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THE WORLD BANK GROUP HISTORIAN'S OFFICE

ORAL HISTORY PROGRAM

Transcript of interview with

RICHARD H. FRANK

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Richard H.Frank Interview

The World Bank
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Q: This is an oral history interview with Richard Frank, Managing Director. The date of the interview is June 6, 1997. I am Jochen Kraske, the Bank's historian, accompanied by William Diamond.

A: I'm Richard Frank, currently Managing Director at the World Bank and Chairman of the Private Sector group.

Q: Thank you, Richard, for letting us talk to you and for joining our oral history program. Perhaps we can talk a little about your education to understand how you became involved in your work on economic development problems. I understand you were trained as an engineer, and subsequently you went into management training. Can you talk a little about the expectations that you had at that time? What sort of career did you anticipate when you went through this education in South Dakota and later in Massachusetts at the MIT?

A: I pursued engineering studies, quite honestly, because I felt challenged by the U.S. goal to regain the lead in the space race. This was in the days of the Russians launching Sputnik and gaining lead in the space race. I decided that I would join the effort to rebuild U.S. lead in science and technology, a very idealistic and lofty personal goal. So I found the best engineering school in my region of the U.S., the

South Dakota School of Mines and Technology, an all men's engineering school, modeled along the lines of MIT and studied mechanical engineering.

As graduation approached, I found the science and engineering tracks somewhat limiting even though I enjoyed my college senior project which focused on one of the US's first rocket programs. I applied to the leading management program designed for undergraduates with science and engineering training—MIT's Sloan School—which offered an MS in Management.

I first became exposed to the problems of the developing world when I was at MIT. MIT had initiated a program – MIT Fellows in Africa - to send MBA and Law School graduates on extended assignments to the newly independent countries of Africa to provide advice and at the same time get a real world experience in developing countries. MIT sent graduates to address the vacuum of talent to help local officials manage the economy or strengthen the legal systems.

The manpower vacuum had been created by the withdrawal of British and French colonial administrators and officers with the strong African independence movement. The lawyers from Harvard and Yale ended up writing constitutions and tax laws, while the MBAs worked on five-year development plans, strengthening the Central Banks and Finance Ministries. This

was pretty heady stuff for people just coming out of business and law schools.

I came along at a time when they decided to experiment with this program in Latin America. MIT had a very strong Latin American alumni group in government and in business, and they lobbied to organize this program for Colombia.

I was selected for the first group for this program - MIT Fellows in Colombia. In some circles it was known as the Wall Street version of the Peace Corps. Going off to developing countries had an idealistic appeal and the participants all thought they could defer the start of their careers for a couple of years. The Program was very well organized by MIT, well financed by the Ford Foundation. The compensation was attractive since we received the same local salary that would be due as an officer in the host private or public sector institution, and then we had them topped up by the Program, so we weren't suffering too much compared to our friends who stayed in the U.S. and went to Wall Street.

We also had strong academic backstopping. The graduates participating in the program in Africa, or in our case Colombia, would be brought together once a year for a series of seminars with the leading lights of MIT and other universities. In this fashion we were able to interact with people who had thought a lot about development, and we would try to theorize

or put in an academic framework, what we experienced on the ground, working in local government institutions or private sector institutions. Among the participating MIT professors were Rosenstein Rodan, Kindleberger, Nyhart.

We were also given a study grant to spend one month each year traveling in neighboring Latin American countries, writing up a paper on our findings.

This program launched not only me, but also a lot of other people, 50 of the alumni of MIT, Harvard, and Yale into the development business based on our experiences in Africa and Latin America. Over a third of the participants stayed in the field by joining the IMF, World Bank, or in the case of the Colombia program, several stayed and became entrepreneurs building successful companies. These are the academic background and experiences, which brought me into development banking.

Q: This was, in fact, my next question about your experience with the Colombian development bank. What exactly did you do? This was a well-established development bank, I take it?

A: Yes.

Q: And you were just an adviser to the management of that development bank?

A: Yes, I was sent to the Corporacion Financiera Colombiana (CFC), which at the time was one of the five main private

development finance institutions in Colombia. It had Bogota's who's who as institutional shareholders. I was sent there and placed in the projects department containing most of the economists and financial people doing project and corporate finance. I was received graciously when I arrived, given a private office and a secretary. It was pretty heady for my first professional job.

CFC was a very elegant, sophisticated Bogota society institution where all the people I worked with came from outstanding family backgrounds with excellent educations. My immediate boss had been to the Harvard Business School. Thus, not only was it a case where I wasn't offering him the latest wisdom on finance and management, it was he who was going to teach me.

I had to work in Spanish, and although I had been given intensive training in Cambridge before going down, I really felt very inadequate.

As a member of the project finance department, I was asked shortly after my arrival to start looking at a major petrochemical plant in which the corporation had invested and which was in deep trouble. The project file was three inches thick and all in Spanish. They left me alone for about a week. Then they invited me to a meeting and after an hour of discussion among the executives, called on me, Dr. Frank --

there they call everybody, with university training, doctor -- what should we do with this company? After a week, I had gotten through about half of the documents with the help of my Spanish-English dictionary, very laboriously, trying to understand the problem. Now, even if this had been in English, I would not have known what to tell them to do. But they thought they had this MIT trained management expert in finance with an undergraduate degree in engineering, he surely must know what to do. They were very patient with me.

I lived alone, I was the only bachelor in the group, so I soon caught up with my colleagues in the Colombia program who had college Spanish, but were married. I really immersed myself in the culture; dated Colombian girls, and had social contact only with Colombians.

Q: Brought one home with you?

A: Brought one home. The great fortune of my life was to meet my wife Irma in Bogota and convince her to marry me. That of course is a separate story and history!

As soon as my language capability improved enough after about three months, I was sent out on my own, to go to other Colombian cities to evaluate requests for financing that were quite interesting. The first was a proposal of an auto parts manufacturer wanting a big loan to expand. I was given an opportunity to present my analyses and recommendations to the

credit committee. They liked my quantified analysis but turned down my recommendations because of the owner's reputation, a risk I had no way of assessing.

They also asked me to run occasional seminars in the project finance group, showing, for example, the use of discounting cash flow and, rate of return techniques for project analysis. So I would conduct small workshops, very informally on key aspects of my MIT training. They gave me some money for textbooks, and I built up their library on financial analysis. They came to see me as an internal resource to help improve the technical level of their work in project finance.

They also threw me, headlong, into their investment activities, including one particularly demanding one. I was sent with an agronomist and an accountant to literally take over management control of a large African palm oil plantation near the Venezuelan border, which they had helped finance. The controlling shareholder was a family with huge land wealth that started the palm oil plantation with two or three thousand head of cattle, in conjunction with the plantation. After five years, they had used up a lot of their liquid resources and took a sabbatical to Switzerland. My organization had so much at stake financially, that I was sent to actually take over management control. It was pretty heady stuff to fly in on the

airstrip of this plantation with an agronomist and an accountant to assume management control. About a thousand workers were employed on that plantation, with fifty core administrative people. I got an incredible indoctrination of what makes the development finance process work at that level.

I was also designated as one of the escorts for visiting World Bank/IFC missions. IFC was a shareholder in the institution, and the World Bank was a lender through the Central Bank. So, I used to receive people that would come from Bill Diamond's DFC department, and take them on field visits and show them what we were doing with their capital. I would try to come up with some interesting slants to make the visit as successful as possible, and when they stumbled across something that wasn't our best face, try to divert them in another direction. It was interesting to see the development finance process from that end of a World Bank/IFC relationship with a local institution.

Q: You were talking about the World Bank. How did you end up in the agriculture department (June 1970)?

A: Quite honestly, I approached the Bank with only a mild interest. I was actually concerned at what I had seen from the other end of the Bank's operation; an overbearing, arrogant, bureaucratic organization dedicated to development but not engaged at the level I had been working and enjoying in the

field. I didn't know if I would get satisfaction at the Bank's headquarters level.

But I did come in for what turned out to be a very interesting series of interviews. One facilitated by Doug Gustafson in the development banking department, where I met Bill Diamond, the person who put out all this wisdom in books and letters to CFC that I had admired for quite some time. Neil Patterson and Kurt Ekridge who were handling the Latin American investment activities interviewed me in IFC. I also met with the people in what was then quite a new department, the industrial projects department headed by Hans Fuchs. Rich Pigossi, who had been a classmate of mine at MIT and on the MIT Fellows in Africa, was in this Department. So I talked to all those people and developed mutual interest.

Then Doug who had been on the MIT Program in Africa, and a good friend of Bob Picciotto's said: "You know, there's a new group being created within the agriculture projects department. The overall Department is really a refuge for the remnants of British and French Colonial overseas services. However, Picciotto is a fun guy, and he is in charge of this new area dealing with Agribusiness or Agri-Industries on a world-wide scope." I went and saw Bob, an energetic person full of ideas. He was looking for a dry financial analyst, and told me that the new division was a combination of traditional agriculture

and industry. I would not have to worry about all the problems of traditional agriculture but concentrate on processing, marketing and transportation aspects of the hybrid projects. And that, of all the alternatives crystallized, and became my starting point in the Bank.

I passed on deferring entry for the next Young Professional selection round and joined as the lowest grade for professional staff as a junior financial analyst.

Within the first three weeks, I went off to do a grain storage project in East Pakistan with an elderly, senior project officer, who was to lead the mission plus a Korean economist, Tae-Hee Yoon, who had joined the Bank on the same day as I had. When we got to Dacca our mission leader disappeared in his hotel suite spent no time with the mission (He had a personal distraction). He joined us for the wrap up session with Government officials at the end of our 4-week stay. Thus, three weeks into the Bank, I became the de facto mission leader, which was a little embarrassing, as this was a joint mission with SIDA of Sweden. They had sent their senior person on this huge project with their own consultant engineer. Here I found myself doing a very quick study of the project, it’s history, and how the Bank operated, policies, etc. Actually, the mission's terms of reference covered the supervision of an ongoing nationwide grain silo project and

appraisal of a potential follow-on project. This meant I was leading the appraisal of a new project as well as supervising an earlier project that was experiencing problems during execution (delays, cost overruns). So this was really baptism by fire. That is how I got started, almost by accident, in agriculture, since I was attracted by this particular new field of agribusiness and by Bob Picciotto.

Upon my return from that first mission, I learned Bob Picciotto had been transferred to the Special Projects Department headed by Bob Sadove. This was a shock to me. Although I still had not realized what I had gotten into, I was enjoying myself and was learning a lot and given a great deal of responsibility from the outset. I stayed in the agriculture department until the McNamara Reorganization in '72.

Q: Then you ended up in EMENA with Willi Wapenhans?

A: Yes, with Willi Wapenhans. I had gotten to know him over the two to three years, of course, because as the Deputy Director of the Agriculture Department, he used to sit across the table and grill me on the yellow or white cover project appraisal reports. It turned out, again, to be one of these luck of the draw situations. As one of the consequences of the McNamara '72 Nairobi speech was a new structure that broke up the worldwide Specialized Project Group into Regional Multi-disciplined Departments. Wapenhans was appointed head of the

EMENA Projects Department. I was assigned to EMENA because I had done quite a few agribusiness projects with the person who at the time had taken over from Bob Picciotto; this was Leslie Helmers from Holland. Leslie was made Chief of an expanded unit that covered Agriculture Credit as well as Agro Industries for the EMENA region. But he didn't like that assignment. As successor to Bob Picciotto, he had been Division Chief presiding over the worldwide Agribusiness operations, and was now supposed to become a Section Chief under the Regional Division Chief David Haynes, a traditional agriculture projects man. So he left EMENA shortly after the assignment became effective. They then cast around for someone to take over this unit. I had been only three years in the Bank by then, so they went through a lot of different alternatives before they finally offered me the job. Again, it was one of those assignments where I was on a steep learning curve. I was to manage a very strong team of agriculture specialists, livestock and agricultural credit experts, as well as agro industries who could write books in their field of expertise. As the youngest and most junior member I became their manager or Section Chief. Willi Wapenhans was very encouraging: "I'm going to give you this assignment, because I think you have the ability to do very good project finance work and to be a very good manager. You will probably run into a lot of resistance, because this is

a very traditionally oriented group of people in the agriculture sector. A lot of them are twenty years older than you are and have many more years of experience. Don't worry if some of them complain when they hear of your announcement. They will also complain when you have to exercise your managerial responsibilities and turn down or change their work. I expect them to come running in here to me, but I will back you completely. So you just go out and do your job." This made all the difference in the world, and I went off and did my job with the sense of his strong backing.

Q: But you didn't have these kinds of difficulties, then. Or was it in fact tough?

A: No, it really wasn't. I just was very fortunate. I treated all the people with respect, because I knew what my strengths were and weren't. I fully appreciated the depth of their expertise in their respective fields. I created a very good working relationship where we both socialized and worked together, and they accepted me in that role. I eventually became a full Agriculture Division Chief for a broader range of agriculture activities as the result of one of those sub-regional realignments that we went through.

By the time I left the Bank proper in '79, I had one of the most outstanding project finance groups. Many outstanding project finance professionals applied to join the division and

we were one of the most popular young professional rotational assignments. We worked in such a wide variety of countries, from Northern Africa to the Middle East, all the way to Iraq and Afghanistan. We were also one of the first project divisions that took on the work in the countries in transition. We didn't call them that in those days, but our work took us to Romania, Hungary, Yugoslavia and Poland. It was fascinating to work in the agriculture sector of those countries as the countries were going through fundamental changes from dismantling the state farms to privatizing the landholdings and starting to introduce market prices.

Q: Even in Poland at that time?

A: We were just starting to work in both Hungary and Poland. We were doing some of the preliminary visits to see how we would support agriculture development within their system. In Romania we did a lot with the state-sponsored cooperatives and agro-industrial complexes. It was a real challenge to work in this highly state-dominated agriculture sector and try to do projects directed by a central planning system, large-scale irrigation projects and large scale agri processing and beef, pork and poultry production projects. The heavy-handed political system was at times depressing for our project teams dealing with their qualified Romanian counterparts, who

suffered under state tyranny that drove peoples' performance with fear.

