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Transcript of interview with

Davidson Sommers

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Interview with Davidson Sommers

By Prof. Robert Oliver August 2, 1961

Tape #1

Q: Would you state your name and tell a little about the conditions that brought you to the Bank?

Sommers: Yes. My name is Davidson Sommers, and I came to the Bank after the war. I had been in the service and then I'd been assistant to the Secretary of War in the Pentagon, where I had worked in the office of John McCloy, who was Assistant Secretary of War, and it happened that his partner, Chester McClain, was the first general counsel of the World Bank. I was also a good friend of Dick Demuth, who was in those days assistant to the President, and I had retired from the War Department and was living up in Connecticut, trying to decide which direction to move, and McClain came along and offered me a job in the World Bank. I'd never heard of the World Bank, and I rushed out and bought a 25-cent paperback by Alvin Hanson on Instruments of Postwar Recovery, read that through, and then went down and said I'd take the job.

That's how I got there. I started in as a lawyer in the law department, and after a couple of years--I started in in November, 1946--and after a year or two I was made assistant general counsel, and in 1949 I think it was, when McCloy left to become High

Commissioner to Germany, he took McClain, my boss, with him as his counsel to Germany, and Black came in as President, and McCloy was feeling a little bit shamefaced, guilty about taking Black's lawyer away from him, because McClain was a very, very influential man in the early days of the Bank, and offered to send McClain back to help Black through his first annual meeting. And I think that rather rubbed Black the wrong way and he said, "Thank you, we'll get along very well without him." I think he was rather annoyed with McClain's being taken away. I was made general counsel then and I stayed as general counsel until I guess it was 1955, when I became vice president.

So I was there from a few months after the Bank opened its doors until January, 1960.

Q: I have heard that the US government attempted to have somebody made general counsel, provided a suggestion--

Sommers: --in the earliest days?

Q: In '49--

Sommers: I don't know about that. It doesn't surprise me either that this was proposed, or that it wasn't taken up. I think there'd been a proposal by the United States government in 1946 or '47 that one of the men that had been in the Treasury and had been much concerned with the affairs of the organization of the Bank, Luxford, would be given the general counselship. Actually Mr. Meyer, who was the first President, didn't want a Treasury man as counsel. He had the idea that he wanted somebody who would be more his man, and he brought in McClain. Luxford did stay on as assistant general counsel, and even after I became general counsel had that job, but then he left to go into private practice.

Q: Can you say anything in general about relationships to the United States government, in managing the Bank in the early days?

Sommers: Yes. Are your questions being put onto this? They are. Yes, the US was suspected by the British and the Europeans of wanting to keep the Bank and the Fund under its thumb, and that's really the essential basis of the whole fight between the Europeans and the Americans that took place at Savannah, that I mentioned in my speech, which went on in the Fund for many years after it had no longer been an issue in the Bank.

I can't say that I saw too many signs of this after the first United States Director left. He certainly expected to run the Bank, but whether that was a personal idea or an idea of the government, I don't know. I'm sure the official position of the US government was always quite proper, and always recognized the independent position of the Bank, but there's a lot of room within that official position for degrees of choice.

After Mr. Meyer quit, and after the interregnum and after McCloy came in, I think the United States government was pretty well resigned, in fact, more than resigned, was determined to keep hands off the Bank as a method of saving it or preserving it. The battle went on in the Fund. I must say, I think the US government was pretty scrupulous in avoiding pressure on us. Now and then individual ambassadors would try to put pressure on us. I remember on one occasion, when we were sending a telegram from Washington to one of our men in the field and we made use of American cable communications because we had no really good code of our own, somebody in the State Department who had read the message (because everything gets distributed all around) had nerve enough to call up Black and say he didn't agree with the policy Black was following, in the message sent from Black to one of his own subordinates. But these were all sort of individual pieces of foolishness, and I don't recollect any really concerted drive to take over the Bank or to pressure the Bank, except in a few cases like the Aswan Dam and Brazil, where they made it clear what they would like us to do--to follow one line or another on a particular project, but even there they recognized that the Bank was an independent thing and that all they could do was suggest.

Q: Would you say a bit more about Aswan and Brazil?

Sommers: Aswan Dam? Gosh, I could take the whole two hours on the Aswan Dam. I think the thing that I remember best was in the days when, after several years in which we had been working along on the Aswan Project without any particular interest on the part of the Americans and the British, and after we finally decided it was a project that made sense, provided it was surrounded with enough conditions, the Russians made an offer to finance it, or were alleged to make an offer to finance it, and then the British and the Americans practically trampled us to death in their hurry to get into the act and we were being pushed very vigorously to not be so tough on such pieces of red tape and technicality as asking agreement from the Sudan before the dam flooded a town of 65,000 Sudanese and so forth. This was regarded as pretty--by the British and Americans, as being pretty finicky on our part, that we should ask for Sudanese consent.

And I remember attending a meeting at the State Department at which Black and the British--I don't remember whether Eden was there or Roger Maken--and I can't remember, I guess it must have been Hoover was there for the State Department. I remember--

Q: Herbert Hoover, Jr.?

Sommers: Yes. I remember Black's standing up pretty firmly and saying that we intended to go along with the project, but that he wasn't going to be pushed into relaxing any of the conditions he intended to impose.

Q: How about Brazil?

Sommers: Well, Brazil is not an incident. Brazil is a whole history. I think it would take too long to get into it. Brazil was a series of recurrent crises in which the United States government ventured forth on rescue missions. That's the most rescued maiden in history, and the dragon is still in hot pursuit.

Q: Did the US government want the Bank to be more lenient in its policy towards Brazil?

Sommers: I would have thought so, on several occasions, yes, and on several occasions we were not as lenient as they would have liked. But of course there's nothing peculiar about the United States' position in that. We had all kinds of cases in which the British might be interested in a particular loan, or the French--the underdeveloped countries were mostly not interested--they had no interest to spare for loans to other countries. They were devoting it all to loans to themselves. So we very seldom got into a case where India was pounding the table about, "You have to make a loan to Ceylon." That wasn't very usual.

Q: How were these negotiations between the US government and the management of the Bank to proceed? Were they outside of the executive director meetings?

Sommers: Oh, yes. In fact, all negotiations in the Bank, or as far as I know in practically any company or organization, if they're really negotiations and hard points that are proceeding with a prospect of working something out, that doesn't go on in the meetings, any more than it does here.

In the early days--there's a whole story which you should go into, of coordination between the Americans and the Bank. It's always been a cardinal principle of everybody that activities of the Bank on the one hand, and the Export-Import Bank and the ECA and the Development Loan Fund on the other hand should be coordinated, and the United States government had its piece of machinery, the National Advisory Council, as it used to be called, which was supposed to effect this coordination.

In the early days under McCloy and Black, we had regular meetings with the Export-Import Bank management, in which we would exchange lists of things we had in mind doing, and projects. We always felt we didn't get told anything by the Export-Import Bank until after it had happened. The relationships were very bad indeed. There was a great deal of jealousy. There was a great deal of competition, and as between Black and the then heads of the Export-

Import Bank there was not very much love lost. So this was a real failure at coordination.

The Development Loan Fund worked very much better, because by the time it got going--and the ICA or the ECA or the MSA or whatever it was called from time to time--here the coordination went on at the working level pretty much, and there wasn't any attempt at regular meetings between the tops. It went pretty well.

We had a similar long history of cool, cold and hot with the United Nations. I think we were regarded by the United Nations originally as being pretty difficult and independent. You know, we insisted on this unique kind of treaty with the United Nations that's different from all the other specialized agencies, because the Bank and the Fund who were together in this have a different status from the other specialized agencies. They're not under the United Nations. Their budgets are not coordinated by the United Nations. So we had a different kind of a treaty. This created a rather cool relationship in the beginning, because we were trying to prevent the United Nations from making recommendations to us for particular projects for financing.

Over the years, the thing got a lot closer, and finally the relationship between Black and Hammarskjold as a result have--as a result of Suez and the Indus and Congo and a lot of things, where we were of real service to the United Nations and where we worked together with Hammarskjold, got considerably warmer. Nevertheless there was always a good deal of well, sort of jealousy on behalf of the United Nations, in that it was natural for them to think that it was too bad that all this money was wasted on us when they had the really intelligent ideas as to how to use it. That's the natural feeling of anybody who's got a lot of ideas and hasn't any funds available to carry them out with.

Within the United Nations staff as well as the membership, there's been a real movement that the United Nations ought to get into the capital financing business. Technical assistance was a first step, and the Hoffman Special Fund is a second step, a compromise, something short of capital financing. But the other -- the pure SUNFED idea, if you remember that proposal, is not dead. That will revive again from time to time.

Q: To go back to the Aswan Dam question for a moment, when the US government decided it would not help finance the Aswan Dam, did it suggest to the Bank that it ought to pull out also?

Sommers: It didn't have to suggest to the Bank, because the whole basis of our considering the Aswan Dam from long before the British and Americans had come into it was that we would only consider it, and that the Egyptians should only consider it, on the basis of something like 50 percent loan, 50 percent grants. Their economy couldn't handle it if they had to repay it all. In fact, one of these famous conditions was based on the concept that if they undertook the Aswan Dam, they were going to have to tighten their belt in a whole lot of other fields, as far as development was concerned, during the period when Aswan represented all outgo and no return. Once it started earning a return, then it would be all right, but it was such a slow project that you practically had, putting it in financial terms, ten years of interest to capitalize. They had just about that much potentiality. So we had always said, any loan by us is conditional on in effect having it matched by grant contributions. So when the British and the US withdrew, our loan wasn't even a starter any longer.

