent needs of our people, our Bank went to work from its first day, and has moved much faster than any of its predecessors.

This has meant very hard work for our staff. In the process, we have acquired a reputation, among people looking for jobs, that the Caribbean Development Bank is to be avoided unless you are looking for a real challenge. But we have had no difficulty in finding good people; our staff are in good heart, and are proud to be giving their best in such a good cause.

The other reason why the money has run out so fast is that it was so small to begin with. Each regional government has subscribed one half of one per cent of its national income, in six instalments, or one-twelfth of one per cent of its national income in each year. Since investment in our region runs out at about 20 per cent of national income per year, the regional contributions are obviously trivial. And since it was also decreed that the non-regional members would all together contribute only two-thirds of what the regionals put in, the Bank clearly could have very little money of its own.

Actually, it is normal for banks to have very little money of their own. The lay public thinks of a bank as a place which lends money, but it is more useful to think of a bank as an institution which is able to borrow money. If a bank cannot borrow, it cannot lend, and must go out of business.

So our crisis is not really a crisis: it is a normal launching of the Bank into its proper business, which is to borrow money and re-lend. From 1974 onwards, the Bank will lend as much as it can borrow and no more.

Yet the word "crisis" is not irrelevant since, once launched, our Bank will not be able to operate successfully without a revolutionary change in the public's image of its Bank. At present, our customers think of us more as if we were a foreign aid fund, continually replenished by parliamentary grants, than as a Bank which has to borrow money in international capital markets. Clearly what the grant-fed agency can do, and what is imposed on the borrower in capital markets are quite different.

Our Bank's position in the capital markets is not strong. We cannot offer the lenders mortgages or Government guarantees of any kind. As the City says, we are borrowing solely on the soundness of our balance sheet. Moreover, unlike most other international development banks, we lend a lot of money to private enterprise, without government guarantees, so we may lose some of that money. To meet this, the Bank has to build up large reserves out of its profits. Our Bank has to demonstrate to the international financiers that it is a very sound commercial undertaking; otherwise, they will not lend us a penny, and we shall be out of business.

This is not generally realised by our public, not even by some of the most respected economists in the region. The idea persists that the CDB was created to run at a loss, through subsidising desirable undertakings, whereas the fact is that the organisation will be stillborn unless it becomes creditworthy in the eyes of those from whom it has to borrow money.

We are not unique in this. When the World Bank was created, it was subjected for years to a barrage of criticism by the developing nations, because of the restrictions it adopted in order to protect its creditworthiness. Nowadays the World Bank is such a sound institution that it can borrow in Wall Street or Frankfurt or Tokyo or Zurich as much as US$3 billion a year; and so can lend US$3 billion a year to the developing nations. If it had, instead, adopted the policies which – they were then urging upon it, the World Bank would long ago have ceased to exist.

Fortunately, our Bank's directors are men of financial experience, who understood the situation right from the start, and set the Bank's policies accordingly. The Bank's rules are determined by three considerations:

One set spring from the need to be creditworthy

A second set are imposed by the Charter, to make a small sum go as far as possible

A third set are imposed on the Bank by the people who contribute the money

INTERNATIONAL CREDITWORTHINESS

Certain policies are imposed on the Bank if it is to maintain its creditworthiness. First, we have to demonstrate that every project is studied very thoroughly. Our biggest lender, the U.S.A.I.D., demands to see a full appraisal for each single loan we make with its funds, and reserves the right of final approval for any project costing more than US$500,000. The German delegation, which recently visited us, has an even lower limit, namely US$150,000. The World Bank, from whom we also hope to borrow, takes exactly the same line. In one of our first submissions to the U.S. A. I.D. for a project over US$500,000 we sent them the paper we had put before our Board; this ran to 46 pages including 16 statistical or accounting tables and 4 maps. They replied that this was not enough information; they also asked to see earlier consultants' reports running into four volumes.