Q: Now, in '79 you transitioned yourself to IFC?

A: Right.

Q: How did this come about? Did you look for this change?

A: No, I had been approached by Gordon McClure, of IFC several years earlier, who wanted me to come and join the Latin American region because of my Latin American background. We talked about that at length, but I didn't go at the time when I was offered a job. It would have been basically a lateral transfer into what was a less structured organization. I was so interested in managing, that I wanted to get into something where I would be clearly in a management role. IFC saw me at that time as a Senior Investment Officer with a grade the equivalent of a Division Chief with only a loose supervisory role. The Bank, on the other hand, had tempted me with the idea that I would become an Assistant Director in the Projects Department structure at the time. I decided to stick it out with what I was doing.

But IFC came back to me a couple years later when P.M. Matthews, one of the stalwarts in the IFC and development finance business, who had been the Deputy Director to David Gill in the capital markets department, decided to retire. IFC pointed out that now they had a position that would involve

management and which would be a promotion for me. This occurred simultaneously with an offer by David Knox, who had taken over in the EMENA Projects Department, to become an Assistant Projects Director overseeing not only agriculture, but education and power. The Assistant Directorship was really quite an interesting but challenging job, operating between the Director and the Division Chiefs. Intellectually, it appealed to me because I would become familiar with more sectors outside Agriculture. In the end, I think the lure of going to the IFC in this particular area, building financial systems through advisory work and by creating institutions as an investor and lender, got me back closer to what I had originally found so interesting in Colombia.

So, I joined IFC as the Deputy Director in the Capital Markets Department with enthusiasm, but soon realized I was taking on a tricky role. I also found out this Department was almost an orphan within the IFC, which was dominated by the regional investment departments.

Q: How many people were in this department?

A: We had only thirteen at the time. It was smaller than the Bank Division that I had just handed over. It had a leader in David Gill who, in a way, was a visionary about what could be done in securities markets. He came from an investment banking background in Canada. He had a strong entrepreneurial

background and found the strictures, even of IFC, very limiting. So he was really trying to build this business in line with his own views and goals and sometimes quite against the grain of the more traditional IFC investment department structures and priorities. I found myself fascinated by the business, but had to handle a lot of the internal IFC management and organizational politics to get things done in a way that was acceptable, albeit never enthusiastically, by the rest of IFC.

I learned a great deal in that area. I was struck by what I thought was somewhat lighter, less in-depth work on issues like securities markets compared to how the Bank would approach such a topic. The work involved the analysis of new financial institutions, putting together the shareholder's agreement and picking the management for new specialized institutions. As compared to Bank work it represented a much more risk-taking and a less rigorous analytical approach. It was really at the time the birth of the emerging markets as an asset class for international investors.

Q: I see in your article in *The Bank's World*, and also in the write-up that your office has provided, that you linked your work in the department to what we now define as the emerging markets. But didn't this occur much later? In this context, I would also like to ask how much of the work of the department

was in response to the demand that was coming from developing countries, and how much was it a department that was performing more of a missionary role, trying to persuade member countries that this was an area they needed to focus on and develop? Can you talk about this a little?

A: I would say it was a combination of the two. There was certainly a missionary zeal that propelled us to pursue a vision that not many people shared within IFC or the Bank Group. At that time, the Bank had not even looked at the financial sector systemically as a sector. It looked at financial institutions that were to be the cornerstone of development finance – the DFCs, and the goal was to build a family of self-sustaining development banking institutions. Later, the Bank saw them principally as conduits for its funds and more generally shifted away from project lending and local institution building to program loans and structural adjustment loans with the policy conditionality of Bank loans taking precedence over institution-building.

In light of this transition in the Bank, I really was struck by the work and devotion of the very small IFC Capital Markets team trying to look at developing securities markets within the broader capital and financial markets through both policy advice and institution building via investments. We looked at the role of regulations, at tax policy, and at ways

to encourage or discourage in the issue of investment securities. We also examined the role of a lot of other financial services, such as the role of equipment leasing, whose relevance to development finance I questioned when I first heard about it. Later, I became a big fan of equipment leasing companies, helped create some of them in Latin America and Asia. I enjoyed representing IFC on the boards of several companies and gained a deep insight.

So I gradually developed my own vision of what could be accomplished in developing domestic capital markets. Shortcuts had to be taken, intellectually, to develop all the underpinning for the development of capital markets in the developing economies. But I began to see the role of not only of the traditional development banks, but also of commercial banks and securities firms. We often got into the debate about the universal banking model versus specialized banking as various countries charted their own courses in financial system architecture.

The Capital Markets Department was a real pioneer with a lot of bright, young people who were half the time doing loan and equity investment transactions to establish credibility within IFC, and half the time thinking about these fundamental issues and advising governments. Our small, rather young staff was bolstered by some very good consultants from the outside

including former SEC commissioners. For me they represented the first time I had been exposed to creative, systemic work of true securities market experts.

Some countries were very eager and willing clients to ask us to help them establish sound securities markets, like Korea, Thailand, and Chile. I was struck by how seriously the officials regarded the work done by that tiny IFC department with the help of some very good consultants who developed country specific blueprints on how to build the capital markets. In the case of Thailand, the Department's work was put into a document that was called the "Blue Book". The officials swore by it and step-by-step built the structure of the Thai capital markets accordingly.

Among other benefits, these types of assistance efforts established the "plumbing" through which international investors could channel investment into the domestic stock markets. By using offshore funds to attract international investments into their stock markets, countries were less anxious about "losing sovereignty" or fueling nationalistic concerns than direct multi-national corporate investment. Thus, a new asset class was born for international financial investors.

Q: Was the department working always with governments or with groups of investors?

A: It was a combination, and we always described our role as a two-hat role. With one hat we were advising governments to create the environment to allow the capital markets to flourish by building investor confidence in the domestic system, and the other was helping companies in the financial business to get started and grow. We would always start working with the local financial institutions or entrepreneurs who wanted to create an investment bank or sometimes of a specialized financial service company. This gave us an opportunity to look at business prospects from the broader government policy point of view. We might conclude there was no current viable business opportunity, for example, in underwriting securities because there were not enough securities in the market. We would ask, why? Why don't companies issue securities, stocks and bonds? We might also find that the problem was on the demand side - there were not enough retail or institutional investor interest because there were no disclosure laws, and the investors were worried about fraudulent offerings. So we were looking at both sides determining the prospects for successful market development and investment.

We advised governments, for example, on the different models of securities regulations. You have a U.S. securities model, which follows a "buyer beware" approach and by making sure the investors have the necessary information. SEC

approves prospectuses and offering memoranda for factual accuracy. However, projections or discussion of a company's prospects are not allowed. The investor does his own analysis.

You have a Canadian model, which requires analysis of a company's prospects in the offerings. You have the English model, which was a gentlemen's club approach to the securities market, i.e., self-regulation. You also had some heavy handed approaches where the securities commission wouldn't allow an offering unless they themselves were satisfied it would be a good investment at the price being offered. This led to government intervention in IPO share pricing.

We sat down with governments who were at the very beginning of creating a securities market and presented them with the four or five models in place around the world. If the authorities wanted to look at any particular one, we were able to give them the pros and cons. We would then help them draw up the equivalent securities regulations. We had experts who could come in for some of this work. We got this expertise funded by going around hat in hand to multilateral or bilateral sources USAID and UNDP with strong supporters. This is how we assisted in the securities legislation for Chile, for example, which became one of the most successful models. The people we sent to Chile rolled up their sleeves and spent months,

drafting securities legislation including guidelines for supervising brokerage firms.

So in those cases, we had very willing and highly appreciative clients who gave us a great deal of praise. This counted a lot because they were linked to IFC's Board. We were directly helping our Governors and our Board members in their own backyard, i.e., the Ministry of Finance, Central Banks and related commissions. We were working on problems they understood very well because of their own involvement in their own country's financial affairs. So it was highly popular among the developing country Governors and Board members, with a high profile, notwithstanding the fact that the department was very small and played a marginal role within IFC compared to the investment departments.

The Capital Markets Department role was a visionary, highly respected activity, and for me it represented a whole new relationship with governments and private investors. In the bank I was used to designing and appraising projects, putting in the safeguards, setting out the conditions, and going into tough negotiations with government officials about the steps that would have to be taken before we would approve a loan and release disbursements. In IFC's Capital markets area, we would advise - not require - the governments on the steps we thought they should take in developing their securities markets or

setting up new institutions like leasing companies. We would present the different models, write a brief report, and help with the next step of trying to create such companies. There was no institutional leverage available or used. In a way, it made it a very challenging job to be persuasive, just on the merits, rather than using the power of lending to get some of these things introduced or Governments to remove existing bottlenecks.

Q: Your work in Colombia and the Bank had been in quite a different field. This must have been a complete learning experience for you?

A: Yes, I was, for example, never an active personal investor in the U.S. stock markets. I knew a lot about credit institutions, but not the securities market end of it. It required, again, very quick learning to be able to talk about venture capital, securities markets, and disclosure standards and the like.

Q: Did you rely on Gill a lot?

A: Yes. He was a prolific writer and traveler - but most of all a very experienced investment banker. The people we had were all fairly young. What allowed us to survive, in this rather cutting edge sort of work in these countries, was a very good cadre of outside advisers. For example, I took to Colombia one of the original commissioners of the SEC. He had

joined the SEC as a young attorney, back in the '30s after the U.S. market crash and stayed until retirement. We were advising the Colombian government on setting up a Securities and Exchange Commission. A very distinguished former minister and powerful industrialist, Hernan Echevarria took on the development role as the Commission's first President. He believed in democratic capitalism, and asked us to advise him on how to get the commission going. It was only up and running for about six months when they discovered a tremendous fraud in the mutual funds industry, which involved one of the most powerful business groups. I happened to be on the scene accompanied by one of the former U.S. SEC commissioners working with us as a consultant, for an episode, which became a critical point in the history of the Colombian securities market. Our adviser quickly sized up the situation and proclaimed: "This is just the kind of situation that we faced in the US – in the early days at the SEC. You don't catch a lot of outright fraud in the securities business through the routine vigilance of a SEC. But, when you discover abuses, you've got to make a very public example of it and come down hard, and I don't care who it is."

He so encouraged the Colombian head of the commission, Echevarria, that he took the problem head on with the top political leaders. While we were still in Colombia, Echevarria

went and saw the President of the country, then went to the Senate where he took a highly principled stand. Unfortunately, he was not backed up and in fact asked to submit his resignation because he was threatening such a powerful group. But Echevarria was so convinced that if this group was able to get away with this fraud, it would create a climate of corruption in the securities market generally - the investors that were hurt were mostly small investors. He felt that this would set back the Colombian securities market for a long time. So, although he resigned, he was wealthy enough to continue the research and investigative work by personally funding a small team based in one of the leading universities and to pursue this case.

When the government changed, he handed over this work to the new President and new head of the SEC. Within six months the case was brought to trial with success. Watching what was happening from the inside gave me a totally new perspective on the powerful forces at play. To witness the first hand interplay between politics and high finance was one of the most fascinating experiences for me. Also working with someone like Gill and the outside experts who were pioneers was a very rich learning opportunity.

The reference I made to the emerging markets asset category that was born with our helping to install the

"plumbing" as we used to call it, in Korea, Thailand and Chile. This did not happen automatically or easily. One of our sales pitches was that if you get your own domestic securities market developed with clear rules and high standards of openness and disclosure, you would not only develop your local markets, you might be able to attract foreign investment through portfolio funds. This was quite revolutionary, as this was still in a period where people worried about foreign companies exploiting developing countries, and foreign companies worried about being nationalized. So we pointed out that in addition to direct corporate investments there was another way to attract capital, through portfolio investments, where the people making the investment are really not interested in controlling the company, but interested in a good return. So here was an opportunity to attract a more neutral form of capital, which could be a very desirable result of attracting capital, which at the same time was pushing security market regulatory and institutional reform.

However, I recall a discussion one day with the head of the securities commission of Brazil who said: "I'm not interested in that kind of money. I want only Brazilian money in my market. I don't want hot money from Wall Street that will come in and go out on whims - and yoyo my market." There

was no way that we could get him to believe in the value of foreign portfolio investment.

We did succeed in the case of Mexico and Korea. The person who first used the term emerging markets was a colleague of mine who joined the department about the same time I did Antoine Van Agtmael. He had been with Bankers Trust in Bangkok in a joint venture with a local investment firm. He came into our department and proclaimed the bright future of stock markets in developing countries. David Gill, of course, had already envisaged this possibility. So we went out and preached the gospel, and then tried to help countries build the underlying systems.

The first country funds for international investors were for Mexico, which we bowed out of as an underwriter at the last moment, and for Korea. These were put together by IFC working with the co-lead managers, First Boston or Merrill Lynch.

The process we had to go through in setting up these funds was fascinating. Among other things we had to bring the securities commissions of the various countries together and sort out contentious issues. No one had ever tried this. For example, in Mexico, there was a highly nationalistic view that underlying securities bought on the Mexican stock through a foreign domiciled fund would have stay in Mexico. Then you had the opposite view in the U.S. securities industry saying that,

underlying securities for a U.S. approved fund had to be available for supervision. Thus, stock certificates would need to come to the United States and placed in a trust. It was a stand-off.

Through the relationships we had developed with the head of the securities commission in Mexico and with their counterparts in the United States, who saw what we were doing as an interesting intellectual market development exercise. We got everybody together several times and eventually found a solution over lunches and various working sessions. The solution in that case was that we could use Citibank in Mexico in a trustee function. So the underlying securities would stay in Mexico physically, but they would be under the fiduciary control of Citibank, New York which in turn was supervised by the U.S. Fed. It was one of these elegant compromises that allowed the deal to go through.