Q: How about the Indus Project?

Sommers: I was in that from the earliest stage.

Q: Could you tell us a little about that?

Sommers: Well, the start of the Indus Project in the Bank I think was legitimately the Lilienthal article in Colliers which suggested that the Bank might be called in to solve this problem because it was essentially a functional and engineering problem--(which wasn't true at all) and because it didn't involve the passions that were involved in the Kashmir problem, which was incapable of resolution.

Well, like many of the things of Lilienthal's, this was a fairly intelligent insight, as events proved, except--well, I think Black was taking to it because of his feeling that engineers speak a sort of international language and communicate across political difficulties that stop the politicians. And he also thought that this was primarily an engineering problem. But that was not the case. It was a lot of other things besides that. In any event, he asked either Iliff or me, as I remember it, to draft a letter to both prime ministers suggesting that we would go ahead, and we did draft such a letter. I remember showing it to B.K. Nehru in advance. He said, "Well, it's a nice letter, the Prime Minister is expert at answering such letters and you'll get a very polite answer which won't say no but will mean no."

But in fact, the letter got a fairly warm response. It didn't get a negative response from either side, although the Pakistanis were somewhat warmer than the Indians, and afforded us a basis for following it up with a second letter, when we could see a little bit more what was bothering the two sides--and before we knew it, we were in business for eight or nine years.

That's one of the most interesting things I've ever had anything to do with. It went in three stages or four stages, the preliminary negotiations, to get the mediation going, in which I think I took a fairly active role; then the whole stage of the engineer's negotiations, in which Wheeler was the leading Bank man, and it was almost purely on an engineering basis. Then I was brought in again to write up the proposal that the Bank made, and after that proposal was made, the engineers sort of dropped into a secondary role, and it became a--more of a negotiating matter when Black and

Garner and I and Wheeler were all in the act, trying frantically to keep the thing from flying apart.

Finally we found a formula on which both sides were willing to go ahead and renew these discussions. And I remember Iliff and I going in to see Black and saying together, "This is no longer a thing that should be treated as a pure engineering matter. You have to have somebody higher up in the Bank's management and also with a little more political savvy in charge of it." We jointly suggested that one or the other of us be put in charge of it. Iliff was put in charge of it at the time.

Q: Iliff?

Sommers: Iliff, yes, and I think he stayed in it for three or four years after that, maybe more, until its successful conclusion. It was a wonderful achievement on his part.

Q: Was this the first occasion in the history of the Bank when the Bank became a mediator?

Sommers: Oh, no. It wasn't even the first occasion on which the Bank became a successful mediator. We had done several things. The one that sticks in my mind of course is the unsuccessful attempt to mediate the Abadan Oil Refinery nationalization, where we did a lot of work and we made a proposal that essentially formed the framework on which a solution was later found by the US government. We made a proposal that in effect the Bank would take over the refinery, as a trustee--not using that name--but that we would provide an international facade, under which the operations could be resumed, bringing in a management not exclusively British but headed by a non-Britisher and with an international flavor, which would run the refinery and the oil operations, under our auspices. We didn't pretend that we, the Bank, would actually direct the refinery, but we would select the people to do it, and there would be some current payments made to Iran, and the whole question of ultimate title, as I remember it, would be held in abeyance. So this was an interim receivership kind of operation.

And part of this format later was adopted. Unfortunately, although both the British and the Iranians agreed to all this in principle, it was just impossible for Mossadegh to actually agree to anything, because any agreement was a retreat from his pretensions, and he just wasn't strong enough or else he wasn't the kind of person who makes those concessions.

So that was not a success, although I must say it held the situation in a state of healthy suspension for some time, and I think made a contribution. Then we had a few smaller cases of mediation. We had a claim between an American contracting company and a Guatemalan borrower of ours, in which there was a dispute as to the amount of the contract. It wasn't really a mediation but it was a--

we finally said that we would designate an arbitrator for them and we did.

Then we had a whole lot of things that weren't formal mediations, but where we would intervene, let's say, in such matters as the proper rate structure for one of the borrowers in Mexico. I think we had a case in Colombia where there were some charges that the Colombian government was unfairly treating a private utility, not our project, and we said, "Look, before--" I don't believe it was the Colombian government, I believe it was a municipality. I believe that we said that before we would go ahead, we wanted to see what they could do about that.

And really the way we got into this most directly, I suppose, was in the area of the policy of not lending to countries that were in default on their outstanding public debt, because that immediately got us into conversations as to how that might be settled.

But certainly the Indus was the first--except Iran--the Indus was the second world-shaking scale mediation that the Bank went into. It was the most complicated, in the sense that what we did in regard to compensation for Suez and the British UK financial agreement was essentially looking at each side's position and putting your finger down on a figure in between, fairly arbitrary, that's what mediators normally do. The Indus thing was different in that it was of such enormous technical complexity that you couldn't do that without--until you'd mastered the whole subject, and it was a dispute that had been going on for 30 years.

Q: I'm curious as to how the Bank got involved in mediating. Did it take the initiative?

Sommers: Sometimes it took the initiative. It took the initiative in Indus, at Lilienthal's suggestion. It took the initiative in the case of Iran, and I don't know whether that was suggested by outsiders or not. Sometimes just friends might come along and say, "Nobody can do anything about this but you, why don't you get into this?" I don't remember the origins of the Egyptian Suez compensation agreement. My guess is that we got into it at the initiative of the Suez Canal Company, to whom it was suggested, probably by some American lawyer, if they had American lawyers, or somebody like that who was desperately looking around for ideas, who suggested, "Why don't you go see the Bank?"

Now, we protected ourselves in this field by the rule that we never went into this kind of thing except at the invitation of both sides, both governments, even if one side was a private party. And that we never would go into anything that was political, rather than economic or financial. Of course, it's sometimes fairly hard to keep a straight face when you say that the Egyptian-British troubles were financial rather than political. But that isn't the point. The point was that the meat of the controversy that was to be settled was money. And as long as it could be settled on the basis of either money or technical engineering considerations, then we would deal with it. If it got into elaborate political settlements, we couldn't handle it, although in the Indus, of course, you couldn't stay out of the Kashmir problem, because it involved building works in the disputed areas of Kashmir, and they would have to invent the most elaborate disclaimer provision ever devised by the mortal man, that nothing anybody did or failed to do should be a recognition or an acknowledgment of anybody else's position, and nobody could invoke this treaty in any other dispute. Quite a thing.

Q: Were there any suggestions of mediations during Mr. McCloy's term as President?

Sommers: I don't remember whether the Abadan incident started before McCloy left or not. That was primarily a Garner matter anyway. It wasn't either Black or McCloy. Garner was the one who worked that up and did most of the work of it.

Q: I take it that Mr. Black rather enjoys the role of mediator.

Sommers: Yes. I think he enjoys it, and I think he feels that it's a very important part of what the Bank has done--important in the sense that nobody else has been able to do this, except perhaps the UN in the purely political field. But there are none of the other financial bodies that have had a role of this kind, successful or unsuccessful, and of course the Bank had a pretty unhappy picture of lots of attempts and no successes, until Suez.

Q: "Lots of attempts"--this sounds as if there must have been more than the two you mention.

Sommers: Well, it depends upon what you include in this area. There were only three of this magnitude--Iran--four really. Iran, two connected with the Suez Canal, and the Indus. But there are all kinds of little ones coming up all the time; sometimes your role as a mediator is formal, sometimes it's just incidental to some work on a project.

For example, I think--I've lost my familiarity with all this, but there's something like only one river between the Nile and the Ganges of any size that isn't an international river. So any river loan, any loan you make for power or hydroelectric power or irrigation anywhere in that area is likely to involve international issues, and there is no law on the subject and there are no agreements on the subject. In Europe this has all been covered by agreements for generations. And these people don't know how to negotiate these things, so it's quite likely that any loan in that area will involve a mediation. We did not mediate in a formal sense between the Egyptians and the Sudanese in regard to the Nile, but we did say to the Egyptians at the time of the Aswan Dam, "No loan until you come to an agreement with the Sudanese," and Black was being gotten out of bed at Cairo at 3 o'clock in the morning by people from the Sudan pushing this view on him. Of course, later on when the Sudanese came to us for a loan on a Sudanese Dam and we said "No loan until you come to an agreement with the Egyptians," they thought this was very highhanded. But the result was, we talked a great deal to both sides. We gave some idea of what we thought was feasible. We made it clear we thought there was plenty of water for both, and the result was, they came to an agreement to which we were not a formal party, although we offered ourselves, and I think the British suggested that we get into the act.

Well, now, I don't know whether that's a mediation or not. That's another important one. But this doesn't appear in the books as a mediation. And there are lots of little ones. There's compensation for the American and Foreign Power properties in Argentina. There's a mediation between French bondholders and the city of Tokyo on a bond issue. There are lots of these things on a smaller level. But there was a time when we had quite a few attempts and hadn't had one success. And then they started falling in fairly quickly.

Q: Might it be said that these mediation attempts began in a sense as early as the Chilean negotiations when the Bank insisted that the Chileans had to make an agreement on the defaulted debt?

