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INTERNATIONAL INVESTMENT OF CAPITAL

Address by

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at the

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This is the first time that I have ever spoken in public in the role of a banker. I doubt that, but for the office I now hold, I would be called upon by any such well informed group as this to discuss economic trends with you. I am sure you realize, as I acutely do, that my assumption of the office of the Presidency of a bank—even the International Bank—has not suddenly bestowed knowledge and wisdom in finance or economics upon me.

When I asked Mr. Myer what I should be expected to talk about he said that the general subject was capital, and I could say something about that. I recall that one man some time ago talked at length about capital and his comments have been the subject of all manner of controversy ever since. Although Karl Marx had the same subject as that assigned to me, I think no one need feel any concern that similar controversy will be generated by my discussion of the subject today.

While I have not been a banker, I have had rather extraordinary opportunities of seeing much of the world and particularly have I seen accumulations of capital disbursed throughout the world in order to achieve definite objectives. Some 50 billion dollars of the wealth of the United States was made available to those who fought with the United States in order that victory in war might be achieved. These billions, added to the much larger sums which the United States herself expended on her own war effort, brought the total of capital disbursed by this country to approximately 341 billions, all used in the main for the purpose of destruction. If we add this to what others have expended for the same purpose, the figures become astronomical indeed.

It does seem that if the world can and does collectively spend so much for destructive purposes, it is time that we gave the best thought we can apply to the international investment of capital for productive purposes, to the creation of conditions of economic health throughout the world.

It is not only political health but economic health as well that we must seek if we are to avoid the disruptions and unholy practices which lead to wars. I recall on one of my somewhat frequent trips about the world—this was after Germany had surrendered—I was walking through the battered and demoralized city of Vienna and suddenly across the street I saw the offices of the Credit Anstalt. It brought back memories of 1931 and I experienced a strange feeling. For suddenly, across all of the terrible destruction of the intervening years, I recalled the uneasiness and foreboding which the announcement of the failure of that bank had caused in knowledgeable circles in the United States. Although I had been entirely remote from any transactions involved in the bank and though I could perhaps not trace any direct connection between its failure and the terrible events that had in the meantime occurred, the sense of their connection was present. The economic disease of which that failure was a symptom was clearly a contributing factor to the fears and pressures which ultimately generated war.

If we are impelled, largely against our will, to invest so much of our capital for the accomplishment of destructive purposes, ought we not be willing to marshal substantial portions of our assets for the purpose of achieving economic and political health?

Now economic and political health are not achieved by the investment of money alone—far from it. But I think it is indisputable that the improvement of general trade conditions around the world has a strong and definite tendency to improve both political and economic relationships. If this be so, it is worth our while to examine together this afternoon some factors underlying the international investment of capital and to explore some of the lessons we have been taught by international investment in the past. It may then be profitable to analyze the role which the International Bank, as one of the principal international financing agencies in the world, may be called upon to play.

By international investment of capital I mean the investment of the funds of one or more countries in another country for productive purposes. That investment can take any one of a number of forms. It can be a loan from one Government to another. It can be a loan made through normal investment channels, by private investors in one country to the Government, or to private enterprises, in another country. It can take the form of direct investment of venture capital abroad. Or it can take the form of a loan to one country, or to enterprises within that country, of currencies of other countries, through the medium of an agency such as the International Bank, which derives its funds from both Governments and private investors.

But whatever the form or combination of forms which it may take, there are two fundamental characteristics of the international investment of capital of which I speak: first, that the investments are made primarily by or through funds derived from those countries which, by reason of their superior resources or productive mechanisms, are in a position to enjoy an export surplus;

and, second, that they are made for the purpose of developing the productive resources and capacities of less favorably situated nations.

It is not a wise international investment if the flow of capital does not equally benefit the borrower and the lender. To the borrowing country, such an investment should mean an opportunity to acquire from the lending country or elsewhere goods and services which it needs to increase the level of its productivity and therefore of its real wealth and standard of living. To the lending country, it should mean the creation of a market for the surplus goods it is in a position to produce and export, and the assurance of an expanding world trade in the future, which will enable it to maintain and increase the output of its productive plant. In addition, the increased import of goods and services which come to the lending country by way of return on its investment contribute directly to an increase in the standard of living of its citizens. To both it should lead to wider understanding, exchange of ideals and mutual respect.

But these results flow only from *wise* international investment. Loans made for uneconomical projects or for purposes which are non-productive or are beyond the capacities of the borrowing country to carry out, merely squander the wealth of the lender, increase the difficulties of the borrower, and induce rather than avoid poor international relations.