We had many such problems, which paved the way for these first country funds. Eventually, we helped roll out a number of country funds in Korea, Thailand, and Malaysia. This was followed by multi-country funds--some for Asia--some across all of the higher end developing countries. We ended up being involved with about 50 funds. There was a whole new securities industry that got created. That was a fascinating thing to be a part of and it proved to be profitable for IFC as it was always

an investor in these funds most of which appreciated in value and the inward flows drove up stock prices.

The other thing that I got first hand experience in and which helped me later in my career in IFC was to assist individual companies access capital in the international markets. We not only thought we could bring capital into countries, but that there was also an opportunity for companies to graduate from being borrowers in the international bank loan market or from IFC to becoming issuers of their own bonds and, eventually, equity securities.

The first step was to do international bonds. We worked on a couple of test cases. One of the first cases we tried to assist as first time issuer of a fixed rate bond in international markets, from a developing country, was my first professional home, the CFC Colombia. We felt CFC was a sufficiently strong financial institution, with very good auditing standards. We felt we could present CFC to the markets in order to borrow internationally and then re-lend the proceeds to their Colombiam clients.

So we went through a very long and expensive process to prepare them for this step, the first time a non-government issuer from Colombia prepared to issue in the international markets. I gained a lot of first-hand experience on how you prepare a bond-offering prospectus, the accounting disclosure,

and the due diligence exercise. It was also an interesting way to come back full circle to the institution where I had started my professional career.

Q: This fun lasted until '83 and then you shifted to the Treasury Department in IFC?

A: Yes. It was really a situation where I was still enjoying work in capital markets. In fact, I narrowly escaped being tapped as Tom Clausen's Presidential Assistant—sort of a junior Chef de Cabinet. However, in 1983 IFC started taking the first steps to seek capital increase.

Q: This was the second capital increase?

A: It was the second. The first one was in '79 and then this one would eventually be approved in '85.

Q: Now this was a bit of a disaster, though?

A: Well, difficulties started with IFC management. The EVP, Hans Wuttke had trouble managing the Corporation. IFC had a very inbred culture that didn't take easily to outsiders. He came from a private sector finance background, the Dresdner Bank in Germany, where he had been involved heavily on the relationship building side. He was a very charming man, but did not have much experience in principal investing. IFC at that time was still quite a small outfit, run hands-on by the top officers, who looked at each project in detail.

I was astounded, when I came from the Bank, to see the things that would unusually be handled by a Bank Division Chief or at most what the Director would handle, always went to IFC's top executives for review and approval. The reviews were being done by the very senior group of people who had big titles and job grades. They were looking at each and every deal in detail.

IFC's Executive Vice President chaired these reviews trying to examine a proposed investment from the macroeconomics, legal, market and engineering points of view and finally the deal structure. You had to have pretty good knowledge of the investment analysis process, and be intellectually up to reconciling different committee member and proponents' viewpoints, and finally cutting through the debate and making a decision. Wuttke didn't have the background for this role, it just wasn't his forte. So he would spend more of his time on the international relationship side of the business, traveling frequently. He also did not hold IFC's Board members in very high regard—believing them to be third tier bureaucrats from Finance Ministries and Central Banks. In turn his condescending attitude towards them made Board relationships difficult for IFC. Although IFC was starting to run short of capital, Wuttke's leadership did not give us much credibility. Yet, I give him credit for taking on the personal risk on what is a difficult task under any circumstances — of

raising capital for IFC. Going to the shareholders on both developmental and business grounds was not going to be an easy exercise.

What we had in that situation was a need for capital not so much to expand our operations but to improve our income generation. Our business for the first four years in the 80s was flat in nominal terms, in real terms it was actually declining. Second, we were getting a lot of loan cancellations as interest rates fell. We'd made a lot of high fixed rate loans and borrowers were trying to get out of them. Thus, at the time IFC was starting a campaign for a capital increase, we had started to face the fundamental financial viability problems.

Although there had been an initial paper put up for a billion dollar increase, it was not a convincing case. It was based on a vision that Richard Richardson of the IFC Economics Department had devised. It proposed new activities for IFC, such as an oil exploration venture, highly risky and somewhat unusual, as well as more business in Africa, promotional of new business in agribusiness such as poultry and shrimp farming. But it wasn't compelling, as it did not address the issues in IFC's core business. Even Clausen said at the time that if the increase goes through, it would be because people believe in your private sector philosophy rather than your business

judgment and demonstrated fundamentals. It was important that we should present IFC as a business and really show how this capital would be used in expanding the basic business. The opportunity was there with a market friendly U.S. administration, but they also wanted to see the solid business case.

I was brought in as Director of a new Department to integrate a cluster of activities, which included planning, budgeting, and financial analysis. It wasn't the whole finance function. The main task, I was told, was to coordinate the capital increase exercise. I was at the time still not really a member of the inner circle of IFC officers. So it was somewhat unusual for this high profile task to be taken away from one part of the group and given to me, a fairly new and junior Director. There were skeptics who wanted to see if I could pull together both the business and the financial case. That absorbed about two years of my life.

It was very difficult, but I learned a lot about the finances of IFC, and the finances of viable lending institutions, because our lending was not viable. This was disguised by the fact that we had a capital base that we used as a free source of resources at zero cost and that made it look like we were viable. We had very little notion about how good or bad our equity portfolio would be. We had a few good

paying equity investments, and we had to scramble as the year would get to a close to show about $20-$25 million for profit. It was a type of superficial income management to prevent year-to-year declines, but it was not a true measure of IFC's financial viability. Towards the end of each financial year we would start to look for what we could sell, while trying to maintain the integrity of the reserving process. Reserves cut deeply into the bottom line.

It was pretty frightening when I started to look into the real profitability of IFC, trying to get a first approximation of the profitability of our various product lines. This area had really not been considered important within IFC – for years Vasant Karmarkar had heroically tried to manage this area with a small, over-matched (vis-à-vis operations) staff. The information system was obsolete, even our normal accounting system was still run on a punched card system. So our billings were late, we didn't have good information on collections, and we didn't have good information on our unit costs. Budgets were set at levels that reflected internal politics and leverage of powerful departments not related to profitability or leading edge priorities. We were really way behind by not having a modern automated accounting or a comprehensive management information system. So we had to rely on special

analyses, to put together the financial and the business case for a capital increase.

In parallel with the intense effort to map out a business and financial strategy we started a wholesale overhaul of IFC's financial management. One of the first items I undertook was to look at the fact that we were a captive borrower: we were borrowing all of our funds from the Bank. This was a system that looked very good on the surface, which was the initial deal that McNamara agreed to. IFC should be considered a conduit -- an extension of what the Bank was trying to do, but in different ways. Thus, he decreed that IFC could borrow from the Bank at the Bank's AAA cost. There was no spread. The principle that McNamara had laid down stuck for many years. He did not believe that it was important for IFC to become a financially self-sufficient unit and never envisaged it growing large enough to be a burden on the Bank lending capacity. But what looked like a great deal on the cost side, turned out to be something that really hurt us in its rigidity.

We would fund ourselves by borrowing from the Bank based on our cash flow requirements. We would estimate our disbursement needs and see when we would run short, and then we would get a hundred million dollars from the Bank at a fixed rate tied to the Bank's AAA borrowing cost, at that point in time for a 10-year maturity. It was a very mechanical

borrowing system based on funding cash flow shortage. I'll never forget, just as I took over the finance area, we had borrowed a large amount of money at what was then the Bank's cost. Not the Bank's average cost, but their latest market borrowing cost. It was around 16.5 percent, to be disbursed against IFC loans that were probably earning 14 percent, so we were already almost three percentage points in the hole. Forget about having a margin to cover our administrative costs and losses.

So I asked why on earth we aren't matching our funding to our loan investments, rather than cash flow borrowing? The answer was the existing system was a construct that had always been there, seemed to work well in period of interest rate stability and no one really anticipated how the severe mismatches could occur. So we had to take apart the whole architecture of financing IFC's from Bank funding based on cash flow to a new system match funding our loans (maturity and interest rates), in order to match the borrowing cost to what we were charging clients on a current basis. As part of transforming to a match funding system we wanted to clean out some old high interest rate loans from the Bank that was producing a negative spread for IFC. This was very controversial as the Bank thought we were getting a subsidy through the cancellation. It was very contentious, but we

finally worked it through the Bank's finance complex. George Gabriel was VP Finance of IFC and also Bank Controller and oversaw the Pension Fund. His cross-relationships helped a lot with getting the approval of Tom Clausen and the Board. While we got relief, we did not feel good about the perception that the Bank was bailing us out. That led us to what Gene Rotberg called at the time, "institutional machismo," we decided to go to the market for our funding. (That's what he told the people in the market, as was confirmed to me later.) I thought that there would be value in looking at funding ourselves directly, not only from the Bank's point of view, but also from getting IFC exposed to the market test.

Q: Was this your own idea?

A: It was my idea, right.

Q: By that time, had Bill Ryrie taken over as Executive Vice President?

A: Yes, Bill Ryrie, if you've read his book, mentions this step as one of the key achievements of his tenure. He records the decision very well, because it happened in his first weeks in the office of the new EVP of IFC. I had been working on this proposal for months, but was discouraged by some of my colleagues within IFC and I was being almost muzzled by Rotberg who didn't want me even to talk about it outside the Bank. I had started it under Wuttke, who was a market man, and who

thought it was interesting. I had been given a very limited hunting license to go out and sniff around the market and let them sniff at us, to say "what if." But the market was intimidated by Gene, who said: “This doesn’t make any sense. We’re the most efficient borrower in the world; we’ll take care of IFC’s needs. IFC's borrowings would confuse the market and could have repercussions on the Bank's costs.”

IFC's General Counsel pointed out that any IFC bond certificate must say, according to its Articles, that this does not represent an obligation of the World Bank or any of its member countries, i.e., that we were all on our own. There was also concern that an IFC bond offering was somehow a liability for the Bank, because ultimately it could not let us fail. Gene also stressed IFC was a venture capital outfit that needed equity funding not borrowings especially in the public markets. So we had a lot of obstacles to overcome.

But what finally led me to persist were a couple of things that happened along the way that I hadn’t quite anticipated in terms of benefits. First, we couldn’t get the type of financing we needed by borrowing from the Bank for some of the loan products we wanted to offer. For example, we wanted to be able to offer floating rate loans. Our clients were calling for this product, although some Board members especially the German chair didn’t think floating rate loans were consistent in a

development agency finance group. Money market finance the German ED called the idea.

We also had technical issues. What would be the pricing benchmark? U.S. Prime, LIBOR? How would we fund these loans? There was a lot of wrangling, and I just kept persistently working on each one of the problems.

Funding posed a big hurdle since the Bank had always been a fixed rate borrower and had only that to offer us. This would create an interest rate mismatch between our funding and lending. However, one day as an experiment, they borrowed through a floating rate note program (FRN). I went to Moeen Qureshi immediately and asked: "Can I have some of the proceeds from your FRN for IFC floating rate loans?" He said: "Well, your Board will never agree to IFC making floating rate loans, the Germans hate this because it would be using money market finance for projects and so forth. However, if you can get the approval, the Bank will fund your loans at the cost of our FRN." So over the objections of some of the Board, we finally got variable rate lending approved on a trial basis.

We were well advanced on the capital increase exercise by then and some of the Board members said that the total reliance of IFC on the Bank for its borrowings really was not very efficient for the shareholders. I remember one Board member telling me "If we increase your capital, you're going to

leverage that four times, with borrowings you’re going to run across the street to the Bank and borrow more, and then I have to give more capital to the Bank to keep it at 1:1 ratio."

That was fundamentally true and I agreed that we were not using the capital bases of the two institutions efficiently. In terms of additionality for the group, it was sensible that in dealing with the markets we should use our balance sheets separately, rather than in tandem. That was one of the arguments I made to the shareholders who were a little nervous about IFC going to the market, as it looked like more of a risk than a benefit for IFC to go out and do its own borrowing, especially, with all Bank finance people making threatening and scary noises. But I fought, and after a quick review of the issue, Bill Ryrie bought it.

This step had a critical impact on IFC beyond getting an alternative source of funding. Many within IFC and outside said: "if you go to the markets, you’re going to have to meet the market test, this will take a lot of financial discipline. And I said, we feel we’re disciplined in our own investment analysis and, we also hold our clients to a discipline by insisting that they repay us. So why not subject ourselves to that discipline? So, we turned the argument around and suggested that borrowing directly would impose a discipline that would be good for us. We had a lot of objections. IFC's

Chief Economist, Richard Richardson has written in his book saying this particular step - IFC going to the market is what killed the developmental orientation of IFC. Indeed, I believed, we had to get away from the idea that we were somehow a private sector oriented development institution that could live only on some mix of shareholder capital subsidies to make our finances work (appear to be in the black). But this meant we had to be credible with the market and the rating agencies on a transparent basis. This increased my worry about our own profitability; of not being able to measure and manage our net income.

I went to Bill Ryrie and proposed to him that we go to the market as part of a fundamental strategy to introduce more bottom line discipline for IFC and the various investment departments. It was not enough to show positive earnings each year; at the time we had a $20-$25 million net income that was very fragile, one large loan failure could wipe it out. Return on our equity investments was highly volatile. We might not be able to produce this required dividends or capital gains in a down market to stay in the black.

I felt inadequate being in charge of the IFC's finances without the ability to affect the outcome. We could only try to manage a net income outcome at the margin. If there were a problem as the end of the year approached, we would scramble

around and make the net income look respectable. This would put pressure on our prudent loss reserve.