I have no quarrel with this, since I believe that a project should be investigated thoroughly before you put a lot of money into it. What takes time is not the cost-benefit analysis, which can usually be completed within 48 hours, but the engineering studies: the drilling of boreholes, the study of the basic data indicating the nature of the technical problems to be solved, and the design itself. This is where the time is consumed. Some of our Ministerial customers find all this investigation very hard to bear. They do not themselves have the staff for this work, so much of it falls on our staff, if it is not big enough (as it often is) to go to outside consultants. Most of their trouble is due to the fact that they do not have Development Plans. A Development Plan tells you what is to be built in year 4, and so gives you four years in which to study precisely what is needed, and negotiate for the money. Without a Development Plan you are thinking only three months ahead, and are frustrated whenever you think of something to do and are told that it may take a year before the preliminary investigations and negotiations are completed.

The CDB is not in a position to make Development Plans for so many borrowing governments, but we have done the next best thing. We have this year sent missions to each of our LDCs, to talk with the department heads and get their plans for expenditure over the next three years. We are thus in a position to sort out with them what further engineering investigations should be started now. As this programme of investigations comes on stream, complaints about the time it takes to prepare projects will diminish.

The second requirement for creditworthiness is that the Bank must build up reserves, and must therefore make profits high enough for this purpose. This is obvious in our lending of hard money, since so much of this goes to private business, without guarantee, and is therefore subject to normal commercial loss. But it applies also to our soft resources. These are mostly lent to our governments or against government guarantee, but most of our LDC governments have no reserves, and would be greatly embarrassed if called upon to honour their guarantees. In the case of hard resources, we can levy on our shareholders to meet obligations to our creditors arising out of losses, but we are specifically prevented by our Charter from doing this in respect of our soft resources, as both the Americans and the Germans have icily reminded us, so we need reserves even more in the soft funds than in the hard, if we are to be able to borrow more soft funds.

Normally, a Bank lends at a margin above its borrowing rates, in order to meet expenses and build up reserves. We do this for our soft funds. But for hard funds we meet expenses and build up reserves out of the earnings of our share capital. We are thus able to lend, for the time being at rates which average out at our borrowing rate. We cannot do this for long; as our borrowings come to dwarf our share capital, we shall have to lend at substantially more than our average borrowing rate in order to stay in the black.

The third rule derives from the financial state of our LDC governments. Most of them are fully stretched, and cannot take new interest and amortisation commitments on to their budgets. Hence we can only lend to them for self-liquidating projects; i.e. for projects which earn enough to meet their debt charges out of their own revenues - like ports, airports, electricity, water supplies, telephones, housing, shipping and so on. It follows that we have to satisfy ourselves that these public utilities will in fact be earning enough to meet their debt charges. This is sometimes a problem. In socialist states, the government enterprises are always run at a substantial profit; this is where the money comes from for new investment. But in our LDCs, a lot of public enterprises are run at a loss, for no very obvious reason, and the Bank's insistence that it can lend only if this situation is rectified comes as somewhat of a shock. Yet it is obvious that the Bank can remain creditworthy only if it lends to creditworthy enterprises. Since our LDC governments receive large grants from Britain and Canada towards their non-self-liquidating expenditures (schools, health, roads, large jet airports, etc.), our confining ourselves to the self-liquidating field is no hardship.

The fourth banking principle, which has perhaps caused the greatest shock, is that we do not lend to our LDC governments more than 80 per cent of the cost of a project; they would like us to lend them 100 per cent. Actually, ours is the only regional development bank which lends as much as 80 per cent. Other international development banks refuse to lend for local costs, so they average well under 50 per cent.

It is a universal banking principle that the borrower, who will be managing the enterprise, must have a financial interest in it. Enterprises run into all kinds of problems, including trouble with new government regulations. If CDB were ready to lend 100 per cent on easy terms we should be inundated with the pet schemes of department heads, without regard to priorities; and would be left to carry the baby when adverse conditions arrived. As it is, we take no project seriously until the Minister of Finance indicates that he is willing to put up 20 per cent of its cost.

In the rest of the developing world, a rule of this kind would be considered extraordinarily generous. For in the developing world, it is now accepted that the government must save at least 2 per cent of the national income, for capital formation. In fact, private savings are so low, that development economists recommend a target public saving of 5 per cent of the national income (the difference between government revenues and expenditures on current account). If a government saves 2 per cent, and can borrow four times as much as it saves, it is in a position to finance investment to the tune of 10 per cent of the national income, which is ample.

