

Finance and Development

Interviews

William S. Gaud of The International Finance Corporation

IFC is the member of the World Bank Group that specializes in promoting growth in the private sector of the economies of its member countries, particularly in the less developed world.

It was brought into being in 1956 to supplement the work of the World Bank. It does so by filling two gaps: it can invest without government guarantee, and it can supply capital in the form of equity as well as loan.

Membership in IFC is open to any government that is a member of the World Bank. At the outset of 1970, IFC had 92 members, which have subscribed approximately \$107 million capital. In addition, it had a reserve against losses of \$54 million derived from accumulated earnings, and some \$428 million that it may borrow from the World Bank for use in its lending operations.

IFC carries out its mandate chiefly by making direct investments in individual private enterprises. In these investments its preference is for joint ventures bringing together foreign and local capital and know-how. IFC also:

—helps to identify and promote projects, by taking responsibility for developing a project from scratch, including feasibility study, engineering and market studies, finding financial and technical partners, and organizing the financing; by investing in pilot companies organized to develop a project; and by helping to organize special purpose financing institutions;

—helps to establish, finance, and improve privately owned development finance companies;

—underwrites issues of stock, with the parallel objectives of helping enterprises in developing countries

increase their capital through stock issues and of developing capital markets;

—encourages the flow of capital into developing countries through the sale to investors, in capital-exporting countries, of portions of IFC investments;

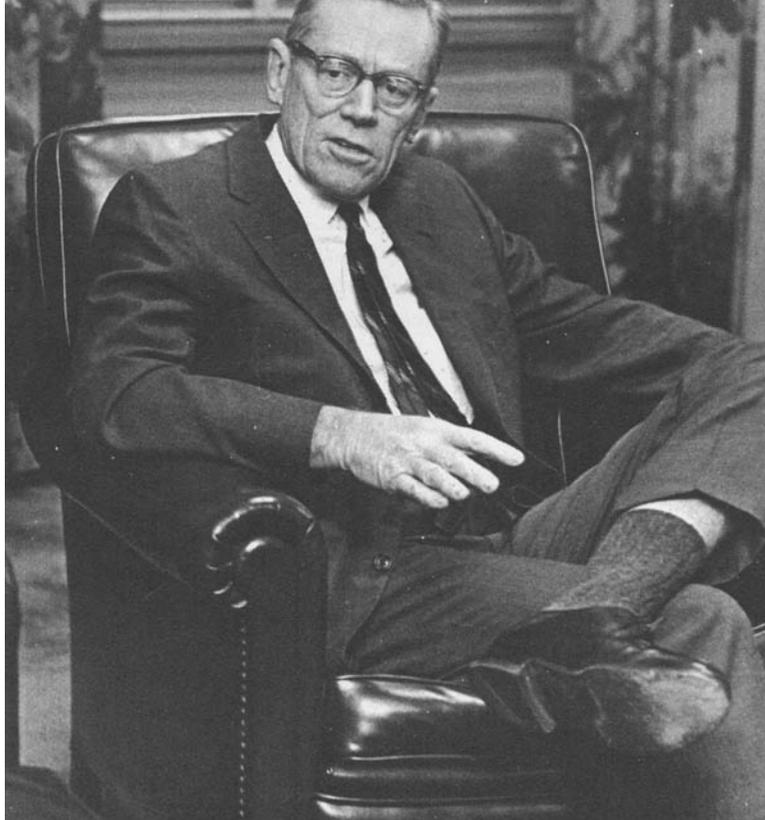
—confers with governments on measures conducive to the growth of private investment.

IFC's investments range generally from a minimum of \$1 million (which can be lowered in some special circumstances) to about \$20 million, with the IFC portion representing, on the average, about a sixth of the total financing (through fiscal 1969 IFC had invested \$365 million in projects in which others put \$1,800 million at the time of the IFC commitments). In any case, IFC expects its commitment to be substantially less than half of the total financing involved in a project.

William S. Gaud was appointed Executive Vice President of IFC in October 1969. He graduated from Yale College in 1929 and received an LLB degree *cum laude* from Yale Law School in 1931. He served as Deputy Administrator of the U.S. Agency for International Development (AID) from 1964 to 1966 and Assistant Administrator for the Near East and South Asia from 1961 to 1964; in 1966 he became Administrator.

In a speech in 1968, Mr. Gaud introduced the now celebrated phrase "Green Revolution," which dramatized the results of initial large-scale use in Asia of high-yielding grain seeds, increased availability and use of fertilizers, and better farming methods as being comparable in potential importance with the Industrial Revolution itself.