Sommers: Yes. Yes, and they all had some relation to lending. There's a common thread. The Egyptians wanted us to do the Aswan Dam, and that led to our position in the Egyptian negotiations because I think Black had the confidence of Nasser, in spite of the Aswan business. In the Indus, what seemed to give us an interest in it was that we had been asked by both sides to finance projects on the Indus system, and had refused because of the unresolved question of the water. We've done that in various parts of the world. And so you're right, that there is a relation to lending. If you write a letter asking to be invited in as mediator, to put it crudely, you generally find the letter winds up with some such phrase as appeared in our letter to Nehru and--I don't remember who the Pakistani Prime Minister was, Mohammed Ali Khan, I think--saying "If you would like to proceed, the Bank will assign people and will be prepared to consider sympathetically any financing proposals that result from the agreement." There's always an overtone of financial help in the background. Otherwise it doesn't have the necessary sex appeal.

Q: To come back to relations between the Bank and the US government, I wonder if you could say something about the Polish loan negotiations?

Sommers: No. I don't know where I was at that time, except that I wasn't--I was pretty new and I wasn't in on that one at all. All I could say was about fourth hand and you could probably get better sources. You ought to go and see Jack McCloy. I'm sorry you can't see my old boss, Chester McClain, who was really a tower of strength. All I know is that the Bank felt it ought to do something about East-West Europe, and started with an ultra-cautious move, an offer suggested I believe from the EEC or ECE, the East-West European Organization. Are you an economics professor? Ok, you know all this stuff more than I do. I think somebody on Myrdal's staff had the idea that it was very important that something be done to counteract the disintegration tendencies of the European Economic situation, and he thought up a rather ingenious scheme which was almost too ingenious, as it proved--that you could make a loan to the timber producers, and since there was such a shortage of timber in Western Europe that it would be practically a self-liquidating short-term loan. And the Bank offered to make loans of small amounts, 10 million dollars or something like that, to Poland, Czechoslovakia, Finland and Yugoslavia.

It did make such offers, which were accepted by Yugoslavia and Finland. The arrangements were so complicated it took months and months to work out this three-cornered deal. And it came to be sort of a farce, because the money kept coming in too fast. The loans were paid off so soon that they really didn't make much economic sense. But the Czechs and the Poles turned those loans down, and the Yugoslavs and Finns took theirs. The Yugoslav loan was the first loan fully repaid to the Bank.

Now, as a second step from that, somebody was working on a large Polish loan which would not have this elaborate sort of collateral security in terms of payments from somebody else. I don't remember the relationship between this and the London government, and the revival of a supposedly consolidated Polish government and free elections and all that business, but I've always been told that the Bank was willing to go in for a loan and that the United States government finally said they would not vote for it, and the Bank finally told the Poles if the US government wouldn't vote for it,it couldn't get through, and therefore it would not be put up.

Q: I've heard that at about this same time, the British indicated reluctance to vote in favor of a proposed loan to Belgium. Do you recall anything about that?

Sommers: Oh, well, the British have indicated reluctance to vote for proposed loans to the Belgians for years and years, but that's an entirely different thing. All of the Europeans felt kind of peeved about the Belgians, because in the first place they felt the Belgians had got out of the war relatively cheaply, and there was a lot of feeling in the US Marshall Plan people that the Belgians were getting away too easy, and for that reason they made the Belgians grant conditional aid, as a counterpart of the Marshall Plan, you remember. And there was a lot of feeling that Governor Frere's monetary policy was much too conservative, and that therefore the Belgians were asking for help which they didn't need; that if they had a less rigid policy of carrying high reserves, and in gold, they would have loosened up their own economy a good deal more. The Belgians had a policy of deliberate deflation. It was an attitude of: Well, if they won't help themselves, why should we help them?

I doubt that this ever got to the point where the British would have voted against the Belgians, if it came to a showdown. But there was always a great deal of difference of opinion in the Bank and outside, as to whether, once the Marshall Plan had taken over, the Bank should make loans for what were essentially internal metropolitan Belgian projects. We did several of them--the canal loan, pure window dressing for a balance of payments loan to Belgium, not for balance of payments purposes but for internal purposes, to enable Frere to maintain a conservative fiscal and monetary policy. Frere was refusing to lend money to the government from the Central Bank, and the World Bank enabled him to get by with it by putting in resources from the outside.

I don't think this was a silly loan for Belgium. It's really a question of priority in the use of the Bank's resources. If there were plenty of money to go around, I don't see why that isn't perfectly sensible. But it was in the context of people thinking that Belgium was not doing its part in various other organizations that this friction arose. It has nothing to do with the first issue, the Polish issue.

Q: What I'm concerned about is any pressure that might be brought by a member government to keep the Bank from making loans.

Sommers: Well, pressure is one thing. After all, you've got to distinguish in the Bank between affirmative pressure and negative pressure. It's always been recognized--after all, the Bank has a board of directors that is supposed to exercise a lot more authority than it sometimes did. And there never has been any question but the fact that the United States government alone could prevent the Bank from doing anything that it decided to, and that any group of countries, the underdeveloped countries as a whole could, if they banded together, probably block the Bank from doing it. It's much easier to say "don't do something" than to make the Bank do something, affirmatively.

There was the Polish case, and there have been several occasions on which waves of opinion among groups of countries in the Bank have persuaded the management to put a different emphasis on its line. But these were not for extraneous political considerations, these were for perfectly respectable considerations of policy relevant to the Bank's operations, such as, "do we have international competition on procurement under Bank loans?" This was actually a management proposal in the first place, but the eagerness with which it was accepted by the advanced countries sort of kept the Bank's nose to the grindstone, once it adopted this policy.

There have been several other things. On the question of taking security--there was a general wave of opinion among the governments, as to what was proper and what was not, that had its influence on the Bank's management. There's nothing improper about that. I don't know of any successful effort to pressure the Bank into doing something that it did not want to do, and I don't know even of the very many serious unsuccessful efforts. Of course, there are always Senators and Congressmen writing you, but I don't know many cases in which any government, the United States or other, really made a determined drive to push the Bank into doing something that was completely apart from its regular line of operations.

We made a silly loan in Brazil for suburban railway cars, in Rio de Janeiro. I guess this was a little urging by the US government that we ought to do something, and I don't think any of us were too happy with that loan. But I think we made the mistake ourselves. We thought we ought to do something in Brazil.

Q: Now, I take it that Mr. Black has become very adept at personal diplomacy, in managing relations between the Bank and its member governments in such a way so that controversial issues never get to the floor of the meeting of the Board.

Sommers: Well, that's true. They try to deal with them outside of the meetings, but sometimes they do get to meetings, and--but it's pretty hard, with a board of 18, to get a solution in a round table conference, and it's also embarrassing when you have weighted voting, in the sense that you don't want three or four countries to vote down a whole lot of countries. So it's generally much more palatable to get some kind of a compromise or deal worked out. I don't think that's any different from any other organization. I don't think very much is decided in the Security Council in debates either. I think that what distinguishes the Bank from the Security Council is not the mechanism by which agreements are reached, but the relative frequency of reaching agreement, instead of reaching an impasse.

Q: I wonder if there are any general contrasts that could be drawn between Mr. McCloy's term in office and Mr. Black's?

Sommers: Yes. Well, the major contrast of course is that McCloy was during the formative period, came in when the Bank was at its absolutely lowest ebb. It was almost on the rocks. It had no reputation. It was regarded by the British as almost a dead issue. They were much more concerned about the Fund. It had no credit. It had no money available to it. It was an empty shell. And McCloy, mostly I think through Black and Garner, put flesh and bones on this paper structure. But still, by the time McCloy left in 1949, the Bank was not a howling success. I think it had a lending rate averaging something like 200 million dollars a year. The Marshall Plan had vastly overshadowed it. It had hardly got into the development field on a major scale, and--but the foundation had been laid and I think Black had been primarily responsible for building contacts with the market in the United States. Garner was primarily responsible for the organization, the essential attitude of the Bank, the somewhat tough attitude which was pretty useful in those days, and the counterpart of it--because Bob Garner was responsible for both the good and the bad parts--a certain atmosphere of smugness, "we know more about it than anyone else." That atmosphere is not too pleasant even now when it's probably true that they do know more about it than most other people, but in the days when they obviously didn't know anything, it was a little bit unpleasant to take.

But it in its turn was responsible for making people think they were better than they were, and they finally got to be better than they had been.

McCloy provided in this picture, I think, essentially a very magnetic personality in whom everyone had confidence. He was very well liked by the Europeans. He devoted a great deal of his time to this fight that I reported in my speech, about the board, which he didn't win. But I never thought that he as a person was the main builder of the early days of the Bank. I think it was Black and Garner.

Now, Black came in, with an equally good personality, with a very much better--much more extensive experience as what he calls a "deal man," a man who knows how to make financial deals, and on the whole I would say a less timid approach to taking risks. And two things set Black off, and made him a success--first, as I reported in that speech of mine, at his first annual meeting he inherited the whole uproar created by McCloy's attempt to reform the board of directors along the British line. Black took that over, when the United States government, which had pledged to help McCloy, turned tail and ran when they saw the opposition.

Black was left with this whole mess in his lap at his opening annual meeting, and--I'll take some credit for this, because I was just general counsel for the first time, and I said to him, "Don't let the governors go through with what they've decided to do. They have postponed the issue for a year. Don't let it come before the governors again. Get the credit for solving this issue with the directors. Come up with some compromise. You can't win on the McCloy line."

So he did, and he's awfully good at it--he's a wonderful tactician, and he immediately went into the directors' meeting and said, "Look, this is a question of relationship between me and you. This isn't something on which we have to go to our stockholders to get it solved. Let's make a joint recommendation to them, they'll adopt it."