The trouble with our LDCs is that their average saving is near zero. Many have negative savings, i.e. their recurrent expenditures exceed their recurrent revenues. The Caribbean Development Bank is expected to ruin its creditworthiness by substituting itself for sound fiscal practice. Obviously, our governments cannot continue for long to run budget deficits, or to fall below the normal standards for public savings. Those which already follow standard practice take the 20 per cent rule in their stride.

In lending to private borrowers, the Bank's maximum participation is 60 per cent of the project. In contrast, the East African Development Bank never lends more than 50 per cent. Yet, just last week the Heads of Government Conference in Trinidad was manoeuvered, by a group of economists who ought to know better, into passing a resolution which implies that the CDB should be lending 75 per cent, without government guarantee, to private enterprises. One can only say that if it became known that we were doing this, our ability to borrow the hard money needed for making such loans would sink to zero. Even senior economists in the region have not yet learnt the difference between a fund and a financial institution.

Imposed by our Charter to eke out the money

Since the founding governments realised that the sum they were putting into the Bank was trivial, they were anxious that it should go as far as possible, and wrote two Articles into the Charter to ensure this.

First, the Bank is prohibited from lending money for purposes for which other finance is available. For example, the Bank does not lend for working capital, since this is what the commercial banks are for; whereas development banks are for long term lending. Besides, since long term rates are higher than short, how could the CDB borrow long to lend short? Neither does the Bank lend for equipment which could be bought on hire-purchase agreements or with export credits. The Bank is willing to guarantee such export credits, where necessary, but the borrower does not need our cash.

The other Article prohibits the Bank from purchasing equity for the time being; we offer only loans. The reason for this is that the Bank's money, in so far as it is borrowed, has to ·be repaid; and in so far as it comes from share capital, should circulate as a revolving fund. The Bank can therefore only buy equity if it can sell it fairly quickly; otherwise the Bank's operations will come to a stop. Unfortunately there is no market for shares in the small agricultural, hotel or industrial enterprises which rely on the bank: these are largely family enterprises, and it is hard to sell the shares of family enterprises anywhere in the world even on the most advanced stock exchanges. So the Bank is very pleased that Heads of Government have decided to create a new fund to buy equities in LDC industrial enterprises; we shall cooperate with it in every way.

Rules Imposed By the Bank's Subscribers

Finally, we come to a long list of rules imposed by those who have put money into the Bank.

1. Loans from the Bank may be used to purchase goods only from countries which have subscribed to the Bank's resources: this is plainly stated in the Charter. Nevertheless, last month a bewildered member of the Bank's project staff was berated by a Minister for half an-hour because the money we were lending could not be used to purchase goods from Sweden, which has put no money into the Bank.

2. Our money has to be spent on new capital formation. We cannot pay for work which has already been done; and we cannot refinance old debt. The governments which make the soft money available, under much criticism from their publics, defend foreign aid partly on the ground that it will finance

additional exports. It must therefore finance new work, on which they have a chance to bid. Yet our refusal to refinance past debt is held to be one of our greater sins.

3. For the same reason, we cannot use soft money to purchase land; this would in addition raise the cry that the "people's taxes were lining the pockets of landowners." Criticism of the CDB on this score is particularly hard to understand when it comes from the proponents of land reform. When governments nationalise assets they do not pay cash; they either issue bonds, or else in modern parlance "they pay out of the rent." CDB could borrow hard money at 9 per cent repayable in 10 years for governments who wanted it to buy land, but our LDC governments have more sense than this.

4. We lend soft money to small farmers and small industrialists, but since the Parliaments would object to "lining the pockets of the rich" we cannot use it for making loans to "big" people. All our loans to private borrowers of EC$100,000 or more come out of our hard resources, at ordinary rates of interest. This incenses those agricultural economists who think that the CDB has a duty to subsidise large plantations.

5. Because they want their countrymen to have a fair chance to bid, the governments insist that all contracts (consultants, supplies or construction) be put out to international tender. This takes time, but is a condition of our getting their money. (There are exceptions for small contracts, and a margin of preference is allowed on CARIFTA goods).