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F and D: *You have come here from being the Chief Administrator of the U.S. Agency for International Development; what lessons that you learned in that capacity would you like to apply here in your new job?*

Gaud: Well, I suppose that as a result of spending some 8 years in AID, I've acquired some understanding of how the development process works—to the extent that anyone understands it. I have acquired an understanding of the fact that the job has to be done primarily by the people in the developing countries. There is a certain amount that we on the outside can do to help but we can't do the job for them. I have learned a good deal about some of the countries themselves; I have gotten to know quite a number of the cast of characters that is involved, both in the less developed countries and in the capital-exporting countries. Also I learned in AID that the business of promoting or encouraging private investment in the less developed countries, and even more so, encouraging the growth of a private sector, an indigenous private sector, in the LDC's is a difficult job. So I would say that I come to the job here with a very healthy awareness of how difficult it is, with a strong belief that the private sector is important, but still puzzled and uncertain as to how we can best go about promoting the growth of the private sector.

F and D: *IFC is now 13 years old. Supposing that instead of that being so, you were starting out, with a blank sheet, and that you were creating IFC. What kind of shape do you think you might want to give it? How would that differ from IFC as it exists?*

Gaud: If I could write the prescription—I feel strongly that IFC as an international institution can do a great many things to promote private investment that a national organization can't do. So I would certainly want it to be an international organization, as it is. I think it's very important that it be tied to an institution such as the World Bank, because this gives it a status that it wouldn't otherwise have. I don't think I would change the powers of IFC very much, except, if I could, I would have it bring into being a multinational insurance scheme, similar to the one that the U.S. Government has. I think that is an important attribute of a foreign investment program which doesn't exist today on the international level. The World Bank has been trying to bring this into being for some time but hasn't succeeded.

F and D: *Can you see the relationship with the Bank changing and developing?*

F and D: *That is one question that I would like to pursue particularly: industrialization. It was given so much importance in Mr. McNamara's speech at the Annual Meeting.*

Gaud: That's right—at least under the present dispensation from Mr. McNamara, who wants to give a stronger thrust to the whole business of industrialization.

Gaud: Well, there can't be any such thing as piecemeal development. This is as true of industrialization or of the industrial sector as it is of anything else, and if you are going to develop the industrial sector sensibly, you have to do it in accordance with an overall strategy of development. This means a number of things that the Bank Group has been paying relatively little attention to in the past. One is making studies of the industrial sector in the developing countries, helping them figure out what their development priorities are in relation to their over-all developmental requirements, giving them advice and policy guidance on what they should or should not be doing to encourage the growth of the private sector. Others include pointing out the relationship between such things as exchange rates, tariff policies, tax policies, and licensing policies of one kind or another, to the development of a strong industrial sector and to industrial growth.

The Bank Group has done relatively little of this in the past and the Pearson Commission Report takes us very much to task for this. If you were starting from scratch, you would set up within the Bank Group, it seems to me, a unit to promote industrial growth. It would deal with these policy questions that I have been talking about; it would deal in some countries with making investments in the private sector; in others, where it isn't possible to do much in the private sector, it would be making investments or helping to develop public sector industrial projects. It would be giving assistance, financial and otherwise, to development banks. You have a whole bag full of tools that you would use in a particular country.

Mr. McNamara has in fact created in the Bank an Industrial Projects Department, which is policy oriented, which will give policy guidance, which will make industrial sector surveys, which will help countries determine what their priorities are, and which will process and screen investments in industrial projects in the public sector. Now, our job in IFC will be to work very closely with this new Industrial Projects Department.

The Industrial Projects Department, the Development Finance Companies Department, and IFC should be working together, following the same policies.

F and D: *Let us go back to one point that you were talking about—the Pearson Commission. Criticism of the World Bank Group on the ground that it has been too much tied up with the big financial institutions was in part directed at IFC. I would like to put two pictures to you: one of IFC as an investment corporation pretty much like any private investment corporation looking for its profits where it can; and the other of IFC as a development institution. There are many ways in which these two pictures could be reconciled. How, specifically, would you wish to reconcile them?*

Gaud: I think that IFC has to do two things.

First of all, IFC's investments must hold out the promise of earning a profit. I say this for three reasons: first, we want partners in the enterprises in which we invest; second, we want to sell participations in our investments, that is to say, we want to sell part of the shares that we buy and loans that we make in order to turn over our capital so we can make new investments; and third, above everything else, we are trying to show that private enterprise works. Unless our investments are profitable, how are we going to persuade people that it does work? So that every investment that we make must meet the test of the market.