And he did this in a few months after he came in. I can't even remember what the compromise was. It isn't so terribly important. Anyway, they made a report, and this was adopted by the governors and was kept off the agenda for the next annual meeting. This was a little triumph for Black when he came in.

Also, about the same time, he completely began to reverse the previous attitude of McCloy and Garner, which probably had been necessary, but had been vastly overdone, of not telling the board anything, of presenting them with *faits accomplis.* Black, as part of this same compromise, proposed a much more liberal treatment to the board, in terms of giving them information and giving them advance notice, and that improved the atmosphere a great deal.

Tape #2

Sommers: So I think that one of Black's key acts was this better relationship with the board of directors and the governors. From the moment he came on, the whole tone was different. The second thing was that he took a more active role, or had a more active influence, I think, on our lending policy, than had been true of McCloy, partly because McCloy was so much more interested in political things than financial. He was essentially a Secretary of State man. I never got the impression that he either had much interest or much real expertise in financial matters. He was not a financial lawyer, although he was always called a Wall Street lawyer. His experience had been in litigation, and in one big case, the Black Tom case; he was not a well-rounded financial lawyer.

Well, in my mind--I suppose you always tend to consider the important things in the history of the Bank are things you yourself were connected with, I'm trying to discount that--but to my mind, the most important thing that Black did in getting the Bank started on a more expansive vein was the first Australian loan. I don't know when that happened, but it came pretty close after he took over.

Now, the history of this had been that we'd had an Australian director on the board who was a bitter hater of Garner and the Bank, and reacted violently against this relationship between the management and the board. And there were a lot of these people. The Bank was an engine of bad propaganda for itself. All over the world the directors were sending out things saying how unpleasant it was.

So this was a leftover inherited by Black of that old atmosphere. The Australians of course had far better credit than almost all the other countries who were members of the Bank. They had carried their full debt through the '30s when I think the foreign debt burden was something like 40 percent of its export revenues at one point, and in Bank's rule of thumb, 10 percent debt service in relation to exports is pretty high.

It had bonds outstanding in the market, and it had to have a big refunding progress in the market, and needed to borrow something besides, because it was a developing economy. And this director had told the Australians to stay away from the Bank. But in the early days, the Bank had, as part of the rivalry with the Export-Import Bank, persuaded the US government that countries should be sent to the Bank first, unless there were special American interests involved. There were a whole lot of exceptions, but that the Bank was the lender of first resort for development purposes. I think this was even before George Humphrey.

In any event, the Australians went to the American government and said they'd like to borrow from the Export-Import Bank, and the Americans said, "Well, you have to go to the World Bank first." So the Australians came to us, hoping and expecting to be turned down, and making some impossible conditions--no project loans, a balance of payments loan, you don't have time for any investigation of projects, as a matter of fact we've only got three weeks and then we're going home.

Black was going away. He saw them, and he was going away. We didn't have a well-organized loan department or areas in those days. Anyway, I know I was called into Black's office and he said, "Now, the Australians are coming in and they're trying to get us to turn them down. And I want you to go in and chair this meeting with them at which you hear their demands, and you do what you want but I would like to make this loan, I don't want them to go back to the Export-Import Bank."

So we came in, and they had in charge a very unpleasant fellow--actually, he's a nice man, but he was acting unpleasant under orders. I can't remember his name but he later became a good friend of mine. And an Australian acting unpleasant can be pretty unpleasant. They sat down at the table, and they just made all these demands on us, and we said at the end, "Well, we don't see anything impossible in all these things. Of course, it's not up to us, it's primarily up to you. If you can supply us with reliable information in time to meet your schedule, we don't see why we can't get the loan through."

They were really shocked. I can't remember all the details, but the loan went through in something like three weeks. I think actually they finally delayed it, because after they decided that they'd been misled by their director, they changed completely, and we made them a loan, and from that time on the Australians were staunch supporters of the Bank, although they used this precedent to make us continue to make loans to them for a long time that we wouldn't make to anybody else.

But this also made sense. There were reasons for it. But the whole attitude, I think, of Europe towards the Bank changed, because this was the first time somebody was borrowing from the Bank who wasn't a pauper. You see, Australia was borrowing in the markets, in London and the United States. Up to this time the attitude was, "well, you go to the Bank when you're either a banana republic or else you're just so desperate you have to do anything, but it's not a place where countries with respectable credit standing go for their normal financing requirements."

Well, this changed this attitude. This also changed the whole attitude about "you take so long and you make so many requests." I think it was a very important move on Black's part. These two things together, in my opinion, much more so than what is generally attributed to him, the ability to handle the market and borrow money, set him off with flying colors.

Q: Was there any concern in the staff of the Bank that the Australian loan was not a project loan?

Sommers: Well, sure. The point is, in an organization like the Bank you have to have much more inflexibility of policy than anybody would like, because the first thing--governments, or government officials, worry about is being criticized by their bosses for getting a worse deal than somebody else got, particularly when they're all sovereigns. We never had this difficulty with private borrowers. They would say "Well, if we get what we want, we don't care whether you ask us for more security or more restrictive covenants than you're getting from so and so." But governments compare these things with a fine-tooth comb, and if you're from Pakistan the first thing you look at is whether the Indians got something better than you did. And for that reason, making loans of the Australian type was embarrassing, when you came to countries like Guatemala. The Australians have a sensible management of their economy. There are two things put together which cause trouble in this respect, three things. First, the project versus the general purpose loan. All these terms are highly ambiguous. We never made a general purpose loan in the sense that this phrase is used in the UN, which means that you don't know what it's for and what the economic justification of it is. But there are cases, as in Australia, where the foreign exchange component of any one project might be so small that you don't really meet the country's lending needs by the specific project method, if you combine with that the requirement that you only lend to meet the foreign exchange component.

So there was always the question as to whether we should divert from our standard lending attitude, in the direction of departing from the specific project approach, or in the direction of financing local expenditures. Either one of these would probably do the trick. Black and Garner originally were very, very rigid on both of these, particularly Garner. Garner felt that, as a result of his experience I think in the '20s, that there was something almost immoral about borrowing foreign exchange for a domestic purpose. I think the general view in the staff was that we were too rigid on both these points, and there was a difference of opinion as to whether you should sway in one direction or the other.

Black finally came down pretty strongly in the direction of financing local expenditures rather than in getting away from the specific project approach. On the other hand, if he'd had no customers except India, Belgium, Australia, and countries which really managed their finances fairly intelligently, I think we all would have felt there was much more latitude for going in the other direction.

You had to find a line which you could be reasonably flexible with, without making too much trouble for yourself. And in the case of the Indians, for example, we solved this--I remember saying to P.K. Nehru, "Why do you fight these theological battles with us? We have now found you a project which satisfies our concept of a project, namely the development of the Indian railways, which can absorb twice as much as the entire Bank lending program for a definite period of time, and it performs all the purposes of a specific project loan and a foreign exchange loan, and yet from your purposes is just as flexible as a balance of payments loan."

Q: What did he reply?

Sommers: Well, he said, "This is all right for the Bank, but then we've got the Development Loan Fund and the Export-Import Bank and they're also following these same lines, and unless we can get either a general purpose loan," which he wanted, "or at least local expenditure financing, we're going to have to pick so many projects, and the financing institutions are going to want to scrutinize each one of those many projects, and it will just take too damn long to get the total that we need."

Q: I wonder if you'd say a bit about the Bank's attitude toward relaxing the credit worthiness approach to lending and particularly the development of IDA as a new organization?

Sommers: Well, there are three kinds of credit worthiness that the Bank has been urged--I mean, three kinds of relaxation that the Bank has been urged to undertake. The first two have nothing to do with IDA, as it finally turned out. One is the general purpose loan versus the specific project. The underdeveloped countries are always saying, "There should be loans for general development purposes." This really doesn't mean anything except that there should be no control, no mutual understanding over the purposes of the loans. All these terms are used as camouflage.

Second is the local expenditure issue. There's a good argument for it, but the real reason for so much agitation is that if you advance money against local expenditures, this becomes free foreign exchange in the hands of the government, so it's not subject to control.

There was nothing in the Bank restrictions that made it necessary to create another institution to get around those two issues.

Q: Just a question about the local currency--

Sommers: --not local currency, local expenditure.

Q: Would you feel that--

Sommers: --providing foreign exchange to finance local expenditures. That meant that the borrower takes the dollars to the central bank and gets pesos and the central bank has free dollars.

Q: As in the case of the loan to south Italy?

Sommers: As in the case of the loan to south Italy.

Q: Would the Bank feel that this sort of loan is more sensible – the Bank at least has some control over some project, rather than a general purpose loan?

Sommers: I would say, that if we were only dealing with Italy or Australia or Belgium, the only purpose of that technique is really public relations, to associate yourself with some big venture, --they have something to take a picture of. Probably that's a little too cynical. The pressure from the Bank might, in the case of Italy, mean (and did) that they would devote more of their resources to this program than they would if the Bank loan were a general purpose loan. You may have more control over it, but what you're controlling there is the allocation of domestic resources, not the allocation of imports. It is a question of whether you want to be in the position of taking that responsibility or not.

Now, in Australia, there wasn't any single big thing that the Australians had to do. In Italy there was something very big that they had to do, and I think the Bank was right in doing it this way. In Western Germany, for example, if we'd made a loan to them, there isn't any outstanding thing that we'd want to concentrate their resources on. I frankly can't see anything but a public relations difference between a Monetary Fund type of operation, and the kind of thing we did in Italy--except that when you come to the next country, that you want to make a project loan to, it's much easier to make a project loan to them if you've made Italian-type loan to Italy. So public relations and this appearance of uniformity of policy are the two reasons.