There's no way I could reconcile responsible financial management with the required business decisions, whether to sell equity holdings, whether we were making good loans, and whether we were making a sufficient effort to collect. All of this was in the hands of the Investment Departments and their officers – not the finance area. My people just added up the numbers at the end of the year, if the income picture looked weak we tried to make them look better by going to the departments with equities that could be divested even if the timing was not ideal. I didn't want to continue this approach while going into the scrutiny of the market and eventually the rating agencies. I wanted to share the responsibility for income management in the hands of the people whose decisions were going to affect the outcome.

That's what led to the introduction of departmental profit and loss management system. Again, that was a highly controversial move. We discussed it at length at a management retreat. Some of the people actually tried to shoot it down. I was told by Peter Dickerson, who had been in the programming and budgeting area for quite some time, that the material he produced as the underlying work had been done about two years before. Jim Kearns was the IFC Finance VP at the time, and

thought that this might be a way to introduce financial discipline through departmental profit and loss statements. He made a presentation to the Management Group and the objections were so loud that he was told to destroy the presentation. People didn't even want the proposal in the files.

Fortunately Peter kept one copy, dusted it off when I came, updated it, and we showed the Management Group what the Departmental results would look like. We knew Africa would be under water, but emphasized that was not the key point. We wanted to know how much under water, and how they would try to manage the deficit and prioritize choices. It was an uphill battle because people didn't like the idea for fear that profitability focus would extinguish the development nature of IFC. We told the Board about the general approach but didn't show the system and results to them. We didn't want them to get involved for fear of divisiveness. This kind of analysis might lead some Board members to dictate where we should put resources, where we lend, where we don't lend, and so forth on a country by country, or even company level based solely on profitability. This in turn would have fueled objections from members representing countries where the business risks and costs were high that our funding would flow to the most profitable countries and companies.

I think it was one of the important steps that we took to create the sense of financial responsibility that now is so buoyant in IFC, and to finally get managers looking at the trade-offs.

One of the first impacts it had, which was quite unexpected, was that even though the department heads knew, more or less, their loans, and equity holdings, they had never thought about their department's operation as a business. They had never been shown a balance sheet for their department, here's what your loans and investments are paying, here's your expense budget, and, if you're going to ask for more budget, what's that going to do to your bottom line? So, for the first time, they had to go beyond the dynamic which was before: give me a budget and I'll promise you an outcome in terms of volume of loans and investment approaches. That was the old input-output approach of McNamara that led to the approvals culture in both the Bank and IFC. Instead, now they were asked if they wanted more budget, not only what it would mean not only in terms of approvals, but how it would ripple through to their departmental income.

Thus, it changed the way people thought about their business and made them more responsible when looking for budget resources and how they were being spent. It put more teeth into something we in the Bank Group had been, and still are trying

to do, namely to focus on the portfolio, and to get away from the approvals culture. With this device, line managers were held more accountable. To meet an income goal, you had to examine your choices and tradeoffs. You had a choice between sending your three best people out to look for a new project or to clean up an old one. From an income point of view, it was probably much better to clean up the old project. Because if you could collect, get money out of the central bank or squeeze the client or fix a problem so he could pay you, you were going to get money now, without having to wait for income from new loans which took six to nine months for the appraisal process and the approval of the Board, and disbursement over two or three years.

So this approach created a bias in favor of working on the portfolio for net income, rather than on booking new business. That brought about an impact that really put teeth into what we had been preaching all the time. Supervision should have a higher priority than making new investments

We coupled that with what was called the famous EFI - the Economic Financial Impact -- that consisted of measuring each project’s financial impact -- positive or negative -- on IFC and not just stopping at the estimated rate of return on a project.

Initially, staff were concerned that this was going to be another dreaded time consuming bureaucratic device. I put this problem to Nestor Santiago, who had joined my group from the Bank. Nestor devised a very user-friendly program that ran on a PC. The program required 5-6 variables to enter for a project: size of the loan, size of the equity investment, the sector, how much staff time being spent, and other fee income. Historical loss rates were part of the program that we had developed for specific sectors and countries. This allowed an investment officer to easily make the calculation in minutes, and present to the Investment Committees via a one-page attachment whether on an expected outcome basis the IFC financing would lose or make money over its life, or how much will it lose or make. One could substitute the standard assumption with one's own assumptions on the loss rates and so forth. So it was a clear, easy exercise with no excuse that you couldn't do it or it would take too long. With EFI sheet attached to every investment proposal that came to us at the Investment Committee, we could look at the estimated impact of the proposed investment size, loan pricing, etc.

The objective was not to establish the absolute basis on which to turn down a project or not, but we were trying to get the investment officer to think about, how much engineering time is he using, how much time he himself was spending,

whether he had really thought about the risk in quantitative terms (and in relation to IFC's previous experience), and finally, how it will affect IFC's bottom line. It forced staff to consider that we had to deduct our administrative costs and losses from expected interest payments and equity returns. Again, one of those devices that underpinned this whole notion of running IFC like a business.

Q: How did this relate to the reorganizations that took place in IFC? Was it part of the reorganization that took place then?

A: We reorganized a lot, going from one overall Vice President of Operations to Regional Vice Presidents and then back. We also moved from Regional Investment Departments to specialized Sector Investment Departments.

Q: And then you separated the portfolio supervision from the new business, didn't you?

A: The separation of the portfolio from the new business side was important as an additional element placing emphasis on the portfolio administration. We wanted to share information on portfolio's historical performance, coming from our accounting and portfolio analysis units to build a more robust information system. Once this was achieved, we could have a more credible impact on the operational side influencing the investment decisions and investment department priorities.

The financial area was allowed to continue pushing these broad initiatives while leaving intact what started as a small analytic department that I had been asked to head to restructure capital increase presentation. Later the controller side was incorporated, followed by creating a small unit, which would borrow money, and for which we finally got the green light, and, suddenly, we also had cash to invest. Eventually, this issue came up whether IFC should have a Treasury Department headed by a Treasurer? Should this VP of Finance and Planning, which I became, be called the CFO?

The Treasury question came up when our borrowing started producing significant liquid assets. Proceeds of borrowings were received immediately and then held until they were needed for disbursement. Should we have the Bank manage it, and if so, how we would supervise their management. So, this function was performed by two people and myself and formed the core of what became a treasury department. Bernardo Frydman joined us and in time became a very effective leader of our market borrowing activities.

The IFC financial complex grew organically but at a significant pace. At various points, we had enough activity to justify adding more people and more structure. But always with the notion that it would have to be tested to determine the financial results. Our liquid asset portfolio, unlike the

Bank's, was measured by the cost of carry, and by how much we earned. Likewise for our market borrowings, we had to show that we were doing at least as well as borrowing from the Bank. Our people were quite innovative. Once we were in the market, and became familiar with the various products, we didn't stop at offering floating rate loans, we offered loans with swaps, caps, advisory services. A whole business grew out of what was initially just another way to fund ourselves. Soon, we became much better known in the markets and the financial community at large; we became a coveted issuer. So we had the likes of the Deutsche Bank handle our Eurodollar issues. The U.S. markets were never a big area for us. We got a better reception in Europe and Japan as they had a higher regard for the multilateral financial institutions per se, rather than green eyeshade financial analysts, which is the U.S. approach.

To those underwriting institutions we made a point of saying, now that you helped us raise bonds, we also want you to help us in our other business, help us finance projects. We did something that the Bank had said should never be done, because it would create a potential conflict. However, we felt we could hold the underwriters to very tough standards competing for the mandates of fund raising, down to the last basis point. We were going to be as tough and transparent as you can be. But that didn't prevent us from having a good

discussion with the same people, telling them, by the way, now that you're selling our bonds, why not join us in financing some of our projects through our loan syndication operations and techniques.

And that became part of our pitch. The markets work that way, and we were able to keep things separate, but also get synergy. I took a personal interest in the loan syndications area working closely with Francis Hamilton who came from a British merchant banking background. We went out and did a lot of promotion of the "B loan" program with commercial banks to get them to join in at a time when many developing countries were just coming out of the debt crisis. We had a hard time getting commercial banks to go back in. They had all suffered with big losses and vowed never to return.

In the end, we created a finance group that became much more relevant to the operational side and impacted on business strategy. We started bringing people from operations to work in the finance complex, or in turn getting our people to go into operations. It changed the whole way that we were looked at within the corporation. As we developed prestige and expertise in the markets, we were accepted in the IFC house as being up to standards of the shrewd IFC dealmakers.

Q: You mentioned the fact that you had some resistance to going to the markets from the staff. There was concern that IFC

would focus even further on the relatively developed as compared to the developing countries. In this apparent conflict between profitability and development, which has been around for a long time, IFC hasn't followed a straight line. There's been a cycle that IFC has gone through. How do you see this?

A: I started with the premise that IFC had a critical role to be a catalyst for private investing. If you're going to invite banks and other investors to come and join you, and tell them we think we are offering a good investment, you need to show a successful track record. You can perform a critical role in mobilizing development finance from the markets but not if you are losing money.

I remember the first time I was asked by the market for our rate of return on our net worth when I was selling IFC bonds, it wasn't all that great, three or four percent. It was clear to me that if we were out there as a credible partner taking the lead and getting other people to invest in projects we had put together, analyzed, and were endorsing, then we ought to be able to have a market based track record ourselves. We had to have a healthy bottom line. So that was one of the key reasons to show profitability.

The second thing that drove the tension between profitability and diversified development assistance was the last recent capital increase. The '91 increase was a very

difficult exercise, just as torturous and just as long as the one in '85, but on very different issues. The questions from the US was, not how do you prove you're financially sound and you have the business, but it was more related to the question of how to reform the whole World Bank Group. IFC's financial needs became hostage to that reform effort directed at the Bank. Within that debate, there was a very sharp focus on our performance by the U.S. Treasury, led by Pat Coady, the Executive Director, with his investment banking background. He really zeroed in on profitability even further than in the past. He pushed us to set an overall return of capital goal – we settled on 8% - over the objection of many of the IFC line managers that this was unrealistic and we were setting ourselves for failure – or a profit maximizing straight jacket. However, we argued if this could be achieved, we could reach financial self-sufficiency and still grow new investments. We translated that into our business objectives, partly because of the fatigue of going through capital increases and the agony that they entail with the U.S. Congress, and partly because we felt a sense of pride as private sector financially oriented people. We said let's see if we can come up with a business plan and a *modus operandi* that will help us build our capital base in the future, more from profit than from shareholder contributions. If we can reach a level of sustainability that

would eliminate the need to go back to the shareholders for the exhausting two year exercise to raise more capital.

So the plan we put forward to get the U.S. to put in one billion rather than $750 million was that we would match that one billion over the next six or seven years with at least double the amount in terms of retained earnings. That appealed to the U.S. Treasury as something they could identify with. In fact, the Corporation is ahead of schedule with this year's net income, which will be somewhere between four to five hundred million alone for this year. So we were driven to make profits by very fundamental reasons. We needed profit to show that we can do business in the developing countries profitably, to encourage private sector investments by way of demonstration: here's how we do it, here are our results, you come and join us. Second, for purposes of long-term planning of the growth of this institution, we needed to generate the resources we required. We thought there was going to be continuing budgetary weariness of our government shareholders, so we wanted to see if we could become self-sustaining, although we never quite said it publicly, our goal was that the '91 capital increase would be IFC's last capital increase.

On the developmental side, we felt that financially sound projects were good for development. The real issue becomes then, how do you subsidize small investments or investment in

high-risk economies. We did not want to under-price the cost of our finance to private businesses because you want them to stand on their own. Thus, how do you subsidize developing those projects, as well as the cost of going into higher risk environments and smaller lending operations? My argument was that, as compared to an institution with a twenty-five million dollar bottom line, you can be much more developmental if your bottom line is averaging two to three hundred million per year (which it is now achieving). For example, you can put up an African project preparation facility and subsidize it to the tune of three or four million dollars a year on its administrative carrying costs, something you couldn't have done out of a $20m bottom line. We also now have an African enterprise fund focused on small companies in high-risk economies. Our subsidy is in the cost of our own appraisal and supervision work. These are things you could not envision with a thin bottom line.

Had anyone proposed those ideas in the days of very limited net income, they would have been dismissed on affordability grounds. Today IFC is being pushed to go even further. Now however, there is a concern that IFC is losing some of their profitable business and is beginning to live on the profitability of the past. In particular, the concern that it is selling off the family jewels attractive equity position.

But I think the important step was that we created the capacity to generate income by focusing on profitability. We increased our charges in line with market conditions without going to extreme of market perceptions of country risk. We introduced a number of fees (front end, project structuring, etc.) in those days to boost revenue. We also put a lot of pressure on cost control to increase profitability. We took the loan portfolio from losing about three-quarters of a percent to earning about half of a percent (on a fully funded cost basis). That's a dramatic swing in the loan portfolio performance. That was one of the major reasons for pushing net income up.

All of that made IFC an institution that is charging the clients to bear costs more in line with market practice. Business increased, even at those higher rates, and now IFC had more capacity to do developmental things. I don't think the Corporation has gotten far away on that aspect of its business, because you have to maintain a careful balance. But I always thought that the stronger we became financially, the more developmental we could become. We knew that in Africa, we were never going to be able to be viable; the African departmental P&Ls were always going to be negative. But unless we pushed our profitable business elsewhere, how could we subsidize those investments?

We liberalized the old and rigid lending policies. We said that we are not just in project finance, but also in corporate lending. We decided to go into financial restructuring, which had been a no-no. Our motto had been we never refinance any investment! One of the restructuring and advisory operation involved a Mexican conglomerate and made over three hundred million dollars for IFC in equity gains when the company turned around. This liberalization of our policies made us more responsive and in many cases more profitable.

Q: I have a question about Ryrie. I suppose your suggestions fell on fertile ground with him? How do you think his perspective was evolving? He doesn’t seem to have had the preparation for this job. His background, as a proficient bureaucratic with a good sense of practical problems and good judgment was that of a civil servant who had never met a payroll. What led him to take on IFC and to undertake all these reforms? Was it your persuasiveness?