This is true of any normal private investment company, but the difference is that we don't stop there. We shouldn't make any investment unless it's going to contribute to the development of the country in which it is located. It's our job, as I see it, to test every

one of our investments against that standard. Does it fit in with the priorities of the country? Is it competitive? Is it going to bleed the country's economy? Or is it going to contribute to the country's economy? We have to be just as hardheaded as a private investment banker, but we also have to make sure that our investments are in enterprises which will contribute to economic development. Now the Pearson Commission criticizes IFC for having put too much emphasis on profitability and too little emphasis on economic development. I don't know how valid that criticism is, but I do feel very strongly that we don't have enough people in IFC who are looking at the economic side of our investments. So we have recruited an Economic Adviser; we are providing him with a staff and we are going to do our utmost to see that we do meet this second prerequisite of an IFC investment.

We were also criticized for sitting back and waiting for investment opportunities to knock on the door. Now we will do more going out and looking for them.

F and D: *In what you have been saying about investments, the emphasis has been on the investment in equity, hasn't it?*

Gaud: This is correct.

F and D: *Do you see a change coming there?*

Gaud: Yes, the past practice has been almost never to make an investment unless there was an equity feature to it. I would pursue a more flexible policy. It is my view that there are situations where equity money is available for an enterprise and loan money is not, at least on reasonable terms. I think that our policy should be flexible enough to do whatever needs to be done to get a sound enterprise going, and given the situation that I have just described where the equity money is available from the outside, and the loan money is not, I see no earthly reason why we shouldn't make straight loans, and I would propose to do this.

F and D: *Where might the equity money come from?*

Gaud: It will come from the private sector. The thing about this business that IFC is in, is that there are very few aid-giving institutions that provide equity. There are aid-giving institutions of one kind or another which provide loan money, but the equity in the kind of situation that I'm talking about, nine times out of ten will come from entrepreneurs.

F and D: *But local institutions are very important?*

Gaud: Oh, very. If there is one thing on which IFC should place more emphasis than it has in the past it is on institution building—supporting institutions in the developing countries. Sitting here in Washington, thousands of miles away from Africa, let us say, or from Latin America, with a small staff, it is impossible for us to handle effectively, much less efficiently, small loans or investments in small businesses. This can be done only by local institutions. The World Bank Group as a whole over the last dozen years has given a great deal of support to development finance companies, and it is through them that a lot of these small investments are made. This is accepted; no one questions it. But I think we ought to go farther. I think, for example, we ought to support intermediate credit institutions that are formed for specific purposes, such as helping particular types of businesses. We here in Washington can't do it.

F and D: *When you speak of supporting them, do you have any particular thoughts about how they might be supported? Is it a form of technical assistance?*

F and D: *You are already looking—and it is very interesting—a little way into the future. Anyone in his first months in a new job has ideas that are perhaps just possibilities, perhaps long term, perhaps not even feasible. Could you look a little further into the future at some of these possibilities that you might have in mind, such as expanding the institutions and the media of the capital markets in the developing countries?*

F and D: *Mutual funds, for example?*

F and D: *Can IFC go it alone in such large issues?*

F and D: *Do you see IFC being a catalyst in this activity?*

Gaud: This is a combination of technical assistance and financial assistance. Getting them going, seeing that they have resources, doing whatever is necessary to keep them working.

Gaud: I would say that IFC by the very fact of investing in the developing countries has been helping to build capital markets. I think myself that as time goes on we can do more in that direction; I think that we can sometimes take more affirmative steps to spread stock ownership in these countries.

Gaud: Mutual funds, perhaps, and many other ways of mobilizing capital seem to me not to be beyond the pale. IFC might support savings and loan associations, credit unions, insurance companies, almost anything that will mobilize capital in the developing countries. If you are going to do that, you have got to do what you can, also, to make sure that investments in those countries will have some liquidity, and mutual funds will contribute to this. There are some situations where you can strengthen existing stock exchanges. And then of course there is another aspect of this business that is important, and that we would like to tackle. Can you capture some of this flight capital that is leaving Latin America, in particular, and put it to work in the countries from which it is now running? Can you do this through a mutual fund device, or through some other means? Personally, I think it's a crime that mutual funds are being formed today and are being sold in the developing countries with the proceeds being invested in the developed countries. This is just hastening the flight of capital.

Gaud: No. A thing that I think that IFC should do and can do is to work much more closely with other institutions in the business. Take ADELA¹ for example in Latin America, PICA² in Asia—there are a number of other institutions of this general kind. Edge Act³ corporations, subsidiaries of large banks, U.S., British, German, French, whatever they may be, it seems to me that there could be and should be a community of people in the business of promoting private investment.

Gaud: Exactly. IFC has been a catalyst in the past to a considerable degree to the extent that it has helped to mobilize capital for particular enterprises. I would hope that we could go further, that we

¹ADELA Investment Company, with some 200 financial and other private concerns in Europe, Japan, Latin America, and North America as shareholders, provides capital and entrepreneurial and technical services to strengthen private enterprise in Latin America.