Now I'm way off my track.

Q: In any event, whether the loan is really going to result in productive development of the country receiving the loan, I take it you feel is a function more of the maturity of the borrowing government than it is of whether or not it's a local expenditure loan or a general balance of payments loan?

Sommers: Yes. I don't think that you can determine the value of a project in any case in isolation. The Bank has been accused of meaning, by the specific project approach, that we judge it by commercial standards, which is a lot of hooey--the Bank's loans have not been judged by commercial lending standards at all. It has made use of techniques that are common in the financial market, but in credit and in terms it's a very different kind of process, and in motivation it's an entirely different process. The accusation has been made that the specific project approach means that you look for the safest project in the whole country and you don't care what happens anywhere else. This has never been the Bank's attitude towards the lending process. We've never felt that a project could be viewed in isolation. It has to be viewed as part of the whole plan of the country, --if it's got any plans. Some countries don't have any plans, and then you have the question, are you going to refuse to lend to them until they've got a five-year program? Or are you going to try to help things along that look as though they're worth doing in the meantime? The Bank has taken the second attitude. But they've always tried to see this in the general context, and if you see it in the general context, then the particular format of the loan does not have complete importance, at least from an economic standpoint. It's not all logic and economics. There is a lot of public relations and a lot of other tactical considerations involved in it. But I would say that if you're regarding the development effects of this loan, the general purpose loan in Germany or Belgium is practically as good as the project loan, unless there's something like the Italian case which is of predominant importance. But when you come even to such a well-managed country relatively as India, then I think there's an entirely different element that enters into it, and there the project method gives you an opportunity to set a standard of project evaluation and analysis.

I do think that, even though from an overall economic standpoint, the specific project approach isn't too vital, it has a tremendous demonstrative effect particularly in the more backward countries, of introducing standards of appraisal, evaluation, and performance that are not known there. And that's even been true in countries which know or claim to know a good deal more, like India. I think the Bank has had quite an effect in that respect. I'd like to make a digression here, to go back to something that you asked me about before, which is the difference between the McCloy and the Black era.

I think a very important difference, which really wasn't the result of Black being different from McCloy, but was just an evolution, was the shift in emphasis in project evaluation from the pure economic and pure engineering point of view to more of a business or financial point of view. Originally we put more resources into the economics and the engineering aspects, the physical engineering aspects, and much less to studies of market potentialities, of rates of return, rates to be charged to the customer, of cash flow, of sensible balance sheet, capital structure. This developed later on. These also contribute to the demonstrative effect, because in many of these countries it is this essential element that is lacking rather than the physical engineering design and the broader assessment of economic priorities. Those skills are available to them, but this financial analysis--which really began in a major way when Aldewereld took charge of project evaluation is very important.

Q: You put emphasis upon management techniques?

Sommers: Financial techniques, I would say. These are the points of views and techniques which are very familiar in all private lending operations, and this is what I meant earlier when I said the Bank makes use of techniques of private lending, although they might not necessarily require the same relationship between earnings and coverage of service requirement on the loan that would be required on a utility loan in this country. They might or might not, depending on other features.

Now, these things, in addition to a demonstrative effect, probably have some relationship to credit worthiness, in the sense that when you're dealing not with the government itself but with some autonomous body, whether public or private, this gets over the first obstacle to getting repaid--that is, having the local currency left. You still of course are faced with the transfer problem, which in 95 percent of the Bank's cases has no relationship to the particular enterprise being financed, but depends on the whole balance of payments situation of the country. Nevertheless there have been cases in the past, (probably they are less likely to arise in the future) in which private debts have been honored from good companies even though the government itself has defaulted on its obligations.

For example, the Brazilian Traction Co, I believe, honored its foreign creditors, paid its foreign debts, even though it had to go to the government and get foreign exchange to do so at a time when Brazilian governmental debts were in default.

So financial evaluation has some relationship to credit worthiness.

Now, coming back to the various points to which criticism and relaxation have been directed--the first point was, general purpose loans against specific projects. I've covered that, and that is closely related to financing local expenditures.

The second one I think is in what the Bank called "lending standards"--the care by which these projects are gone into from a financial and economic and a technical point of view. There has been some attack on that, but I don't think it really comes from responsible quarters. Nobody claims that the Bank shouldn't make the studies and the evaluation. What has been attacked is the conditions that the Bank interposes on some elements that are considered to be matters of local political concern. In the field of utility financing, for example, the Bank has insisted on adequate rates being charged, to provide coverage of the cost of service. It has not followed a black and white line but has pushed in the direction of discouraging governments from subsidizing railroads, power and things of that kind. The Bank has been more successful in the area of power than in the area of railroads because obviously power is something that is in much greater demand, and there's more elasticity in what the traffic will bear. The Bank's position essentially has been that since, except maybe in the one bulb user category, the cost of electricity is a very minor part of the cost of producing in general (with the exception also of chemical industries and a few others which are not very frequent in the underdeveloped countries). Therefore the customer can well afford to pay the cost of providing electricity, and in a capital-short country it's silly to subsidize industries which can be self-supporting when there are such colossal demands for government assistance in the area of hospitals, education, transportation and so forth, where the government's going to have to put in resources anyway.

A good deal of this philosophy has penetrated around the world, not only in the underdeveloped countries. I think it's had its impact in England. I know it had a tremendous impact in India, in Austria, and in places of that kind. I think this makes pretty good sense. Nevertheless, it's unpopular, particularly in Latin America, because the lesson of the New Deal was mis-imported, imported in a distorted fashion. The New Deal emphasis on low rates, promotional rates, was at a time of overcapacity, at a time of large amounts of available resources in the bond market, and at a time of very little demand, and in a mature economy which already had a system built up. To import that concept into an economy where there is no capital available for low return investment, where there's no bond market available, where the demands for capital on all hands are colossal, and where there are endless unfilled demands for electricity, has been a great distortion and has cost those countries a lot of misdirection of public money.

That's the second field. Related to that is the Bank's emphasis on not financing industrial, as distinct from public works or public utilities, ventures, for which private management and capital is available. This derives from a provision of the charter which says the Bank can't make a loan if private capital is ready to undertake it. The Bank has extended the application of that provision so as to say to Pakistan, "We're not going to finance a pulp mill project on a government-owned basis if you can attract private investors to go into it."

There's a great deal of argument, both within and without the Bank, as to whether the Bank hasn't pushed this far too far. My own view is that there's something to the Bank's position, but it was pushed too rigidly and too far.

Now, I wouldn't say there was any necessary reason to create an IDA in order to cope with these problems and get more flexibility. All you needed to do is to decide on a different policy. And in general, I don't think that there will be any difference in policy, as between IDA and the Bank. In other words, IDA is not supposed to be a lending agency for lower priority projects, for less carefully planned or executed projects, or generally for sloppier lending techniques. It's designed to meet one particular problem, which is credit worthiness, and not in the project sense but in the balance of payments sense. This has been a longstanding position of the Bank, that there is a limit to the amount of high-quality external debt repayable in foreign exchange at levels of interest comparable to what prevails in the outside world and at fixed maturities, that the very backward countries can absorb, and that reasonable development in those countries (of which India and Pakistan of course are the outstanding examples) will need more external capital than can be supplied on that hard loan basis.

For a long time, the Bank and everybody else flirted with various alternatives to IDA. Black's view was grants. Then people played with loans repayable in local currency, up until the time that Public Law 480 came into effect, when excess or large amounts of local currency counterparts got to such magnitudes that it made the whole thing rather meaningless.

But, in any event, the feeling that there was a need for an institution which could provide loans that had a less severe and a more flexible impact on the balance of payments, long term, was the origin of IDA. In the minds of some of our governments, including the United States, it was also colored by a desire to beat the SUNFED advocates to the gun, and to get this kind of an agency out of the United Nations' auspices and into an organization which had a tradition of perhaps less political logrolling and a more businesslike approach.

The actual way in which IDA received its initial impetus was as usual in these political things, pretty haphazard. Senator Monroney, who had a mixture of motives, was promoting something--he didn't know what it was, except that it had a title, the International Development Association. I should say that the idea for some kind of a grant or soft loan agency under international auspices went way back to the Rockefeller--Nelson Rockefeller Advisory Committee Report. I think Rockefeller originally got the idea from McCloy, who got it from Dick Demuth, who had been thinking along these lines. In those days it was thought of more along the lines of a Ford or a Rockefeller Foundation approach, a grant agency. Anyway, Monroney had three motivations. In the first place, he was terribly worried about these vast quantities of local currency piling up. He couldn't see why they weren't useful. The distinction between foreign exchange and local currency as being one in which, on the one hand, you actually brought resources into the country, on the other you just decided how local resources were going to be allocated, never really penetrated his mind. He just thought it was terrible that the funds were piling up and couldn't be used. In the second place, he had visited Southeast Asia and was very discouraged about some of the US aid programs, I think in Thailand, and liked what the Bank was doing. And in the third place, all of Congress was then and continues to be awfully tired of voting on foreign aid every year. Monroney had the idea that maybe we could take one big swallow and do something like allocating all Marshall Plan repayments to an international agency and get foreign aid out of the way so we wouldn't have to vote appropriations year after year.

Anyway, he was vehement in urging this viewpoint on Anderson and the Treasury. On the other hand, the Treasury was being pushed by some people in the US government to look more kindly on SUNFED which had a great deal of support in the United Nations. I remember that Anderson finally called up Black and said, "Monroney says he's going to spring this idea publicly unless I can come up with something that I can suggest to him."