A: No. He was just superbly trained, maybe in the tradition of the British civil servant, but with a very good analytic mind, and a sense of strategy and direction. When I proposed on how we should change the financial management with new products and so forth, he was very receptive. However, he had to be satisfied he thoroughly understood what was involved. Once he did, he was prepared to take risks--institutionally.

He was also receptive to a lot of other far-reaching initiatives such as, the land privatization schemes in Russia, which got us into things that we would have never tried before. Hundreds of MBA students were sent to Russia under loose administrative arrangements. Those managing these schemes were often new in IFC and young. However, Ryrie could see the vision and the value of these initiatives, which led to IFC getting involved in new imaginative ways. He took risks that no one before him would take vis-à-vis the Bank and the Board – or financially.

I had a conversation with Nick Brady recently, and I know that the U.S. Treasury complained when Ryrie was named. He must have been--I don't know if they ever conceded it--a very pleasant surprise. He came in on the heels of someone who had come from the private sector, Hans Wuttke, and for all of Hans' attributes, he had a hard time putting together this puzzle of development and profitability and business orientation. Bill Ryrie came, so to speak, from the world of development aid. This of course was helpful. He had no trouble with the Board, since he had credibility with these people. He was one of them; he knew them and their mentality well. He didn't get tripped up as Wuttke did and was forced to ask us: "In the development business, what is development? Can you give me a book that explains it? What is it that IFC needs to do to be

developmental?" This is something that we all take for granted; it's second nature for the veterans in the institutions. But, if you come from the outside private sector, the concept of development, in terms of balancing risks to achieve economic--sometimes un-quantified--benefits can be daunting. Bill Ryrie didn't have any of those problems.

For someone who came essentially from the opposite end of the spectrum and took the institution in a very different direction, it was a little bit like Nixon going to China. In his book, Ryrie has a chapter "My Nine Years in IFC". When I look back, it was like participating in a renaissance period. It was not only that we grew and became more profitable, there was also the diversity of new initiatives and activities. A sense of creativity and pride prevailed. Morale was high at all levels.

Halfway through that period, I described it to one of the previous vice presidents of IFC, Gordon McClure, who had been a very effective leader in his own right at IFC. I described all these things that we were doing such as new lending products, the Treasury operation, the project preparation facilities we created to help small businesses put together business plans in the Caribbean, Africa and so forth. "I can't imagine what it must be like to just manage this complex organization today," he said. In the four or five years since he left, IFC, which

had been a tightly run conservative investment organization suddenly, exploded with new dimensions. It was such an uplifting environment to be in.

Up until then, you would put up a new idea to the executive floor and it went into the black hole, it disappeared. You wouldn't get a yes, and you wouldn't get a no from people up and down the line. Even when I was a Director, ideas and initiatives slowly died from inaction. It was really discouraging. Then comes a chief executive who said let's take this idea and put it on the table. Bill Ryrie was more inclined to do this, to take risks, and to act. That made all the difference in the world.

Q: To what degree do you think he already had the underlying feeling that IFC ought to be an independent institution?

A: I think that's an issue that still is debated here. I must say that Ryrie never came out and said, "let's see how we can distance ourselves from the Bank," for example. He felt that there were advantages to being able to stand on our own two feet. He articulated this, especially in the later years of his period, even if he seemed to have felt a certain lack of respect coming from the Bank for IFC. He would say, "now we're larger and stronger; we'll not pretend we're equals in size or prestige, but I think we deserve a bit more respect. I think

we are getting grudging respect for what we've achieved. IFC is no longer the step-child in the World Bank Group."

The funding of IFC by the Bank issue was a very important strategic step for the various reasons I mentioned earlier. I remember in 1979 when I went to IFC, some senior people in the Bank, were asking "are you sure that's the right move for you because you know IFC can only do as much as we, in the Bank, agree to lend them. Yet, the Bank has its own plans, priorities, and constraints." That view conveyed a sense of dependency on the Bank that I took with me to IFC; it made me somewhat uneasy that I might be joining a marginal institution. Bill Ryrie didn't accept these limitations but rather than seek independence for its own sake, he felt that it was important to run IFC as a business. The success of this course led us to be less dependent on the Bank. He was perceived among his senior Bank colleagues as being independent, because he probably found, quite frankly, that the grand forums of debate around the President's Council were ones that, even today, the head of IFC probably doesn't find that germane. The President is preoccupied and spends still 85% or more of his time with the Bank. So Bill Ryrie would send substitutes to these meetings, and that was probably taken as lack of interest, and as just not really caring about the relationship with the Bank.

Q: Would you, in that context, talk a little about the impact that different presidents of the Bank have had on IFC? McNamara, with all his grandiose schemes, never included IFC in the doubling and quadrupling of lending targets. Now, Clausen coming from commercial banking, what was his attitude? Was he more attuned to IFC and supportive of it? Then came Conable, what was his impact?

A: These various Presidents practiced a combination of benign neglect and cheerleading. I don't think McNamara particularly thought IFC was an important element in the Group or for the development process. He kept pretty tight control on our operations – personally signing off on every transaction. Surprisingly, he was the only President that looked at each one before it went to the Board. He would very seldom say no, but he might comment on something that struck him. He would look at the business planning process and the annual budget closely, which subsequent Presidents didn't do, but this reflected his frame of mind and management style.

Clausen clearly came with a private sector orientation, as you say. After being appointed, but before taking office, he said flattering things about IFC to the press. I think a couple of things happened to Clausen as to why he did not take more of a direct interest once aboard. One, is that he may have seen the Bank's Group's relationship with the private

sector more as co-financing. This was one of his major themes that he brought from the Bank of America. He wanted to make co-financing with the commercial banks a big initiative. People in the Bank said, that's interesting but not one of the main things that we ought to be concerned about. They were mainly concerned about the overall development scenario and all the other things needed to alleviate poverty with the Bank's own resources. He pushed that theme to the extent that he could.

He was clearly disappointed with IFC under Wuttke's leadership. He felt that IFC management did not really have its act together; his key concern was the problem of suitable leadership. In the meantime, he went through a period where he didn't really think he could devote a lot of new attention as he struggled with the Bank's management structure and processes.

I also think that we in IFC felt he "discovered poverty." All of a sudden his own mindset changed -- which I think happens to a lot of the presidents from a private sector background. Clausen believed the private sector should try to address poverty problems. But he in the end concluded its direct role was limited and thus concentrated on the Bank.

In fact, Jim Wolfensohn is also very private sector oriented, however, he has not made this a private sector Bank

Group. Supporting the private sector is an important activity, but he probably would say that today he has more passion for what the Bank does in the social area. I think the poverty/development dimension does strike somebody from the private sector, and intellectually, when you're at the helm of the Bank. So your background doesn't necessarily determine your priorities or your outlook as World Bank President.

Barber Conable didn't come with a general background in either the private finance or development aid business. As a former U.S. Congressman, he was more familiar and comfortable with public policy issues – although he was pragmatic and straightforward in his dealings within the Bank. Conable saw the IFC as a junior affiliate. All of those presidents, Conable, Clausen, and then Lew Preston, got so caught up with the need to deal with a reform process for the Bank that they had not much time for IFC. So, we in IFC, just resigned ourselves to their benign neglect and lack of proactive support. We accepted that they were not going to take a strong interest in IFC one way or the other. They were not holding us back, but they were not really boosting us either.

Q: Can we go back to the two capital increases? You said they were very different. I understand that in '85 it was a question, essentially, of how much business you really have and whether there was a need for this kind of money? In '91, in

contrast, there was no question that IFC needed the capital increase, but the U.S. had decided on their own that they wanted to link their agreement to certain other problems they wanted to fix. I have never understood this exactly, because here was IFC which was doing all the things that the U.S. were preaching and obviously in need of money to continue its mission, and yet the U.S. Administration was holding this operation up. Why did this happen? And how did you deal with this?

A: It was very difficult. I think as financial people the U.S. Treasury authorities believed very much in the working of the markets. They saw the world had changed very fundamentally from one dominated by governments and public sector activities to one dominated by the private sector. In the World Bank Group you had two institutions, one huge and one small. If you're looking at it from a shareholder's point of view, you ask yourself what is the job you would like the Group's institutions to do. They said we like the job IFC is doing, but we would like you to try to make more profit and be more selective in your investments. This was a tough agenda in itself, which led to things such as an agreement on net worth return, which a lot of my colleagues didn't want to commit to although I actually thought that it would be useful to have such a target.

The selectivity issue was difficult because there was an attempt to over prescribe. For example, a detailed test on whether or not there was market finance already available. Some of this was in response to U.S. commercial and investment Banks complaining that IFC was becoming a competitor in providing finance and advisory services. These complaints increased when the "weather was good", i.e., lower Emerging Economy risks. However, when there was a downturn for a particular region or countries, then banks headed for the exits. It was difficult for IFC to start and stop its operations in a given country.

But I think the U.S. felt there was a bigger prize – reform the Bank. Although they didn't know how to achieve it, since they had not been asked for a capital increase for the Bank. They wanted to change the mentality and orientation, in other words, the culture of the Bank to be more supportive of private sector led development. They tried to impose a variation of the EBRD formula. At one point, they said, half of the projects that the Bank does should be private sector oriented. Now what does that mean, and how would you do that, because the Bank's requirement of government guarantees was a big obstacle with the Bank's Charter? The U.S. insisted on a study of a change of the Articles of Agreement. The completed

study outlined the difficulty of an Article change including the potential impact re the Bank's credit rating.

They also asked the Bank to agree to hire X number of private sector specialists to develop more of a private sector mentality among the staff. They were basically saying, the biggest institution in the Group, with the biggest balance sheet, is still doing the old style business; backing governments, public sector, state-owned enterprises, and this has to change.

The U.S. recognized that their leverage was not great since very few other shareholders wanted a dramatic change in the Bank's orientation and in the meantime the IFC was being held up. They made some progress, but not much. The other shareholders finally got quite annoyed because the U.S. would replay the argument of the need for the Group to work with the private sector and maintained that the most relevant affiliate is out of money while the Bank had excess capacity. As we were being held hostage, we actually took our situation to the brink. We said that we were in a fast growth pattern, that we had plenty of business, but that we had to cut our operation back. For FY90 we put up a restrained business plan and a budget and told the Board we're going to cut back growth to 3% and turn away more business. We could be growing at eight or ten percent a year, but next year we're going to grow to only

three percent, and after that it will be zero percent, because we can't get into trouble by overextending ourselves financially.

The Board accepted the three percent increase for FY90, but the U.S. attitude was resented by a lot of other shareholders who pointed out that the U.S. would not put up the capital to allow IFC to grow even though it was its champion. This finally came to a crisis point. It was one of those periods along the way where I saw how the President of this institution works with the largest shareholder.

You might recall during those periods that Barber Conable and David Mulford, U.S. Senior Treasury Official, were very much at odds on Bank policy. There were rumors that Mulford was interested in becoming Bank President. David Mulford was calling the shots on the IFC Capital Income and Bank reform and his tough point man at the Board was Pat Coady, the U.S. Executive Director. Conable had pretty well decided he wasn't interested or that he didn't think he had the support to be nominated by the U.S. for a second term as President. But, he made it clear that he thought David Mulford would not be a suitable candidate to succeed him. So that added a personal element to this relationship, although the basic factor was the very heavy-handed U.S. Treasury attempt trying to reshape the

Bank and getting the Bank thinking like a private sector institution.

This played out in high drama. At one point we thought we had satisfied the U.S. after having gone through very careful drafting of undertakings by both the Bank and IFC. To help in the final process, we brought Sven Sandstrom, who was advising Conable as his assistant, and Johannes Linn, who was in charge of the Bank's financial policy and planning.

Larry Summers joined the Bank as Chief Economist during the process and tried to help us with his U.S. Treasury contacts. We went through long discussions and drafting sessions with the U.S. in working out each issue, making commitments, along with a separate side-letter that was negotiated. Then this all had to be endorsed by the Board. The proposal had twenty action points, but only four or five were ours and the others were the Bank's.

When we thought that we had agreement from the U.S., the IFC increase was tabled in a formal Board session. But as the Board session proceeded to where we were expecting approval from all key shareholders who had swallowed the compromise with the U.S., Pat Coady got up, left the room, and then come back and announced: "I'm sorry, my authorities told me that they are not prepared to support this." They had of course the power to block the proposal.

The meeting was hastily adjourned. We huddled in Barber Conable's office -- I hadn't had that much contact with him, and quickly learned he was a highly emotional man. He said: "Get me the White House, I want to talk to the President. I will not allow this to happen, I know what's going on, but I'm not leaving here with this kind of humiliation." He felt that the U.S. Treasury action was very personally directed at him. He called the White House and President Bush came on the line while we were sitting there. Shortly, after the conversation took place, Brent Scowcroft, as Foreign Affairs Adviser to President Bush came over, in a very unusual role for him, with David Mulford and Pat Coady in toe. We sat and worked out some compromise wording in less than an hour.

Under highly unusual circumstances, the capital increase proposal was tabled once again: under a prescripted arrangement there would be no one in the Board room except the EDs, the President, the Executive Vice President of IFC Bill Ryrie, myself, and Pepe Camacho our General Counsel. The capital increase was introduced with a short statement and then approved all within five minutes!

Barber Conable probably wished the IFC increase hadn't come along. But he found himself so caught up in it and so challenged personally, that to succeed became a matter of pride

for him. My personal respect for him grew immensely as a result of the stand he took.

At the time, of course, the U.S. had a Democratic Congress and we weren't getting that much help from the Congress to approve the U.S. Treasury's request for the Budget authorization from IFC capital increase. This led to another episode, which I will always cherish. There was a Congresswoman who controlled one of the key congressional committees, Appropriations, by the name of Mary Rose Oakar from Ohio. Bill Stanton, also a former Congressman, was Conable's Counselor for Congressional matters, and he decided that her support was going to be key. She represented a district in the Cleveland area. Thus, we were sent to the Hill to see her, Bill Ryrie and Bill Stanton, as well as I. This was very unusual since such contacts with the U.S. Congress were the domain of Treasury.