6. The Governments would also be embarrassed if the money they made available to the CDB were used to support one political party rather than another. (If they want to enter that game, they make their own choices). Now in many countries, certain types of lending are highly prone to political influence, especially agricultural credit, small business loans, land settlement and housing allocations. Therefore when we lend money to governments for such purposes, we have to write in terms designed to minimise political influence. Actually political integrity is higher in our part of the world than in most others, so most of our governments have no trouble with these conditions. But " the one or two who do are outraged by the apparent infringement of their sovereignty.

Demand Exceeds Supply

This is such a long list of rules that it is not surprising that people who are not used to dealing with international development banks feel a strong sense of frustration when first they become involved with this type of financial institution. This is especially the case if they have been led to believe that an international development bank is going to solve all their financial problems. Sophisticated borrowers know that there is a whole spectrum of financial institutions. No single institution meets every kind of need; all are restrictive in some way. Some lend long, others short; some buy bonds, others take equity; some are for agriculture, others for housing; some for small business, some for large; and so on. When a borrower needs money he seeks out the kind of financial institution which is set up for his type of need; to complain that other institutions meet different needs is hardly rational.

But complain they do vociferously. Some of our project staff have had vulgar personal abuse hurled at them by some of our cruder clients; to be discourteous to professional people is the order of the day in the developing world - it is one of the reasons for our big brain drain. One or two of our Ministerial clients would like me to leave. Actually, I had no hand in drafting the Charter of the Bank, and have no vote in its policy making bodies (the Board of Governors and the Board of Directors), so the venom is misdirected. My departure would not alter any of the constraints under which the Bank must operate, if it is to be able to borrow money. The only way out of this jacket would be for member governments to decide to contribute 10 per cent of their national incomes to the Bank instead of one half of one per cent.

The question which so much frustration raises is whether the area really can support an international development bank, able to borrow from the end of next year every cent which it will lend; or whether from its traditional financial habits and misconceptions, it is not yet ready to support a creditworthy institution.

The answer is not in doubt. Despite grumbling about the terms of Bank lending, the demand for Bank lending on those terms greatly exceeds the supply. If this were not so, the Bank would not be moving so swiftly to a crisis of empty coffers. The fact of the matter is that the Bank could lend every penny that it could borrow even if its lending terms were much more restricted than they are. This is the decisive test of our ability to support a proper financial institution.

As it now appears to us, the Bank, while maintaining all the usual international tests, can lend in its LDCs about EC$10 million a year for agriculture (public and private), about EC$5 million a year for manufacturing, about EC$3 million a year for hotels, about EC$10 million a year for housing, and about EC$8 million a year for self-liquidating infrastructure, making a total of about EC$36 million a year.

Why can we do so much business? Well, I have been reciting what a few people do not like about the Bank. What our potential borrowers do like is that ours is the only institution - which lends money for periods ranging between 10 and 25 years, beginning with a substantial grace period, at rates of interest ranging between 4 and 9 per cent; throwing in as well, at no cost, a full development plan for their undertaking. Whatever we may fail to do, the demand for what we actually do is beyond all previous expectation, both from private business and from the self-liquidating public utilities. True, the Bank has gone out of its way to help in identifying worthwhile projects, both private and public, to the extent that we now have more than we can finance. But this is part of our duty too.

Some of our smaller MDCs are also very anxious to borrow from us, especially Barbados and the Bahamas. There is a place for the CDB in all our MDCs, handling the smaller loans. The average World Bank loan is about EC$40 million, and even the Inter-American Development Bank is uncomfortable handling loans of less than EC$10 million. It makes a lot of sense that CDB should handle the smaller projects throughout the region, while leaving the large loans to our giant brothers.

Our Bank, therefore, could easily dispose of EC$60 to $70 million a year, while adhering strictly to the conditions required for international creditworthiness.

What are our chances of raising such sums? As of now they are good. The Bank is well respected in international financial circles. The very rules that some of our customers find so irksome serve to reassure potential creditors that money lent to us is carefully invested and likely to be repaid. Or so they have been telling us.

The test will come at the end of next year, as we move into the financial markets. We shall be seeking to borrow hard money in the financial capitals and from the World Bank, and elsewhere. And we shall be seeking to persuade the various foreign aid agencies either to replenish past contributions or to make new ones. I hope that our public will learn to judge its Bank by its success in borrowing money, rather than by the ease with which it shovels it out.