I went over to Anderson's office in the Treasury with Black and Demuth. We said, "Well, we'll get up an outline of something," and I think in about 24 hours we produced the first draft outline of a proposal for IDA, which didn't differ essentially from what finally came out, except that there was more emphasis on loans repayable in local currency. (This was what Anderson thought Monroney was interested in. But Monroney really was interested only in using the frozen local currency resources and having them paid back in local currency, while Anderson was talking about foreign exchange loans repayable in local currency.)

There was a great deal of skepticism on the part of the United States administration that the European countries could really match the American contribution, in meaningful money, in money which wasn't frozen in some way. Black insisted that he could get at least one good dollar from Europe and Japan for every dollar the Americans put up. Actually it came out much better than that. This was an early example of what continued for several years to be the fact, that the US government never believed that the Europeans really could be pushed up into putting more money into foreign aid.

Well, Anderson took this outline and gave it to Monroney, and Monroney brought it out as his idea. At the next annual meeting of the Bank, Anderson sprung it as a US proposal, and it was voted that it should be studied, not by an international conference but by the executive directors of the Bank acting as an international conference. We carried on negotiations for several months and drew up a charter.

The main battles in developing the IDA charter were along two lines. First, between the underdeveloped countries and the developed countries--the underdeveloped countries wanted it much larger and looser. They didn't ever use the word "looser," but they kept talking about "social projects." The Latin Americans wanted IDA to do health and education, housing, things of this kind. There was a more general feeling that IDA should continue to put emphasis on the kinds of projects financed by the Bank, but perhaps be a little bit less rigid than the Bank is, in terms of productivity, concepts of what kind of a project is productive and what is not.

Q: Doesn't the question of credit worthiness arise here? A country might be at the limit of its foreign borrowing, foreign exchange, but still be within limits of usefully using additional domestic resources.

Sommers: Well, that was not an area of dispute. That was generally agreed, that IDA should be a complementary agency. I might say that the reason it was set up as a separate entity was merely so as not to get IDA operations entangled in the Bank's credit, as far as marketability goes. It was agreed that for all practical purposes it should not be a separate institution, but just a different kind of money.

Everybody agreed that IDA was to be used for countries whose credit was limited, and there was discussion of possible questions about applying the principle. It doesn't mean that you have to fill a country up to the full with hard loans before you can do any soft loans. Credit worthiness is not such a clear concept as that. It was agreed that in a country like India you would continue to make hard and soft loans in combination. In some countries--Jordan, let's say--you might not want to make any hard loans, you might make all loans from IDA. Mexico, I think Mexico itself agreed that it was not an IDA candidate. But then you get into borderline cases like Argentina, which ought to be able to finance itself entirely on good loans, hard loans, but what do you do when it's just recovering from the Peron period? Might not IDA be the first venture on the part of the Bank into the Argentine situation, before the Bank might be ready to hazard its own credit?

That's the kind of discussion that went on. I don't think there was any major difference on that. The difference came in the softness of the project standards. By and large the American, European and Bank staff approach was adhered to. A second difference concerned the technique of lending, whether IDA should do grants, loans repayable in foreign exchange, or loans repayable in local currency. The United States wouldn't go along with grants, although there was a great deal of sympathy for them, and the question of the character and terms of a loan was left open in the charter, so as to postpone the decision. But the Bank staff had pretty much a definite idea as to what it was going to ask for, and what it was going to ask for turned out to be the kind of lending format that has been announced--very long-term loans, no interest at all except a half a percent which is designed as a sort of service charge, no repayments during the first ten years, but all payments to be in the currency lent in foreign exchange. The theory was that even in the case of a country whose credit worthiness is very hazardous, it's one thing to bear a debt burden of 12 percent per year in terms of amortization and interest, and another to have a free period of ten years and then to pay off at the rate of 2 percent a year, taking into account the fact that all currencies decline in value and that all economies grow. This was thought to be the best possible middle line between the grant, which is rather invidious, and the loan repayable in local currency which is just kidding yourself. There was thought to be no reason at all why countries couldn't repay on this kind of a schedule, particularly with the understanding that since the money wasn't borrowed and there was no rigid requirement for repayment to private creditors, in case of need, even these payments could be postponed and made flexible.

I think IDA really made a great contribution in bringing out this formula. The United States government was converted to this from its own lending formulas. Unfortunately, IDA delayed so long in announcing it, that it lost some of the credit for it. It leaked out first. But all of the countries that had been in favor of loans repayable in local currencies, the underdeveloped countries, I think liked this formula much better, and I find it very sensible.

Q: Yes, I can't imagine myself what the United States government is going to do with all of its local currency.

Sommers: Well, they appointed three “wise men” to look for suggestions for using it, and then interviewed me. I suggested that instead of getting this currency deposited in bank accounts, they should ask for payment in bank notes, which they could then burn, thereby creating energy without inflation. They said they weren't prepared to adopt this plan but that it was the most constructive suggestion they'd received so far.

You said you wanted anecdotes. I've got one anecdote about the IDA negotiations. I can't remember the people involved, but the Malayan director in the course of the debate as to the size of IDA--he was plumping for a much bigger IDA--referred to a remark made by the governor for Vietnam to the effect that the IDA should be three times as big as proposed, or something like that, and he asked his colleagues at the table whether they remembered the remark. One of the other directors said, "I remember it very well, and my sentiment about it is one of regret that the remark wasn't made by the governor for the United States instead of the governor for Vietnam."

Q: Well, it is a very small capitalization.

Sommers: It's not so terribly small. It's only small if you regard it as something finished, but everybody went into IDA on the idea that this should be replenished. There was a good deal of debate as to what the replenishment period should be. I and my colleagues in the Bank staff said we would much rather have a low lending rate for a few years, namely 200 million dollars a year, which is about what this will furnish, with a five-year replenishment period, than be in the position of going back every two years or one year for more appropriations, because we would gradually become more and more under the thumb of parliaments and the US Congress if we did that. Now, after all, they've only done 100 million dollars the first year, so that they'll have a little leeway to build up. This capitalization isn't very big, but I think it is not so far out of line with what IDA is going to be able to use in the first three years. At the end of three years they'll have to start their replenishment process anyway, and if they've done a good job presumably they'll get more money.

Q: I wonder if you could say a few things about the concept of absorptive capacity and credit worthiness?

Sommers: Well, I think absorptive capacity is a highly debatable subject on which I don't know very much and I don't know whether anybody else does. Certainly absorptive capacity is greater than credit worthiness, and it certainly is far less than need. Now, in between the two, I don't know. The absorptive capacity in India, which has already reached a fairly high level of economic activity and particularly a high level of sophistication of institutions, is, I would say, pretty great. The absorptive capacity of Panama is very low, if you're talking about absorptive capacity for high-priority projects. Brazil, Argentina, there it really isn't a question of absorptive capacity, it's a question of whether other governmental policies aren't so bad that no matter how much you absorb, all the economic benefit is being drained off in other directions. I don't know whether absorptive capacity with ruinous inflation that distorts the whole economy is absorptive capacity, or whether both these are part of the same equation. I think absorptive capacity for the underdeveloped countries as a whole is probably almost meaningless. In fact, I think the term "underdeveloped countries" is almost meaningless. I think all the economists and the underdeveloped countries and the Bank and everybody else is falling into, or pushing themselves into, an intellectual trap by creating this classification, which seems to put Argentina and Jordan in the same class. Actually, Argentina is much nearer to Italy than it is to Jordan. Leonard Rist made a good comment when he visited Argentina for the first time after Peron. He said, "I was very much surprised. I thought I was going to an underdeveloped country and I found instead something very familiar to me, a bankrupt European country."

So I think you can only estimate absorptive capacity on a country-by-country basis, and then add them up. My guess is that the studies of absorptive capacity have been done on all kinds of macroeconomic calculations which are valuable but highly imprecise.

Q: In other words, if you ask people talking about the absorptive capacity of a country, if you ask for what specific projects it might be used, they'd have a terrible time?

Sommers: Yes, they start with what is the desirable rate of economic growth? Well, you can put so much error into that value judgment to begin with that the error may be greater than all the precision of all the other calculations that follow. But even if the growth rate is right, it is right on a planning basis, and I just don't believe they're able to assay the abilities in execution. The Indians, I would say, were better in planning than in execution, but even in the planning area they made some colossal miscalculations. They just didn't have the--well, for example, now the UN census is showing that their whole census figures are wrong by 12 to 15 million people. That just throws a gimmick into the whole planning mechanism which makes it completely distorted. They weren’t able to get cost estimates the way you could do in the United States--from the executory agencies. They weren't able to figure out how long it would take and which things had to be in which order or sequence. It was too unreliable. So there's a big lag which these calculators try to allow for, but I don't know how they do it, frankly.

I've heard it said, "I'm not sure it's true--that the planners in India calculated that with an increased standard of living, the masses would change their dietary habits, and there would be a great need for the next higher level of diet, more proteins and so forth; but in experience it turned out that the great impact was for more of the same kind, more rice and more grain, rather than a shift to higher levels of diet. Such a complicated business. I don't know how you can make it very precise. Nevertheless, I don't know that it really makes an awful lot of difference, because I think every conceivable calculation of absorptive capacity on a global basis will show more absorptive capacity than there is capital available.