She welcomed us and asked: "How is my friend Barber Conable?" And then she said: "I just want to tell you, gentlemen, that I support whatever he does. And, I told him I'd support whatever you're proposing. But tell me, what is IFC and what does it do?"

Now I thought we were lost. Bill Ryrie, in his very articulate way started to explain. Now there are some people you can speak to in theoretic and abstract terms, and there are

others who need examples. Bill started talking in general terms about the development process, and I could see that it didn't make any sense to this lady at all. Her eyes glazed over. But I had heard, two days before, that there was a health clinic in the Cleveland area that wanted to set up a similar clinic in Poland and had come to IFC for financial help. So I jumped in and told her about this project. She knew about this clinic, as it was luckily from her district. They wanted to invest there and they didn't have a local partner, or any financing. We could help them find a partner as well as provide financing. She exclaimed: "Oh that's what you do. Well why don't you come with me to my district and tell my constituents that is what you do. Because I have a lot of people like this."

Q: Again, all this came to an end suddenly in 1995 when you came back to the Bank? Was that part of your career plan?

A: Not at all. It came completely out of the blue.

Q: Did you know Lew Preston through your banking activities?

A: Not really, but I got off to a good start with him when he took over in 1992. He wanted a one-hour briefing on IFC. He was using a small office in the Bank prior to assuming the Presidency. Bill Ryrie was on leave at the time and called me up and said: "Well Richard, just go over and tell our story, what we do, and what our priorities are." As I was told, he

didn't want a bunch of papers nor any documents, I prepared a one-page outline with our priorities, describing what we're doing, and the few issues we have.

Preston was a very gracious man. I remember him walking out of the door of the small office he was using and saying: "Can I get you a cup of coffee?" I just couldn't believe this. This was the great international banker/Wall Streeter Lew Preston bringing me coffee. Such a gracious man.

Then, in order for him to get a better feel for the Corporation, I organized a lunch for him to meet with all the IFC department directors in town. After the one-on-one briefing we went to the Presidential dining room, had lunch and had each one of the Directors tell their story. He had a couple of probing questions about collaboration between the Bank and IFC, and whether people move back and forth. He had heard that I had moved back and forth. Later I would see him from time to time at the Board, when I had to handle some pretty difficult matters on new financial products, new ways of investing, and the whole annual budget business plan presentation. I had the impression that he respected me, but again, he spent at least 90% of his time on Bank matters.

The only other signal I got was, when the EVP job opened up, Bill Ryrie told Lew Preston that he would feel very comfortable handing over the job to me. According to Ryrie,

Lew Preston had said that he would do that immediately if he could, but he couldn't on nationality grounds. That was also fed back to me by a couple of people close to Preston. Meanwhile, I went about my business as IFC's CFO. I was at a point where I had done so many interesting things in this position and still in my early 50's that I was thinking it was time to leave and join a private firm.

Then Lew Preston called me, completely out of the blue. It was one of those incredible situations. I was in the shower in Melbourne, Australia. My secretary called and said that Mr. Preston had just asked for my phone number. I had barely gotten dried off when I received his call. In a very friendly and outgoing way he said: "What the hell are you doing down in Australia?" I told him we were out promoting business with Australian companies, encouraging them to invest in various Asian countries with IFC's help. Then he said that Ernie Stern had just reached an agreement to leave the Bank and to join a good Wall Street firm. He said: "Ernie was about to go off and do the wrong thing. He was going to join Salomon Brothers, but I finally got him sorted out, he's going to join J.P. Morgan." He went on to say "I know those people in Wall Street, they will probably want to announce it tomorrow, and I'm going to be in a spot. I will have to go to the Board and as soon as they find out he's leaving, I will have to tell them who's going to

take his place. I want to tell them that you're going to replace him." It was just like that. I was really taken aback.

After expressing my gratitude for his thinking of me for this position and the honor I felt, I told him that I had already thought it was time to move on and do something else, and I quite honestly thought that it would be outside of the Bank Group. He said: "Well, you can always do that, this will be good for you no matter what. You come on over with me and we'll have fun together. We'll screw up together."

He just put this in such a nice way that I said: "Well, could I think about it and let you know?" He said: "Richard, this is a very important decision. Think about it. But give me a call back tomorrow afternoon and tell me you are going to take the job." There was only one answer he wanted, and I could not talk to anybody about it in the meantime. So that's the way it was done.

People on the other end told me that when Ernie Stern walked into Preston's office after he hung up the phone with me he said: "You know what Richard Frank said? He said he wanted to think about it. I'll break every damn bone in his body if he doesn't take this job."

So it came completely out of the blue. It was a real honor and a surprise. He outlined what he wanted me to come with, my background in finance, a private sector orientation in

Latin America, and to work in what was going to be a whole new generational team of Managing Directors in a collegial style. Gautam Kaji had just been appointed two months before, and Sven Sandstrom was in transition as a full-fledged MD. So it was a whole new generation of MDs picked by Lew. He was very excited about it. Later I asked him about the U.S. Treasury reaction since I knew that Larry Summers was also keen to get his people in key places in the MDB's. Lew told me that he had received a call on the appointment from the then Secretary of Treasury – Lloyd Bentzen. According to Lew – he told Bentzen "you can advise me on policy but leave the personnel decisions to me."

Q: As it turned out, you never actually worked with him, because by the time you took over, he was ill.

A: The night I was to move my office, my secretary Lyda Tanco and I were packing boxes when Ernie Stern called me. It was at the end of January when Lew had gotten the diagnosis of his terminal illness, which Ernie Stern shared with me. I said: "Well, Ernie, what do we do now?" He said that he had talked to Lew who said: "You tell Richard Frank to get the hell over here which meant moving in to Ernie's office." Lew and I had met several times in the intervening period, as it was at the end of November when he appointed me. During those two months we had great conversations. Even at his home over the Christmas holiday when he was a little ill, we still had no

idea of the seriousness of his illness. When he came in the first time after his illness was diagnosed, we were up to our eyeballs in the Mexico crisis. He was very preoccupied with the unfolding Mexico peso crisis. He asked: "Can you start now, and take over what is happening in Mexico? We don't have leadership on this and so forth." So he and I talked business a fair amount in those remaining weeks on what to do with Mexico. I took the lead of the Bank team.

Q: Wasn't Shahid Husain then still in Latin America?

A: No, Husain had moved on to Personnel Administration, and Shahid Javed Burki was there, about a year on the job. But Ernie, who stayed an extra month, thrust me into the middle of this affair. Ernie said that this could not be left to a vice president to handle. Indeed, there was two billion in additional immediate new commitments needed, which was over our country ceiling of exposure. There were a lot of high-level discussions with U.S. Treasury, IMF and IDB.

Q: Wasn't it really the IMF and the Treasury who were carrying the can?

A: Certainly at the beginning they were able, with their large-scale immediate programs, to get some stability on the currency and the U.S. use of funds from the stabilization program helped calm short-term market concerns. But in the Bank we detected, both from the market and the Mexicans, that

people were worried about the underpinning of the economy completely disappearing if the banking system collapsed. So the focus became, how do we shore up the banking system. I formulated a program for the Bank to help both in an advisory role and then come up with the biggest amount we could handle. This turned out to be the largest loan in our history, a billion dollar loan directed at restructuring the banking system. IDB joined us with another $500 million.

Q: Not as large as the first loan that the Bank ever made to France which was $250 million in 1947, which today would be close to $3 billion!

A: Touche! I was really thrown in leading this effort, very much with the backing of Ernie Stern. He insisted, even though a regional vice president would normally handle this: “I’ve been through these things before. There has to be someone to speak who represents the very top of the Bank.” So I represented the Bank in all the discussions with Larry Summers, Stanley Fischer, and Enrique Iglesias.

We from the Bank were able to put matters in a perspective, which was quite different from what the Treasury and IMF were looking at. We were seeing not only what was happening in a banking system, but we brought in IFC’s perspective on what’s happening in the real sector--how companies and banks were faring. We predicted far before

everybody else a number of key elements: First, that the banking crisis would cost far more in recapitalizing the banks than anyone thought, and second, that Mexico would have an export-led recovery.

On the latter, our insights were based on the fact that the companies that were clients of IFC were signing export contracts left and right. I think that the Treasury and the Fund finally understood that we knew what we were talking about from the micro point of view. They had started out to manage this crisis entirely with macro tools -- interest rates, etc. We emphasized that every increase in interest rates will increase the arrearages of the banks' portfolios, which are far worse than the figures were showing. Because the figures were based on accounting and reporting systems that were inadequate, they allowed rollover of interest rates and loan payments. So, what looked like a 7% arrearage problem for the banks before the crisis, was far worse than that.

The banking system was in bad shape before this crisis; with the crisis they just got battered. In all of that, the Bank played a key role, and I was personally very much involved, leading the two missions, and negotiating the overall aide-memoire with the Minister of Finance, Guillermo Ortiz and conferring with President Zedillo. Lew Preston was also very involved by offering advice. He would talk about what kind of

instruments should be used to recapitalize the banking system. Had we thought of subordinated loans? What should be the terms if the banks didn't come out of the woods? The loans should be converted to equity to avoid a re-nationalization of banks. How they should be floated in the market? He was superb, and had a tremendous insight in all these financial and banking system matters.

It was during that period, that he asked the U.S. Treasury to find a replacement for him, although in the meantime he was determined to run this place with his three new MDs. The question came up of Ernie staying on perhaps as Interim President, and for how long. Lew basically said that there was some subtle pressure for him to resign, but he took the stand that he would resign when a successor was found. And, in the meantime, he and his "three boys," as he called us, will run the Bank. So Ernie, after one month's extension, left. We set up a system where the Managing Directors would rotate monthly acting for the ailing president.

It was on my watch as Acting President that he died, and I was the one who had to announce it to the Board first, and the world next. We had about a two-hour advance to announce his death to the Board, and immediately thereafter to the staff and the world.

This set in motion, then, something that I guess hasn't happened too many times in the Bank. The Acting President status that we operated on was no longer valid. Thus, the General Counsel Ibrahim Shihata came to me joined by the Dean of the Board, Al Assaf from Saudi Arabia, and Jan Piercy, the U.S. ED, and said there were three options in order for someone to have the authority to chair the Boards and run the institutions: IBRD, IFC, IDA, and MIGA. Apparently, there was only one other time that this has happened before. Maybe you know.

Q: Yeah, when Meyer resigned in December 1946.

A: And I think the U.S. Director took over?

Q: Initially, there was a Vice President, and then he died. Then there was a hiatus and the U.S. Director tried to fill in, but the General Counsel stymied this, essentially, at the time. Meanwhile, negotiations went on with McCloy and eventually he agreed to take over.

A: They dredged up this history and wanted to move very quickly. So the three choices were: first, see if Wolfensohn could come immediately-- but he couldn't as he needed considerable time to settle his own affairs, his complex financial holdings and so forth. Second, the Dean of the Board, Al-Assaf, could take over as ad interim President. No one quite mentioned the U.S. ED precedence, but that was

lurking under the surface. The third option would be to ask me to take on the Presidency, ad interim, and become chairman of all the boards, and head of all the institutions, IBRD, IDA, IFC and MIGA. That's what happened. It was a brief transition period but it was a wrenching period for me personally, having made an important shift in my career to return to the Bank and then only a few months later having to announce the death of the man who appointed me to that position and for whom I had really started developing a fondness. Then I found myself with a new boss and someone totally unknown to me.

I had become involved tangentially in the Bank President selection process, particularly through my close relationship with the U.S. ED, Jan Piercy. Jan was very close to the White House (classmate of Hillary) and took the selection process to heart. She shared with me the discussions at the White House with President Clinton on the appointment.

When it came down to Jim Wolfensohn versus Larry Summers, she had a real dilemma. I don't think she felt either of them were the ideal candidate for very different reasons. When Wolfensohn won out, she was a good sport and tried to be as supportive as possible. However, I don't believe Wolfensohn ever trusted or respected her. He suspected she had not supported his candidacy. That, and some other incidents prior to his arriving made for a difficult start to his Presidency.

Q: Now, if we can cover two more subjects. First, the private sector responsibility that you were given soon after Wolfensohn became president of the Bank. My second question is to ask you to talk a little about Wolfensohn, his style as well as his impact on the institution. Perhaps you could also comment in this context on the problems that the Bank is facing and the crisis that we seem to be in?

As far as the first question goes, yours was a very peculiar assignment in the sense that you seemed to be not really in charge of anything, and yet presumably in a position of authority, but authority without real teeth. The task itself - coordinating the Bank's support of the private sector - sounded somewhat vague. Sure, the private sector was the rage, but what did it really mean to let the whole Bank Group speak with one voice on private sector issues? How did you define your task, and how did you carry it out not being able to really tell those in charge of IFC and MIGA what they were supposed to do?

A: You're right; it was a unique assignment, and a unique structure. It evolved really with Jim Wolfensohn who, upon taking office, went on a tremendous crash course trying to understand the Bank and all its dimensions, and understand the management structure. On the one hand, he thought that the Managing Directors had not been instilled with enough line

authority under the old format, which was more of a collegial one. For instance, under Preston, I had two regional and two functional vice presidents who reported to me, and was generally supervising their work. But the vice presidents were reporting directly to the President, albeit in a collegial style, Management Committee setup. Of course, as long as Ernie Stern was around, he exercised a lot of authority even if it wasn't formally defined. Jim Wolfensohn found that very awkward and wanted to have more authority executed by the Managing Directors, and he announced that. Although in practice, he does not fully respect that approach.