²The Private Investment Company for Asia was organized in 1969 by financial and other concerns in Australia, Europe, Japan, and North America and provides financial and other assistance to strengthen private enterprise in Asia and the Far East.

³These are subsidiaries of U.S. banks chartered under an act of the U.S. Congress in 1919 for foreign investment. At the end of 1969 there were some 60 such companies.

could get people working together more, cooperating more in other ways than simply putting capital together for a specific enterprise. Agreeing on what the objective is, trying to work out agreed solutions to some of these problems, this kind of thing.

F and D: *That goes a very long way beyond the putting up of funds merely, as it were, for particular projects?*

Gaud: It seems to me that if you are going to try to develop a strong industrial sector in a country simply by investing in specific business enterprises, it's going to take you forever. The only way to get there, and you still won't get there fast, is to build institutions, provide policy guidance, so that you get the country into a position where it can be doing for itself what we are now doing for it. So if IFC is indeed a developmental institution, which I believe it to be, we have got to spend a great deal of our effort and a lot of our time and a lot of our brain power on devising ways to do things that will have a multiplier effect—not just making individual investments that are going to earn a profit.

F and D: *This institution building, this acting as a catalyst, is not new for IFC?*

Gaud: Oh no, it's already established. For example, last year IFC helped to organize the International Investment Corporation for Yugoslavia, which is a very imaginative business, taking advantage of a Yugoslav law which permits joint ventures between Yugoslav enterprises, run and operated by workers' councils, and Western business enterprises. A group of Yugoslav banks and IFC, joined by a large number of other banks—Austrian, British, Dutch, French, German, Italian, Japanese, Swiss, and U.S.—brought into being the International Investment Corporation for Yugoslavia, with a capitalization of US\$12 million. Its purpose is to promote joint ventures between Yugoslav and other enterprises. Similarly, last year IFC set up in cooperation with a number of banks and businesses a corporation to promote tourism in Tunisia. In other words, IFC has already been on the track of institution building, and what I want to do is put more emphasis on it.

F and D: *Do you expect to be getting into any altogether new activities?*

Gaud: Yes. For instance, there is the International Executive Service Corps (IESC) in the United States—and a similar organization in Canada known as Canadian Executive Service Overseas (CESO)—which exist to give technical assistance to specific, individual business enterprises in the developing countries. IESC was started when I was in AID and I had a good deal to do with getting it moving. It is privately run by businessmen, and it sends businessmen to the developing countries for a period of two, three, or four months at the request of business enterprises to give them advice on how they can improve their methods. IESC now has something like 500 projects a year. The men who go over there are either retired businessmen or they are midstream in their careers and their companies turn them loose. The President of the Corps is Frank Pace, the Chairman of the Board is George Woods (former President of the World Bank), and David Rockefeller was the former Chairman of the Board—so you see it's a pretty distinguished body.

I'd like to establish a working relationship with the IESC and CESO so that when they ran into a situation where capital was needed—as they must do—they would go to their nearest development bank or they would let us in IFC know. This could be a reciprocal relationship. We would run into situations that we would refer to the IESC.

F and D: *Would you like to see institutions like the IESC grow up in other countries?*

Gaud: Absolutely. If a man running an insurance company, or a shoe factory, or a tire factory, whatever it may be, in a developing country, can get some advice on how he can improve his business methods from a man who has been doing the same business all his life in France, Germany, the United Kingdom, or somewhere else, this is worth a lot.

F and D: *Again it's a matter of bringing people together?*

Gaud: This is very important in all our fields of activity. There are some things that IFC can do that no other institution that I have ever been connected with could do. I'd like to give you an example: a large international corporation wants to invest in an enterprise in a small developing country. The international corporation may have wealth that is large by comparison with the economy of that small country. The investment opportunity is so good that the international company is prepared to put up all the money that is necessary. But the country is uneasy about going in with such a powerful partner. That's one side of the coin. But, similarly, the company in a developed country that wants to invest in a developing country, uncertain of the climate for investment there, worried about the policies of the country, not familiar with operating overseas, may also be uneasy. Both sides may be reassured if IFC takes a hand—if it shares in the investment.

F and D: *So you see IFC reducing the tension and the anxiety that often impede investment, improving the political acceptability of private foreign investment in developing countries?*

Gaud: Correct. Another thing of course—this in a sense gets back to the capital market business but it also bears on the political acceptability argument—it is IFC policy not to invest in any enterprise unless some provision is made for local participation. We insist on local ownership where it is available, and where it isn't available immediately, we try to pave the way for it in the future. In this way also, we perform a function which goes beyond that of merely providing capital.

F and D: *That's the essence of it, isn't it?*

Gaud: Yes—that while we invest in private enterprise, we do more—we're an arm of the World Bank Group's war on economic underdevelopment. That about sums it up.

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