Q: That of course is the thing that puzzles me a little bit, these various computations of capacity are fairly high, and yet many people in the Bank say that there's never been a shortage of Bank funds to stop the Bank from making more loans, but lack of credit-worthy countries and leak of sound projects.

Sommers: Well, the Bank has never turned down a loan for lack of funds available to the Bank. But 700 million dollars a year is not a whole lot. I don't think this is a very meaningful statement. It's a good statement to make and I think it's true, but there's an awful lot that goes on in the world that the Bank has nothing to do with. Take the whole area of education, for example. I haven't any doubt that there is a colossal absorptive capacity, although there are limiting factors perhaps in the rate. I don't think you can get into high gear in absorptive capacity the first year that capital is available, because teachers aren't available and people aren't available. But I still think that if there were no limit on the amount of capital available, that absorptive capacity would be pretty large, because if you have enough money, people become available.

Q: You mean by absorptive capacity here now the ability of a country to use the funds for some productive purpose.

Sommers: For some sensible purpose, not necessarily productive in the narrow sense--education, health, all these things, social things as well as economically productive, directly economically productive.

Q: Well, it's sometimes argued that you increase the productive ability of a country if you increase the education of its citizens.

Sommers: Oh, sure, there's no question about that, but very often in these circles "productive" means something that directly increases the production of goods-- the production of goods and services.

Tape #3

Sommers: In the early days of the Bank, I think the lawyers played an unusually predominant role. This is partly because of the fact that the Bank's general counsel was a very strong figure who had the confidence of Meyer, McCloy, Black and Garner, and was a very experienced financial figure; second, because the recruitment of lawyers went rather ahead of the recruitment in some of the other areas, and I think that the legal staff was stronger relatively than some of the other departments; next, because the early work of the Bank involved legal techniques, getting our framework of legislation, getting our basic loan contract forms, our basic bond issues format, and so forth. But the lawyers certainly had a role extending way beyond that. And I might give as an illustration of the position of the lawyers at that time the Brazilian Traction loan which was the first really complex development loan that the Bank negotiated, although it took a long time getting on the books. This was in substance, though not in form, negotiated largely by the lawyers. And I think that illustrates the fact that American lawyers are rather used to being injected into formless, chaotic organizations, and found it a little easier to make their way than some of the people who had been used to more regular kinds of procedure.

Q: I've heard that in the case of the French loan, the very first loan the Bank made, there was some concern, mainly on the part of the French, in the language used because it was drawn up by attorneys who were accustomed to draw up--

Sommers: --yes, well, the Bank's original loan agreements were pretty formidable in language. But, I think the French are intelligent enough to really have their eye on the substance and not on the form, and there were some substantive things that they didn't like. The form was a little obnoxious to them. After I became general counsel, we got rid of most of that heat by taking all of the mechanical and standard and boilerplate language, particularly the part of it that had caused most trouble, and adopting it as a loan regulation which could be incorporated by reference into loan documents, and although it was subject to change, in any negotiation, and wasn't binding or mandatory, we found that as soon as this was adopted as a sort of a standard thing, people hardly ever paid any attention to it. The loan agreements became documents of seven or eight pages instead of documents of about 50 pages, and it reduced the area of fighting about language very, very much.

I may also say that a lot of these asperities of language were softened in the process. We also had them translated into

Spanish and French, so that it became easier to deal with. Also as we got more and more loans, people were less worried about making a better deal or making a worse deal than anybody else and having their parliaments compare different provisions. The whole issue faded into insignificance. There were a few substantive provisions that the Bank insisted on from the beginning, like the right to be consulted on external debt, which was later found to be unworkable and thrown out.

Q: Could you say something about the work of the Bank lawyers in preparing the market of the United States for sale of bonds?

Sommers: Yes. This was divided into two areas. In the first place, preparing the market was done by Black and Dunston and the marketing people--that is, going around and seeing all the dealers and the financial people, and preaching the quality of the security behind the Bank's bonds. We--the lawyers got into this in a small way, by preparing statements showing the rather novel and peculiar corporate structure and its relationship to the security available to the creditors, and also by clearing up ambiguities that needed to be cleared up. But essentially the law department's role was in the field of getting legislation, which was needed to enable the bonds to be sold. This consisted in part of a state-by-state drive to get legislation or administrative regulation which authorized insurance companies, savings banks, trustees and institutional investors generally to invest in the securities. There was hardly a state in which any of these institutions could buy them, by law, when we started business. In many states each of these separate kinds of institutions had a separate law and had to have a separate hearing before a separate Senate and House committee. In Ohio we had to have one for life insurance companies, one for casualty companies, one for savings banks, one for trustees--and several for state funds, five or six different kinds of legislative enactments. That was a big job, full of a lot of big and little fights.

Then there was the whole federal area. We'd early got a ruling from the Controller of the Currency that national banks could invest in the bonds, but we wanted to get two other freedoms. We wanted to get exempt from the Federal Securities Act, and we wanted to do that because the sanctions of the Securities Act really made no sense. The sanctions of the Securities Act are liability on behalf of directors and officers and underwriters. Our directors were exempt by international agreement from these liabilities, as were our officers, and the underwriters didn't have the same control over the issue that they do in a normal private issue, so it was unfair to put the whole burden on them. You have the anomaly that the Bank can't issue securities in the United States without the approval of the United States government, and so we had to put on the first page of the prospectus, when we were under the SEC, as required by the SEC laws, "It is a criminal offense to represent that the Securities and Exchange Commission has approved the issuance of these securities," and on the first page we had to put "The issuance of these securities has been approved by the United States government." The whole thing just didn't fit.

But the history had been that at the time of the Bretton Woods agreements' ratification, there'd been a question in the United States government whether to try for exemption from the SEC laws. I understand the decision was not to try for it but hope to have them exempted later on. But, on one occasion, in answer to a statement by Barkeley that the United States government's liability was limited to the United States subscription, Senator Taft got up and said, "How can that be? Securities will be issued in this country under auspices under which it will be impossible for the United States to deny full responsibility for every penny that's issued." Barkeley then said that he didn't understand that at all. These securities would be "approved" by the Securities and Exchange Commission in the same way that they approve all other securities (which of course they don't do); therefore the United States would have no more responsibility for these than they would for any other security, except to the extent of its stock subscription.

Well, this was a silly exchange, but the fact that Barkeley in answer to Taft had said these bonds would go through the SEC process even though he'd said it incorrectly, was the basis on which the SEC said, "It's perfectly clear that these bonds are not entitled to exemption from the securities laws." So our first issue was subject to the securities laws. We later tried to get an exemption.

The bill was referred to the Committee which usually deals with SEC matters, which wasn't very sympathetic, so it got thrown out one year. The next year Luxford, who was the assistant general counsel and a very capable legislative representative, had the whole bill recast in the form of an amendment to the Bretton Woods Agreements Act rather than an amendment to the Securities Act, with the idea that it would be steered to the Banking and Finance Committee which was sympathetic to the Bank, rather than the Interstate Commerce Commission which had turned us down before. We coupled this with an exemption to the Banking Law which would permit commercial banks to deal in International Bank bonds, to underwrite them. This time it went through pretty easily. I remember one incident.

The only way we could get the bill through finally in the Senate was by unanimous consent, because we got caught in a legislative jam at the end of the year. There'd been a favorable report by the committee; and if we could get unanimous it would go through; otherwise it would be taken up in order and it would die on the vine.

At the last minute the sponsor of the bill, and I can't remember who it was, got up and asked for unanimous consent to this bill, the purpose of which was to exempt the Bank's securities from the jurisdiction of the Securities and Exchange Commission, but which did have the provision that the Bank must make reports to the SEC. Senator Langer got up and said, "Before deciding whether to comment or object, I would like to ask, what is the purpose of the bill?"

And the sponsor said, "The purpose of this bill is to subject the International Bank's bonds more effectively to the jurisdiction of the Securities and Exchange Commission." Senator Langer said, "No objection," and the bill went through. That's a sample of the haphazard way in which the legislative process takes place.

This story you asked me about is another small example of that. For years we tried to get legislation in Congress authorizing District of Columbia insurance companies, of which there are only one or two and small ones, to be authorized to invest in Bank bonds. We didn't care much about this as an extension of our market, but it looked anomalous that when we were trying to go around to get similar legislation in all the states, we couldn't even get it in our back yard from the United States government, which was our creator. But the District committee of the House and Senate, if you've ever been there, spends all its time deciding what size rockfish can be taken and what to do about the starlings and major issues of this kind, and year after year we would never get to first base. Nobody was against our bill but nobody was in favor of it. Nobody was interested in it. One year we'd get through the House and die in the Senate, and so forth. Of course, all these District bills can be passed only by unanimous consent.

So we started out another year, and I asked one of the young lawyers, Dick Bateson, to prepare for the introduction of the bill in the usual way, by drafting a letter for the Secretary of the Treasury to send to the chairman of the committee. He drafted a letter in routine form reporting what had happened the last year, and he said, "The bill passed the House without amendment but failed of enactment in the Senate." We sent this over to the Treasury and the Secretary signed it and sent it in.

The clerk of the House committee called me up and said, "There's a misstatement in this letter of the Secretary's. The bill was amended in the House, though not in any material way."

I said, "That's funny, we looked it up in the Congressional Record. It says there it was passed without amendment."

He said, "I know it says that. That's wrong. The only person who knows it was amended is me and I have it in my records."

So I reported this to the Treasury, and the general counsel's office of the Treasury got awfully excited and said, "You've made the Secretary of the Treasury make a misstatement in a letter to Congress. This is very serious. You will have to appear and make a statement explaining this and assuming responsibility for it."