From 1815 to 1914 Great Britain took by far the most important position in international investment. From the middle of the 19th century onwards her foreign investments increased by about 300 million dollars annually. In terms of present day purchasing power the investment was much larger, and it was made against the background of a population and a productive plant very much smaller than that, say, of the United States today. Not all of Great Britain's investments were wise or fortunate, but on the whole they were of enormous benefit to Great Britain, enabling her to build up in the period of her greatest industrial supremacy new markets with which to trade and a source of income to support her standard of living when that supremacy was challenged. They were of enormous benefit to the rest of the world, too; much of the development of industry in Europe, and of the industrial and agricultural development of both North and South America and of the Far East was made possible through the financing provided by Great Britain and to a less extent by other creditor countries such as France, the Netherlands, Belgium, Switzerland, Germany, and Italy.

World War I brought this phase to an end. Great Britain drew heavily on her foreign investments during the war, and though she was able to restore them by 1930, she had difficulty thereafter in achieving an export surplus. The United States, on the other hand, suddenly found itself in the unfamiliar role of being one of the major sources of international credit. From 1920 to 1940, approximately 9 billion dollars par value of foreign dollar bonds were issued in the United States, and large sums of American equity capital were also invested abroad. Estimates indicate, for example, that in 1938, the outstanding external investment of the United States amounted to eleven and a half billion dollars.

As you know, some of this foreign investment of the United States during the period from 1920 to 1940 was haphazard and misdirected; a portion, at least, of the apparent capriciousness may be attributed to the unfamiliarity of the American market with international finance. Money, in some cases, was loaned for unproductive purposes, countries were encouraged to over borrow, and there was little or no supervision of the expenditure of the proceeds. During the speculative boom in the United States in the last quarter of 1928 and in 1929, there was a sudden diversion of capital from abroad to the purchase of stock in domestic enterprises, thus causing major embarrassment to European countries. As a result of all this, when the world-wide depression occurred, we were confronted with significant defaults and losses on foreign dollar bonds, the major areas of default being Latin America and Germany. It is worth noting, however, that despite the widespread defaults, full payment was maintained on the outstanding foreign dollar bonds during the period by Australia, Argentina, Canada, Eire, Finland, France, Switzerland, Luxembourg, The Netherlands, Norway, Newfoundland and the United Kingdom. Czechoslovakia, Denmark, Belgium, Estonia, Haiti, Italy and Japan had no defaults until World War II.

As a result of the recent war, the role of the United States in international finance has become far different from that which it heretofore has been. Great Britain, instead of being a capital-exporter, has, at least temporarily, become a capital-importing nation. Most of the other highly industrialized countries of the world have also been ravaged by the war and must during the period of their reconstruction have a continuing net import balance. On the other hand, the United States, with its great productive machine not only intact but expanded to a capacity never before known or even approached, stands as one of the few, and

certainly much the most important of the capital-exporting nations of the world.

This position gives the United States an opportunity to contribute to the recovery of the world, and to its own prosperity, an opportunity perhaps unparalleled except by the experience of Great Britain in the 19th century. As Great Britain then enhanced its own economic position by financing industrial and agricultural development throughout the world—railroads in the Balkans, gold mining in South Africa, rubber plantations in the Far East, to pick but a few random examples—so the United States today has what appears to be a comparable opportunity to contribute to a prosperous and expanding world economy by assuming the large role in international investment which its favorable productive position makes possible.

I do not want to talk too much about the United States and its position. Today the United States is the great lending nation but political and economic health is not induced by the economic domination of any one country. International investment of American dollars will provide essential assistance, but in the long run it will only be by a full acceptance by other countries of their opportunities and their responsibilities that really satisfactory economic conditions can be fully achieved.

We shouldn't think of this essential international investment merely in terms of money; money is only a measure of the goods and services which are the real subject of the investment. And when we think of the object of the investment, it shouldn't be simply in terms of export and import, or balance of payments or budgetary statistics, important as these may be; we should consider as more significant the harbors, the airfields, the hydro-electric projects, the steel mills, the factories, the oil fields, which that investment will make possible.

The financing of these developments at the present time is not only an opportunity; it is the satisfaction of a desperate need. A great part of the economic community of the world has been destroyed or demoralized. If its economic rehabilitation is made possible, the world will be a better place to live in for all concerned. If however, its economic health is not restored, there may not only not be an expanding world economy but a vastly contracting one, the consequences of which no country would ultimately escape.