In the case of the private sector, one of the first things he did was a lot of homework trying to get the views of the Bank and IFC from people within and outside the institution-- I think he got a lot of garbage dumped on him by the market in particular. Some complained that IFC was very bureaucratic, or that IFC was exploiting its position as a publicly funded institution and crowding out private sector finance. Some would complain that it was impossible to deal with the Bank because of established bureaucracy or outdated mentality; there was a general sense that there were many things the Bank could do to help private sector investment if it was properly organized and led.

Then there was MIGA, the newest member of the family, which had achieved a pretty good reputation for its operational efficiency but was facing financial constraints. During his internal orientation, I joined Jim and saw the presentations he received and how bewildered and frustrated he became.

Take a theme like privatization. IFC would say, we have a whole department that advises governments on privatization policy, how to sell state-owned enterprises, and sometimes we also advise companies that want to buy Government assets. Next, he found a group dealing with privatization in the Bank under the Rischard Vice Presidency. They had a group advising Governments on privatization. Then he went around to the Bank regional complexes and people would tell him that their big adjustment operations were aimed at getting governments to privatize. So he exclaimed, this is about the fifth time I've heard people dealing with privatization.

Obviously this created the impression of a lot of fragmentation and lack of coordination. Each time, of course, he had different impressions of how good the people were dealing with the subject.

Then he got into issues like investments in the power sector, which was going more and more to the private sector. He was just completely overwhelmed. To hear that each Bank region had three or four power divisions, and that each

department was self-contained technically was difficult to understand. There were six regions, take four country departments in each and each one had a power unit, so multiply that by six, you had twenty-four power units, each somewhat self-contained. Plus, you had a power group at the Bank's center in the Private Sector VP. IFC had a power division, and then there was MIGA guaranteeing more infrastructures investments including power. This didn't make any sense to him; this looked to him like unnecessary fragmentation, and indeed, he was right.

This led to trying out different management and organizational schemes. The one clear conclusion he arrived at was, he said: "I'm the only person here who's really looking at what all four of these institutions are doing. I find it highly fragmented. I find it very inefficient. The different units are like ships passing in the night, not talking to each other and not working together. I get a lot of complaints out there. What about you taking this on, Richard, full-time, trying to sort out what we're doing in the private sector across the Group and bringing things together."

This was appealing to me. The question was then how do you do it? So we started talking about different structural arrangements, and it was Wolfensohn who came up with this Chairman title right at the beginning, and he stuck with that.

He thought, in fact, that he could designate someone with authority over all the parts of the puzzle. I was the first one who said that maybe he would run into legal and certainly some cultural issues; issues of institutional autonomy, and a lot of people who feel that they report to the president directly, and not to anybody in between. He initially brushed that aside, and said if anyone challenged my authority they should come to him to get sorted out. But, as he got more into it, we had to recast the idea of what should be the role and what would be the levers and tools to do it.

To Jannik Lindbaek, as IFC EVP, and Mr.Ida, as MIGA EVP, my role was a threat and they were very protective of their status and reporting line to Wolfensohn. Shihata played a mixed role – seeing me as having authority over these affiliates to bring about coherence, but not in a formal sense out of fear of the Bank being drawn into courts and litigations as a result of overlapping executives.

In the end, it wasn't my design, nor was it Wolfensohn's initial design. The idea was that I would be empowered, not in a formal sense, as the person to pull the team together and chair a group of the top Group executives, EVP IFC, EVP MIGA, Bank, VP Private Sector, VP for Cofinancing, that would meet on a regular (weekly) basis. I decided to play with the hand I had been dealt. I also had a lot of confidence in myself to

persuade my colleagues that this would be the right thing to do. Finally, I was counting on Wolfensohn for support. This seldom happened. He did not relish getting involved in organizational turf battles. Wolfensohn promised to come in and join the PSD Group meetings from time to time to reinforce my role, but it was rare.

Thus, it was up to me to pull everything together. And the issues were: what is our vision for Private Sector Development across the Group? How does it fit with poverty reduction at the country level? How do we work together at the country level? How about projects of common interest? Can we work on projects together? How about the Bank Group's products and services, can it help direct clients on where to go? So we came up with an agenda: Define a PSD vision for the Group? Coordinate operation at the country level integrating our strategies through common Country Assistance Strategies. My team produced an inventory of individual projects supported by more than one part of this Group, delineating the respective roles and the work that had to be done and then going for approval in joint Board sessions. This worked for a few high profile cases--the Hub River Project--, Pakistan had both IDA and IFC financing. We were also looking at the question of how to bring together some of the expertise available in the Bank Group. We have managed to consolidate a little bit, at least

by co-locating Bank and IFC units in the new IFC headquarters building, where the center of the Bank's private sector activity is now located. In the Rischard vice presidency we have co-mingled, the power group from IFC and the power group at the center of the Bank. That is already starting to create some interesting interaction.

We took up a number of special initiatives, for instance, trying to get more guarantee products out to the clients and improve their delivery to the clients. We have been working through a whole series of those kinds of issues. Wolfensohn follows those developments generally, those that are very visible, he's a big fan of.

We created a Business Partnership Center (BPC), a WBG private sector call center with two or three fairly junior people who take phone calls everyday on how to get information about private sector support, who to talk to. They will send materials, offer advice, and then keep a central record. That, to Wolfensohn is fantastic; he is a marketer of services, but people brought up in the traditional Bank culture dismiss those things as simplistic. Wolfensohn promoted the BPC on all of his trips. I was in his office one night when he was packing his briefing books, and he asked me for a pack of those Business Partnership Cards. They are purple plastic cards with the telephone, fax numbers and website. He takes a pocketful

of those wherever he goes, hands them out, and talks about them.

He is supporting the extension of this concept to a sophisticated, comprehensive corporate relationship system for the Group. The system merges private sector contact lists from across the Bank Group. We now have a system to quickly get information on the people and companies we want to interact with; we have 85,000 corporate relationships on file. Wolfensohn is someone who doesn't just have his friends in industry who might call on him in the way they would call on Lew Preston, or Tom Clausen. He will actively go out and seek relationships with executives of corporations with whom we've never done business. On Wall Street he was known as the investment banker with the Platinum Roledex – and I can see why.

An example would be the Ford Motor Company. He was at a dinner a couple of months ago with Alex Trautman, Chairman of Ford, who'd hardly heard of the World Bank. Initially, when we accessed the Ford Motor Company name the system came up with only $5 million worth of trucks and vehicles, which were on three Bank-financed procurement contracts. It is one of the largest corporations in the world, it has huge operations in Latin America, and they're going to open big plants in India, China, and Russia.

The Chairman was excited after he spoke to Wolfensohn about how Ford and the Bank could work together. A team from Ford flew in three weeks later on a visit organized by me with my Ford counterpart, Devine, then the Treasurer at Ford. We brought together the Managing Directors of Bank operations, the head of IFC, and then defined all the areas of mutual interest and what we could do together. We exchanged industry expert views as well as country analysis. These are some of the things that Wolfensohn sees in making the WBG-private sector partnership approach really happen.

We have a long list of things where we've made progress through the PSD team. We also had to take on the dialogue with the NGOs. The Bank is trying to focus increasingly on the environmental impact of its business, but IFC has been reluctant, and MIGA is a disaster. The NGOs are worried that our private sector driven development will be harmful to the environment and the poor. At the project level we have different standards across the Group, and need to sort that out. The PSD forum is a perfect window, it allows putting issues on the table, involving IFC, MIGA, and IBRD, and examining how can we bring them together, standardize them, but still leave enough room for the differences in applications of policies and standards, as well as having a format which is more one of fostering cooperation and collaboration.

Wolfensohn always had in the back of his mind that if the current PSD format doesn't work, he would come up with a "harder" model. It has basically worked up to this point. To the extent that we have made progress, we have relied not on having formal authority, but basically on the power and the logic of the ideas and that it made sense to work together. At the end of the day, if it's really going to work, it will because people believe in it. You try to persuade the key players and tell them that refusing to be a team player is not the way to make points to get ahead in the Group. Now we're trying to do what we call the zipper approach: trying to hook the institutions from top to bottom. We have a lot of individual interlocking activities like field offices, for instance, that should be co-located and working together on projects and on strategies at the country level. In the future, more World Bank and IFC country officers will be co-located.

I have often thought that the lack of coordination between the Bank and IFC had become our downfall, in the sense that with the increased emphasis on a market-based approach to development, that we became divisive and competitive, or even destructive in the way we talked about each other internally and externally. However, diversity should be maintained and turned into an advantage where we present a long menu of

products and services from the whole group. At the other extreme, if you tried to fully merge all of the institutions and personnel you end up with a homogenous blob, and no diversity or specializations. The Bank would for example lose contact with the in-house IFC dealmakers who can tell you whether current policies are going to get companies or the foreign investors to invest or not in a given developing country.

So coordination while preserving and taking advantage of the diversity of our institutional structure has been my goal. I am currently leading a strategic exercise with the senior Bank Group people which I will report on to Jim Wolfensohn on June 20th – ten days before I leave. We are calling it PSD 2000, which is a vision of where we go from here.

Q: When you took this over, it was introduced as something that would have a limited time frame. There was a suggestion that after a certain period of time, the task would be completed and coordination and would then function on its own. Is that still the expectation, or is somebody going to take over from you?

A: That understanding was never one that I had. But it was a general impression that was created. When I was speaking to Wolfensohn about my assignment, I said this may have to go on forever, and that we may have to make it stronger, not weaker.

In fact, there would be logic in having more than two (President, Secretary) group level executives. But this was not the way in which the task was announced. We were expanding the number of managing directors from 3 to 5 and there was a sense that maybe a couple of these won't be needed forever. There was sensitivity at the Board level that the new structure was getting too top heavy.

When I had my first discussion with Jim Wolfensohn about leaving, I told him that I was offered an opportunity on the outside that was very interesting, that I was 55 years old, had been in the Bank for 27 years and that I would like to explore this. His first reaction was: "Oh, I don't have anybody to take on this job, I want you to sleep on it." But then he said: "In all honesty, it would be unfair to discourage you, because I've done just what you are thinking of going off to do. Trying to build a finance firm with all the thrills, risks, and the hard work of being entrepreneurial and in a partnership arrangement."

We will announce in two days that we will keep the private sector group format intact, with new arrangements for the chairmanship. This will keep my team together that works on supporting this work from across the Bank Group. With the team's responsibility for the business partnerships and the broad support, we will probably expand these activities. There

is not going to be a near-term decision on reappointing a managing director responsible for the private sector activities per se, but Wolfensohn is holding that very much open. He told me that he doesn't have an obvious candidate. He hasn't ruled out someone from the outside. We've had a lot of calls of concern from the Board, the shareholders, as well as from the private sector who really saw this activity starting to gain momentum.

From the Board's perspective, this is the first time that they've ever seen country strategy where IFC and the Bank laid out together what they are going to do in a particular country or sector. This is what they have been waiting for. The governments on the other side say that it's the first time they could see what the Bank and IFC are trying to do together in building the financial sector.

So there's been a lot of support for these efforts that we've launched, but they need to go further. They need to be institutionalized. It's just a question of how we do it.

Q: Now, finally, about the Bank. As you know, there are a lot of people who are questioning the need for the Bank, and whether it is still a relevant institution. How do you see this and how do you see the Bank's development over the last five to ten years? Do you believe that with Wolfensohn's leadership and the Strategic Compact that he has announced,

this is being brought to some closure and that there will be a new constructive beginning that will revitalize the organization and reaffirm its relevance?

A: I'm convinced of the importance of the Bank's future role even though private capital flows will probably continue to grow. In fact, to sustain those flows requires some of the very services the Bank has been providing, but these need to be provided in a more efficient and coherent way. Since I've been in this business, this is the time I've been the most optimistic about the future of the developing countries.

I say that looking back at my first mission for the Bank to East Pakistan, with poverty of the most depressing scale and depth. We were then looking at a scheme to import food, and some people said the best thing to do is to close the cities, encourage people to go back to the countryside and try to survive on subsistence farming. Let the excess population starve. They argued there was an unnatural balance between the population and the available resources. By sending in food aid this unbalance would be perpetuated and grow. Now, you've got Bangladesh and similar countries feeding themselves. As a collective group of countries, the developing countries are leading the world's economic growth and they are producing at least 50% of incremental global trade. Sure, performance has not been uniform, but I see some very strong lights at the end

of the tunnel. It’s still a tunnel, with population growth adding a hundred million a year.

But we have some models that have worked very well for countries that we really thought were going to be permanent food importers, like Bangladesh just to keep alive. Where would the food come from? In the case of East Pakistan, it surely wasn’t going to come from India. It had to be either from the United States or Australia as it did. With developments in agriculture, technology, credit and irrigation systems supported by the Bank, the country is now self-sufficient.

I find the reliance on the market for many of the services and for lifting the investment load from the public sector very promising. I am more worried about it being sustained, and I think the sustainability is not just an environmental question; it is also a social and political issue as much as anything else. But until we spread the results that we’re getting in East Asia, until we get those in Latin America, until we get the standard of living really coming up, and the market forces pulling people out of poverty, until we get education and health expenditures directed to these people, which is part and parcel of a successful economy, we run the risk of being faced with widespread revolution against this approach and the danger of reverting to a state-dominated, socialistic approach.

I think we've got a lot of achievements that we can look to as the result of successful economic policies. But there are still a lot of places where we don't have it all together. In those countries, the Bank can play a tremendous role. The combination of what we've worked out here recently in the strategic compact is very promising and I must say that Wolfensohn has added a lot. We used to see governments as the principal agent in the process of development; then we recognized that the private sector needed to be given more of a role in the interest of job creation and so forth. Now we've brought in civil society as yet a further dimension. I think the triangular relationship of government, private sector, and civil society, is the most promising way to develop some of the solutions, which will produce sustainable growth and development, not only in economic terms but in social terms as well. It is for this reason that we're trying to promote corporate responsibility as a way of thinking in the developing world. We are trying to convince corporations to worry about the health and education standards of their populations. This is needed not just because it's right, but because it's good for business; local business leaders must understand that their countries and companies will not join the global economy on a sustained basis unless they have better educated and healthier workforces. I think the Bank, from the private sector angle,

can do a lot to get the corporate world starting to think about this and participating in a broader and more enlightened way.