So I went to the District Committee and they were dozing along talking about starlings and rockfish, and I started out by saying, "I want to begin by apologizing for causing the Secretary of the Treasury to make a misstatement in his submission to Congress." I explained this. Well, for the first time in five years the members of the committee got interested, and they cross-examined me about all this to make sure there wasn't any funny business. By that time they began to get interested in the merits of the bill, and somebody said, "Well, these sound like pretty good bonds. Why shouldn't they be legal investments?"

And by the time this was over, the committee really got behind it and for the first time we went sailing through, all because we started off with making the Secretary of the Treasury make a misstatement. I told the young lawyers not to profit by this experience.

Q: How important do you feel the type of loans the Bank has made have been in the ability of the Bank to sell bonds?

Sommers: Well, that's a very complicated question. I think that unless we had made--we had adopted a lending posture and lending techniques which sounded sensible to the market in this country and in Europe, it would have been very hard to get off the ground. At the present stage--and of course, the fact that there have been no defaults and all that has been a terrific selling point. At the present time, the Bank's--the confidence of the market in the Bank's operations is pretty firmly established, and I think it's been five or more, eight years since the Bank has been in any way under pressure from the market to avoid going into things that it hadn't gone into before.

If we had made a big loan to some country which had just expropriated an oil business, there would have been an awful furor. Whether it would have actually limited our ability to sell bonds, I don't know. It certainly would have in the early days. But I don't think they scrutinize the day-to-day lending operations the way they used to. Of course, the Bank has sold a billion dollars' worth of its loans to banks, without guarantee, and although these participations are not made wholly on a lender's motivations--there's a good deal of new business getting on the part of the banks involved--nevertheless I don't think the Bank could go haywire in lending without having that dry up, and if that dried up, there would be questions asked about how the Bank was operating. But the questions of policy on which I've said there have been some differences of opinion, questions of degree as to how far you would go with general purpose loans or local expenditure lending, whether the Bank decided to go in for loans for water distribution, which it's never done, municipal water supplies or telephones which it doesn't often do, I don't think these things would have the slightest affect on its credit. In fact, most of those are loans for which domestic lending agencies lend normally.

Q: I understand there was a time when some investment bankers' act focused on the International Bank?

Sommers: Well, that was in the days when we were under the jurisdiction of the SEC, and the investment bankers thought they were going to have the liability of underwriters. We got a ruling from the SEC that they didn't have that liability. It wasn't that the investment bankers wanted to look at the books, it was that the investment bankers raised the question as to whether they should not follow their normal practice of having their own lawyer give them a legal opinion that the organization of the bank was legal and that the members had all subscribed and that the United States was liable for its subscription. I don't think anybody took it very seriously. We said, "no lawyers," to begin with--in those days we had a vast crowd of underwriters and we didn't want to get into too much complication--but after we hit on our pattern of borrowing, of having an underwriting syndicate headed by First Boston and Morgan Stanley, they were represented by lawyers and we've worked out a pattern by which those lawyers rely on an opinion of the Bank lawyers as to the legality of the Bank's existence and the membership and so forth. There never was any question of looking at the books in an auditor's sense. After all, we have Price Waterhouse and we always work on audited figures. It was really a question of the legal structure of the Bank, and it was pretty silly, because we didn't want to get into, in the early days, the question of how the United States had accepted some of the required documents saying that all steps had been completed under a country's domestic laws--a lot of it was pretty sloppy. But it was sloppy by Wall St. corporate standards. It was normal by international diplomatic standards.

Q: Some people I've talked to have said that the Bank's ability to sell bonds depended solely on the guarantee of the US government, that it could sell bonds given that guarantee regardless of

Sommers: --well, I think originally this was a necessary but not a sufficient condition. I think the bare guarantee of the US government would provide an adequate security for anybody who was otherwise inclined to invest. But these bonds didn't offer so much better yield than other bonds that were available, and of course, nowadays, they offer very poor yield compared to what the Equitable, for example, expects to get. I'm sure that there had to be some affirmative motivation, and the affirmative motivation was that this was going to be a good thing and run sensibly, and that the financial community had an interest in this kind of organization going on. I don't believe that the US guarantee alone would have been sufficient. Nowadays, of course, it's very easy--you just say, "Well, the Bank has two billion dollars' worth of bonds outstanding, and there's a direct call on the US Treasury for over five billion." In the old days people used to think: well, what's going to happen when you make loans? (Everybody thought you were just going to dish out the money.) And what's going to happen when you go beyond the US guarantee? Well, now it's been proved that it took 15 years to get to the limit of the US guarantee, and when the Bank got to that point all the guarantees were increased. So I think people treat it as substantially a US guaranteed obligation, but in the meantime, of course, all the guarantees of all the other countries have become so much better than they were in those days that the whole credit structure of the Bank has enormously improved, as is evidenced by the rating of its bonds improving to Triple A.

But I doubt very much if, let's say, UNRRA, with the same US guarantee, would have had an easy time establishing itself in the bond market. I don't know.

Q: Given the fact that the US government guarantees, I take it you don't feel that it takes much to sell these bonds?

Sommers: Well, if the Bank had agreed in advance that it would limit its bond issuing amount to the level of the US guarantee, it would have had a Triple A rating right from the beginning, or might have, and probably could have saved fractional interest rates. But in those days the Bank's interest rates anyway were 3 percent, (what it paid, it loaned at 4 1/4) and I don't think its interest rates have been unreasonable. And I don't think really the policy aspects of interest rates are settled entirely by what the Bank has to pay. I think the policy aspects of interest rates are more influenced by the question, how great a subsidization should be given to the underdeveloped countries, many of whom couldn't borrow at all without this capital structure, but should they be enabled to borrow on a--at a rate which is lower than the Bank's best European members would have to pay if they borrowed much smaller amounts directly in the capital markets of the world?

Generally, apart from all other considerations, there's been a sort of an unconscious feeling that if Belgium and Holland and Norway would have to pay 5 1/4 percent or 5 1/2 percent to borrow in the American market, there is no reason why Jordan should borrow from the Bank at less, and particularly so since this would defeat the Bank's efforts to force countries like Norway and Belgium to meet their demands in the markets rather than coming to the Bank. I think this is a more important consideration than some of these other things.

On the other hand, the pressure for lower interest rates should be, will not be but should be reduced, because you accomplish the same result now by a judicious mixture of Bank loans and IDA loans, and you can arrive at practically any service level you want by dishing them out in the proper proportions. So that ought to give the Bank all the flexibility it wants to meet the problem.

Q: Would you say just a bit about the development of Bank policy with respect to selling some of its borrowers' obligations to the private market?

Sommers: Well, this has always been an objective of the Bank. At Bretton Woods, as you know, the idea was that the Bank was going to act primarily as a guaranteeing agency. Well, that didn't prove feasible for a lot of reasons. In the first place, guarantees are not very acceptable in the American market. There are a lot of legal quirks in guarantees. In the second place, what would have happened would have been what happened in the case of housing bonds. Those essentially have the same investment quality because they're all backed by the US government. Nevertheless they sell at different yield bases because of the so-called names. A good city sells at one yield and a bad city at another. Similarly, a Holland loan with the Bank's guarantee would have sold at one rate, and a Nicaraguan loan at another. In fact, you might have been giving the market more power to dictate the allocation of your resources than you would have liked, because the market might have said, "No Nicaraguas at all, nothing but Holland no matter what the rate." It might have said, "We've got a lot of people who don't like Nicaragua or Egypt, for example."

So there were a lot of reasons for not going the guarantee route. Nevertheless, the concept of the Bank as being a sort of a bridge, to use McCloy's figure of speech, between the public institutions and the private market, that we should try to bring the private investment community into our operations, was very important. It's had a tremendous effect on the good will of the investment community towards the Bank. It's always been regarded as a friendly institution, and the fears that the Bank would try to take over the international business--such as it was, there was practically none of it--have been allayed, because any time anybody has accused us of doing something that they might have done, we've just said, "Our whole portfolio is for sale, you can take it all over." This has been a wonderful line.

So even in the early days of the Bank lending operations, we sold out of our portfolio. But in those days we could do it only with a full guarantee. This was silly, because in effect it meant we were paying more for money than we did when we issued direct. These were non-marketable type securities, and we had to pay a higher effective interest rate on them. Nevertheless, it was done for public relations purposes, and gradually we've moved away from the guarantee technique into direct sales. At first this was only the short maturities to central banks. There was a good deal of buying back loans in the country in which they were made. It was a nice way--if a central bank had a little excess money, it could cut down on the interest rate their country was paying by retiring obligations a few years in advance. And it meant that the Bank's borrowing requirements were somewhat lowered at a time when the buildup was very fast, and where it didn't want to be forced into the market over and over and over again. The chief weakness in the whole bank's borrowing operation has been the necessity for coming back several times a year. Investors didn't have the feeling, "gee, we'd better get in on this issue while we can," because up until later years when the Bank did not borrow so much in the United States: "Well, what's the hurry, there'll be another issue along in three months." And the problem of keeping the market guessing and hungry was a very--a problem of very great tactical skills, which Black is a master at.

Q: The only other question I can think of I'd like to ask--how long have we?

Sommers: About two minutes.

Q: The reasons for the three vice presidents?

Sommers: Oh, that was just the usual bureaucratic reason of not being willing or able to choose any one. You'd better ask Mr. Black about that.

Q: Well, thank you very much.

Sommers: Thank you. I enjoyed it. An interesting institution.