Let me emphasize that when I speak of need I am referring only to the need for financing the restoration or development of productive facilities and resources. I do not mean the need of funds for relief from starvation or misery or want. There has been, and still is today, a tremendous need for relief abroad, in places like Greece, Poland, Hungary, Italy, Austria and China. But the grant of relief to such countries is not intended, like the international investment of capital, to be directly productive; it is designed rather to let the people of such countries meet the minimum requirements for actual subsistence. International investment starts where international relief leaves off, at the point where it is economically sound, both from the standpoint of borrower and lender, to utilize foreign capital for the restoration or development of productive facilities.

Relief is only a temporary stop-gap. Long-term reconstruction and development requires long-term capital investment in economically sound and productive projects. On an international scale, such investment is obviously the function of private capital in the capital-exporting nations.

It was precisely because of the desire that private capital be employed in all capital-exporting nations for international investment that the International Bank for Reconstruction and Development was formed. I say this because the International Bank is primarily a mechanism whereby private investment funds in the capital-exporting nations—temporarily this means predominantly the United States—may be made available at reasonable cost for the restoration and development of the productive capacities of the capital-importing countries. The significance of the Bank is that it makes such investment of private capital possible because, through the security afforded by the capital subscriptions of the Bank's members, it minimizes the risks of international financing particularly as they are present today. The Bank forms a sort of safe bridge—safe so far as the investor in its securities is concerned—for private capital to move into the international field.

I would like to examine this concept with you a little more closely, since the role of the International Bank has not always been clearly understood. Many people think of it as a bank with eight billion dollars in its till contributed by the member Governments and available to lend to any nation which can demonstrate its need for funds. And people wonder why a Bank with all this capital is not tending to all the needs of the world without necessitating further calls on the United States Congress.

In the first place, the capital funds of the Bank paid in or to be paid in by the member Governments amount to only 20% of

the Bank's total subscribed capital, or approximately $1,550,000,-000; the remaining 80% of the subscription of each member is subject to call only if needed to meet the obligations of the Bank. It is *not* available for lending purposes. It is there really only as an encouragement and an inducement to others to invest.

In the second place, and this is most important, of this $1,550,-000,000, *only* some $725,000,000 is represented by United States dollars; the remainder is represented by the local currencies of the various members other than the United States—pounds, francs, kroners, pesos, and the like. Only a relatively small portion of this other money, contributed by the few other countries which are today in the position of capital-exporters, is immediately available for lending purposes. Moreover, the need and the desire of practically all potential borrowers is primarily for dollars. The Bank must, therefore, look for its lending funds partly to this $725,000,000, but primarily to the sale of its securities in the private investment market, predominantly the United States market. Most of the Bank's loans, in other words, will be made out of funds borrowed by it from private investors, and *not* out of funds contributed by the member Governments. The Bank will have no hesitancy in lending its own funds. It has every intention of doing so for a number of reasons. But those who are responsible for the organization of the Bank, I think wisely, so arranged it that the Bank is forced to rely on private capital for its duly safeguarded major operations.

In the third place, the Bank's funds are not available for loans simply upon demonstration of need by the applicant country. To the contrary, loans can only be made if the Bank is satisfied that the project or program to be financed is economically sound in the sense that it will raise the level of productivity of the borrowing country, and that the prospects of repayment are such as to make the loan a prudent risk.

You may well ask why, if the Bank must rely on the private investment market for most of its funds, and if it can take only prudent risks, there was any necessity for its establishment; why, in other words, was the job not left entirely to the investment market?

The basic answer is that, in this transition period after the war, the needs of Europe and of the Far East to reconstruct productive facilities ravaged in the war, as well as the needs for developing the productive resources of the underdeveloped areas of the world, are so large that the necessary financing would simply not be available in the private market without some form of effective international guarantee such as that which the International Bank affords. Countries which might readily raise 10 or 20 or 50 millions of dollars in the private market need 100 or 200 or 500 million. Even though their credit rating is good, the sums required are so large that private investors are unwilling to provide them without the additional security afforded by the Bank. Apart from the consideration of the size of the investments, another element is the uncertain political factors which now pervade the world scene. I take it that the Bank should not hold back from granting loans until the whole political scene unfolds. By the influence which the availability of long-term capital may have in stabilizing economic conditions, it is hoped that the Bank may play a part in helping to create a healthier political scene.

The loans of the Bank will, as I have stated, be made primarily out of funds borrowed by the Bank from private investors, but the capital subscriptions of the members of the Bank, whether paid-in or on call, will serve as security to those investors enabling them to apply their funds to international investment, through the medium of the Bank, with the security of the 80% call on the member governments as a protection. Because of this same security factor, and because it is not primarily a profit-seeking institution, the Bank will be able to make loans for projects which, though constituting good risks, are not attractive enough to secure purely private financing.