I think the most difficult part of the world, still, is Africa. The Sub-Saharan region outside of South Africa is basically being by-passed by the capital flows; they're only getting about $1 or $2 billion/year. Against that situation I have coming through my office here once a week, either an oil, gas, or mining company, or an infrastructure developer looking for new opportunities. I tell them they need to go to Africa, because that's where much of the remaining oil and gas resources are. True, much of these resources being developed are now in Russia and the former Soviet Union countries, but a lot are also in Africa. A lot of the minerals are there, as well as a lot of opportunities to bring private finance into activities like power production. Private capital and management are needed to get that type of activity off the government balance sheet and create the fiscal space so that government money can be used for health and education. When you add up the numbers, external development assistance plus the government's own resources together, they can carry the social service investment as long as the private sector takes care of the infrastructure and industrial investments.

If there were no working models and potential investments in these difficult countries and the private finance wasn't

coming, I'd feel more pessimistic. For me, the challenge and the dilemma is how do we make this happen. Commercially viable investments will take place with all the spin-off benefits, and we have to think how we can take advantage of these investments for the benefit of the countries better than we did in the past. There should be ways to capture the government share of enclave project revenues, tie it into escrow accounts, where we can watch through budget and expenditure reviews what is happening and make sure the money is going for what it should in the country, and leverage that up.

One of the joint Bank IFC projects – the Chad Cameroon Pipeline project – has these features. I can see direct investments in Africa double in two years time if we were able to offer IDA in the form of guarantees against narrow political risks for private sector investment, rather than only as a long-term 35 or 40-year concessionary credit. We wouldn't even need to use as much IDA as we do, because we have projects now where the sponsors are looking at maybe a 5% involvement of IDA in the form of a guarantee against sovereign government contractual risk. In many cases, the projects don't need the direct funding, they just need the guarantee through an IDA device, and so the government will in fact honor the concessions that they have awarded to private companies.

Countries that have been left out of the normal process are now trying to do the right thing. I know some of the projects will not happen if we can't find a Bank Group involvement to facilitate that. We have to make it work financially and socially, so that the benefits of the projects do help the local population. The society needs to see these benefits, and people will throw the foreign investor out if they see that something's happening like a mining project but with no benefits for their community. They need to be sure that all of the money isn't going to Switzerland. In that whole context, I really see a role that links the market-based approach to development, with social development.

Q: Do you see the World Bank Group ready to slip into this role? Is it already moving in this direction?

A: I can tell you that many of the people in the trenches, especially the Bank trenches, are resisting and still trying to do business the old way. If they're given a choice between making a loan to Brazil as a government borrower to fund the state-controlled Petrobras, for a pipeline project, they'd rather do that than find a way to use a smaller amount of Bank resources to guarantee the political or policy risk which would then make the private capital flow and provide most of the financing. Because the latter is a more complex structure and they're not sure if there is sufficient interest in the private

sector. Booking a big Bank loan is still seen as the way to get recognized in the Bank and be popular in the country with the Government. So I think there is still a cultural obstacle, a way of thinking and a mind set which works against seeing the Bank's role as facilitating in a responsible and developmentally oriented way the private sector investment. There is still much internal suspicion about this approach.

True, there's a group of people who may not be suspicious but just unequipped to do it, who are technically not able to handle that kind of analysis and financial engineering. I recently talked to Tony Pellegrini, the head of our Water Department, a very good man who's been in this business for many years, about how to solve the problem of helping 40% of the population in developing countries without access to drinking water.

You know the Bank has financed water treatment projects in almost all of the major cities around the developing world. They have a high failure rate operationally and financially. If we relied on the projects to pay back World Bank or the IDA credits, we would have massive arrears. How do we solve this? Tony believes we need to get more private management, maybe private investment, because we have very few public systems that are working efficiently, and that we have tried everything.

Tony believes that a fundamental reform of the civil service mentality that affects the running of these projects is needed, but we just don't have very many successful examples. If Lyonnais des Eaux could come in and take over a couple of water treatment plants in Buenos Aires as they have done, then they'll do it in Manila, and so on; how can we put this approach together for Cairo, Bombay? He thought that we had the people who knew technically what needed to be done, and the French companies knew how you arrange the finances of a water treatment company so it's more viable. But we need to do some creative financial engineering to provide some very specific guarantees to mitigate risks too great for private companies. We should get IFC more involved. But he confessed that in the Bank we didn't have people thinking that way.

I recently addressed the urban services people; they're all depressed with their track record, and I had to tell them that there are ways to succeed. Cities are now starting to go to the market directly to raise money. Rio de Janeiro, Bogota. These cities are strengthening their finances and building new facilities and infrastructure with market finance. There is a Bank role to help cities get their finances together and to provide services in a more efficient way.

I'm afraid there is still only a minority of Bank people who approach developmental problems in that way. We are

working to bring about change. We have workshops, and we bring up examples; we've focused in particular on the urban services, talking about how to get cities' finances in shape. This is a great role for the Bank staff to think about. Some people here will respond to that, but, again, it will be only a fraction.

I think the combination of the reform that Wolfensohn is crafting, which may look somewhat chaotic now, with the effort to retool and reorient our staff should eventually bring about the needed transformation. We will probably have a higher staff turnover than what we've talked about to bring about a change in thinking. The 700, who are expected to leave, will be important, but I don't think it will be enough. Some existing staff can pick up the techniques and a new way of thinking, so I think the investment in training should pay off. Even in institutions like IFC and MIGA, it will be critical to upgrade the professional quality of our specialists and to match world standards.

I'm concerned that there's still going to be too much of a cloning process. One of the big things that hit me when I returned to the Bank from IFC, was how the managerial ranks are filled with macro economists who are almost exclusively carrying the line responsibilities. Someone pointed out the other day, that there was a whole new generation of appointments of macro economists at the director level. Bright

as they are, and as powerful as economics training is, I think this emphasis on economics has skewed the outlook and orientation of the institution. You need to get people thinking about some of the developmental issues in a different, more practical and business-like way. But as long as you continue to promote from within your hierarchy, they're going to be biased towards feeling more comfortable with people who think in the same way and who have the same analytical approach.

I would insert people with varied backgrounds more broadly into the institution at all levels, even if it makes people uncomfortable, and it will. In a way, we will improve the richness of the mix of people in staff and management along gender lines and nationality. That is really becoming more of a big factor for innovation and reinvigorating the Bank. I have spoken out about that, as I didn't see any cross institutional-appointments in the latest selection of managers either in the Bank or in IFC.

One source of the problems we have is that we're not training or recruiting people for management. If we were a major corporation, we would be consciously doing that. That would be one of the criteria, along with nationality and gender diversification objectives. We would have that cross-fertilization at the top, and throughout the middle management,

on both the Bank and IFC side. I hadn't seen many people cross the street yet in one direction or the other. So I thought I was going to be a model for a lot of people. It's still going to be a rarity, I guess. This is also related to the skills mix. I would have that as a more explicit objective rather than just pronouncing that we will promote other disciplines into the managerial ranks and promote across the Group.

Q: You certainly seem to feel that Wolfensohn is the man who both has the wish and the vision, the right kind of vision, to lead, as well as the leadership abilities to get this organization on to a new track?

A: Yes, I think what he brings is more than most others could have brought to the job. I knew of some of the other people who were candidates for the presidency of the Bank in 1995. There were two or three of us whom they talked to during that selection period. There were some very good people who had all the credentials - maybe looked even better on paper. They were the right age – the U.S. was looking for someone in the mid-50s -- they had a broad international and a finance background. A couple of those people actually took themselves out of the running, or at least, the U.S. Treasury people said they did.

One of the reasons they gave was even though the position was prestigious and challenging from an idealistic point of view, they felt the job was going to be very difficult: the

reform of the Bank and the adverse political attitude towards development assistance. They concluded that this is not how they wanted to spend the next five to ten years of their life. So you, first of all, have to give Jim Wolfensohn credit for having taken on what may be a difficult, thankless task: he took it on with vigor and commitment. He also made it known how difficult it was both inside and outside the Bank. In fact this was overdone and negatively affected staff morale.

Q: Are you saying that the need to reform the Bank was presented quite explicitly as a challenge at the time of the transition?

A: I think in 1995 people looked at the Bank and said there's a fundamental reform that needs to be taking place. We've had a lot of wrenching reorganizations under previous Presidents, but they haven't really solved the problem, whether it's the vision thing or whether it's how the Bank operates, or how to change outdated staffing and a thinking pattern. It was clear that the job presented a fundamental challenge. Preston knew that, too. He had health problems and family tragedies, which prevented him from taking the bull by the horns. Wolfensohn, not knowing fully what it was going to be like, but highly attracted to the prestige of the job, has taken on all these problems head on wherever he found them.

I just mentioned the example of the Bank managerial selection and change. I would have liked to have seen us push it even further. We had a lot of turnover and hopefully we'll get some fresh blood even though we still see the same economist discipline dominating the managerial ranks. Wolfensohn is going to give this as good a shot as any top executive can, and while he does not like criticism, he has pushed forward.

Right now, one of the complaints is, that he is very prone to sponsoring a lot of initiatives. I had my initiatives and he sponsored most of them. But there is a proliferation of initiatives and priorities. Somebody recently suggested we should now go back into agriculture with a new vision; we also have new initiatives in education, in health, and in the environment. He is backing outreach programs to labor groups, religious groups – in addition to a vigorous campaign to win over the NGOs. Part of Wolfensohn's strength is that he is a man who has incredible intellectual interest and energy and recognizes the importance of each of these initiatives. Maybe he's over multi-tasking. He runs the risk of embracing too many new initiatives, too many priorities. He could seriously diffuse the Bank's focus. He could blow up trying to do too much, to please too many constituents. He's trying to change the heart and soul of how the place operates, both how we do it

and what we do. Changing both simultaneously is obviously going to look a little chaotic and will feel chaotic when you implement it. If you were to decide that it is better first to come up with a clear set of priorities and embark on this or that initiative and try to graft that onto an institution with an unchanged, outdated mentality, I'd say that's a waste of time. So you have to tackle the different sides of the reform issue. This is a difficult process and, we're only at the first stage of it.

We're at the stage at which we're getting squeals out of the institution at the managerial level, which is a key level. This is a painful process. We're trying to turn over the management, as it is clear that some people are not making it and are blockers to change. The first round of senior people to leave in Wolfensohn's first year – Husain, Jaycox, Thalwitz had been Bank stalwarts. However, the Old Guard that left was replaced with a New Guard with similar mentality and perspective. More managerial changes at the top and middle level are inevitable in the next couple of years. But, the next round is going to be at the staff level. The skill mix is wrong. That's going to produce a lot of noise.

Q: Except for McNamara, Wolfensohn is the only president so far since the Bank really got cracking that does not have a chief operating officer. You've referred several times to

Ernie, before him there was Burke Knapp, and before him Bob Garner. Does Wolfensohn find that something is missing there? Do you find that something is missing there that could be essential in running the institution effectively?

A: You can envisage alternative management structures that relies on a greater distribution of authority for effectiveness. I think Wolfensohn is still trying to see how that will work. While we have the five Managing Directors today, I was never in the top of the management structure of the Bank before, but from what I saw from a distance, this one functions much closer and more cohesively than when there were only two or three top executives. One of the reasons is that we meet across the table with Wolfensohn every morning at nine o'clock. It's a partnership style management. You can have a quick exchange with your colleagues and then go off to do your own thing. I've never seen that kind of intensity at the top. That is one way you try to get the general coordination but rely on delegation that won't be second-guessed. That is an excellent approach but I do not believe we are fully there yet.

The second element is to produce close cohesion of the Management team for the key priorities. If you take our Friday sessions right now, they are dedicated to one thing, which is a prioritized list of everything we've set out to do within the Compact and what's happening on that. What are the top

priorities, and where are we going? Wolfensohn chairs many of those meetings, and with that there is a system of pulling together priorities, and to know who's accountable. The MDs are listed with their specific responsibilities. I'm accountable for about five of those items included the Compact; everybody else has their items, and everybody feels accountable to the President to get them done. Wolfensohn takes a close interest in the Compact and - irrespective of his peculiar style - at the critical time he wants to get in first hand on critical matters. It's not enough for people to tell him, not to worry; I'll take care of it. He gets directly involved, relying on his tremendous intelligence, sensitivity, and information gathering. If enough signals aren't right, then he will go right back into it in the depth he wants. Now, that can be very disruptive. But I don't think that he is the kind of person who will sit above it all and take a presidential or a prime minister role and say, this is my cabinet, take off and do your thing. He will always want to dive back in and hold people personally accountable at various levels. He holds Managing Directors overall responsible for their various areas to look after. But he still wants to be on top of the regional Vice Presidents and wants direct contact with them, and not only to talk to him through the Managing Directors. This can be very disruptive unless there's a good flow of information. I

don’t know yet whether it tends to make people more guarded or more open or more insecure.

Q: This was a very helpful and very frank interview. Many thanks, and let me extend our best wishes to you for the future.

A: Thank you very much.

Q: I hope you’ll come back at some point. Maybe then we’ll talk a little about what you did outside the Bank.

A: My pleasure. We used to have people who would come from the developing world, gain experience through their work in the Bank and then go back to their countries to practice what they had learned. What do you do if you come to the Bank from the United States? Well, you can go out and work in the international private sector and practice what you have learned. Put yourself on the line to help mobilize capital from the developed world to invest in the emerging economies. That’s why I say I don’t feel like I’m leaving the field; I’m going to continue in the field, probably in a more risky part of it, private equity investing, but hopefully it will be rewarding as well. Since I am not leaving the field I am not saying good-bye.