A further reason for the establishment of the Bank was the recognized necessity of avoiding the misdirection of international investment. As the experience of the United States in the 1920's demonstrates, such investment, without guidance, may all too easily lose its way. By reason of its character as a public international agency, the International Bank is in a position to secure information, both with respect to the economy of the borrowing country and with respect to world economic trends generally, which is not available to private investors. Such information is invaluable in appraising the merits of proposed projects and programs and in assessing the risks which their financing involves. Furthermore, because of its character as a public international agency, rather than a simple lending agency, the Bank is in a position effectively to supervise the expenditure of the proceeds of the loans which it grants, and to maintain contact, even after the period of disbursement, with economic developments and trends in the borrowing countries. Finally, since the Bank is not primarily a profit-making institution, it will not be subject to the

temptation of encouraging excessive, or otherwise uneconomic, borrowing by its members.

In the long run, however, international investment of capital is primarily the function of the private market, not of public agencies. The founders of the Bank recognized this when they wrote into the charter of the Bank that one of its fundamental purposes is to promote private foreign investment, and that, to this end, no loan may be made by the Bank when the loan is otherwise available to the borrower in the market on reasonable terms. Moreover, the Bank is empowered to assist private capital by its guarantees of and participations in private international loans. Indeed, the degree of success of the Bank may well be in inverse ratio to the length of time its services are urgently needed. The greater the contribution of the Bank to the creation of conditions of economic stability and prosperity throughout the world, the sooner can private agencies play their traditional role in the process of international investment.

Before I close, I would like to say a few words about two questions which frequently are raised in connection with the organization of the Bank. One is whether the Bank will be unduly influenced by political questions, and the other is whether the representation of potential borrowers on the Bank's Board of Executive Directors will result in improvident lending.

The Articles of the Bank provide expressly that loans shall only be made for productive purposes—and by several other provisions which restrict the character of the loans which can be made, political loans as such are definitely excluded. The Bank need only follow its mandate and act in the independent manner which the Articles clearly contemplate to insure that no purely political loans are made. It is the firm intention of the administration of the Bank that that mandate be followed. Having said this and not by way of hedging the significance of what I have said, I wish to add this comment in order to be realistic. The line between political and economic is not always sharply drawn. We all know political conditions can affect the economic and vice versa. What I take the mandate of the Articles to be is to judge the loans which are made in the light of all circumstances which bear upon their productivity and the accomplishment of the purposes of the Bank as they are defined in its charter. We can't and won't *grant* loans in order to accomplish political objectives; we can and will *refuse* loans, where the political uncertainties are so great as to make a loan economically unsound.

So far as the Executive Directors are concerned, it is true that a number of them represent potential borrowers, but a controlling number do not. The Directors act only after a favorable recommendation for a loan is made by the administration; in fact, the charter of the Bank forbids any loan being made that is disapproved by a loan committee which is composed, in practice, of the officers of the Bank. Furthermore, it has been my experience, after a very short time thus far with the Bank, that the Directors have every desire to act as an objective body, conscious of their responsibility for the success of the Bank. They are men of distinction, attainments and self respect. There is a sense of collective responsibility among the Board which may be one of the most important factors in the development of the Bank and the part that it will play in the course of its operations. If the attitude of the members of the Board of Directors is indicative of the state of mind of the member countries, there will be developed among the members a sense of co-responsibility for the obligations to the Bank. If this be the case, we may find that there has been introduced into the field of international investment a most effective stabilizing factor. This attitude may take the form of the strictest adherence by the borrower to its own obligations on the one hand and a collective effort on the part of the members to see that no member finds itself in the position where it cannot meet an obligation to the Bank.

The contribution of the Bank to the creation of conditions of economic health in the world can be, and I sincerely hope will be, significant. The productive resources and facilities, the trained manpower, the will to produce, are all present in large measure in the world today. What is needed are the raw materials and capital equipment for reconstruction and development. The Bank's loans, to the extent that they make such raw materials and capital equipment available to the borrowing countries, will increase their level of productivity and, as a direct result, will serve to promote the long-range balanced growth of international trade. We must never suffer the delusion, whether we be borrower or lender, however, that loans can do it all; indeed, they can do only a small part. But peoples who contribute the major elements to their own recovery do deserve such help as can be given them in the form of productive capital from abroad. If we can bring such peoples and capital together, we may help create a better world economy and, if we do, it will represent a large step forward toward the goals we all seek—stability, prosperity, progress—all the handmaidens of peace.