CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

"THE ROLE OF THE MULTILATERAL DEVELOPMENT BANKS IN EMERGING MARKET ECONOMIES"

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MR. HAKIM: I'm sure none of you expected to be able to just enjoy lunch and conversation today. I want to welcome you all here. We're delighted you could join us. We're delighted there's this level of interest. We're here to talk about the role of the multilateral banks, the World Bank and the regional development banks, in emerging market countries – basically countries that have access to private capital flows.

We're going to discuss a report that was done by what's often called a blue ribbon commission – I've been looking for a synonym for blue ribbon and I still haven't found one, so I'm going to keep calling it a blue ribbon commission – that was chaired by Paul Volcker, the former chairman of the Federal Reserve, and Angel Gurria, the former finance minister and foreign minister of Mexico, who unfortunately cannot be with us today.

The commission consisted of 26 persons. These were drawn from – I've made a quick count – of 11 different countries. They came from a variety of different backgrounds, including former bank officials, people from the private sector, academics, and several representatives of nongovernmental organizations. Three organizations sponsored the report. These were the emerging market partnerships, who is represented on the commission by Javed Burki**,** who unfortunately also is not with us today. The Carnegie Endowment for International Peace, with Nancy Birdsall, who will be talking with you today. And the Inter-American Dialogue. You can ask what the Inter-American Dialogue is doing in this issue that spans the entire globe, and the fact is that one-third of the countries that we talk about, emerging market economies, are from Latin America, and there are three organizations, so it's perfectly appropriate for the Dialogue to participate.

In any event, I'm going to move us right along. I hope you've gotten far enough along into your lunch, but we do only have a short amount of time. Let me present the co-chairman of our commission, Paul Volcker.

MR. VOLCKER: This was all arranged because I decided to go on one of my periodic diets, two days ago, and this will help me, not eating on this particular occasion. But I have to tell you, I thought as I came down here, I feel somewhat like Nancy Birdsall's chauffeur. You know the story about the professor who went around giving a lot of lectures on a particular subject and after a while one day when he was going to one of his lectures, the chauffeur said, I've heard you talk so many times, I could give the speech. So the professor said, well, why don't you try it this evening? And the chauffeur gave the speech and it went beautifully. Then of course he got a question. He said, that's a stupid question. I'm going to let my chauffeur in the back of the room answer it.

My chauffeur in the back of the room is – it's the other way around.

Let me just make a few very brief remarks about this effort and this report, which so far as I know Peter and Nancy dreamed up themselves, and thought it was important to get a respectable view out in public about a subject that's become quite controversial. I'm amazed that this many people are here at this lunch to discuss this report, but maybe I'll just forget about Washington and forget about the hunger that exists. But I am delighted to see you all.

I want to emphasize what the report is not about. Peter already mentioned this, but this isn't about HIV and AIDS in Africa, it's not about poor countries and what the World Bank should be doing about that, or the other multilateral institutions. It is not about the internal management of the World Bank, which I understand is a matter of some discussion here and elsewhere.

It is a single subject – what should the position of the World Bank and the other multilateral development institutions be with respect to the so-called emerging market economies that presumably have access to world capital markets, and do in fact some of the time, maybe some of them most of the time, have access to world capital markets, and have in fact, at least until the Asian crisis, but to some degree recovering now, have much more flow of funds from private markets than they ever had from the official institutions, or ever will have from the official institutions. So the question arises, what is the role in this circumstance in free and open markets that are so much praised, what is the role of these institutions in this new world.

I will describe our process. When Nancy called me, she sent me a little piece of paper about the subject, which I thought put a few simple points logically and straightforwardly. So we just had one meeting to get this out. I thought, well, that's okay, but I warned you it would take two meetings. Well, we had one meeting, and we certainly did not arrive at any great conclusions. We had another meeting, which I could only sum up at the end of the meeting by saying, I think the only thing that there was an absolutely clear consensus on is that the report should be no more than five to ten pages long.

You will see how successful we are in having implemented that bit of consensus. I think it's quite in keeping with my old – maybe they've changed – my old familiarity with multilateral institutions that like to write long reports, single spaced, small type, which are very difficult to get to. But this is, I think, written with a sprightliness that is not necessarily characteristic of my distant memories of those institutions

It does make a few, I think, rather simple reports that by some coincidence very much parallel the points that Nancy had in mind before we started. And let me just remind you what they are. I hope you have looked at the report. We looked at the basic question of whether there was any role at all for the official multilateral lending agencies to continue to lend to countries that most of the time would have access to private markets. There was a strong consensus, I think, that that role should continue, for a variety of reasons. Really, I think two main reasons while these countries do have access to private markets some of the time, and most of the time, they can't count on it on reasonable terms and particularly long terms continuously, and we have seen lots of examples of that in recent years, so I hardly have to belabor the point. While the multilateral lending may be smaller than the potential and the actuality of private markets, it can be critical at times when private markets are not actively favoring that kind of lending, or even fleeing from it.

At the same time, and complementary to that, I think there is a feeling that whatever the fungibility of money well developed, well directed, these lending programs can assist these emerging economies to strengthen what are necessarily not very stable institutions in many ways, to stabilize the objectives that people talk about endlessly in terms of enhancing institutional strength, transparency, supervision of markets, attention to poverty and the poor in particular – all of these things we talk about, and the question is how to get it implemented.

One way to get it implemented is by being willing to provide some money along with clearly defined purposes and even conditionality that needs some further discussion, I think, as to the nature of the conditionality. But there is a real purpose served in encouraging countries to do what hopefully they want to do anyway, but may find it politically or financially difficult, but with the assistance, the technical advice, and the financial assistance of the multilateral lending institutions, those generally accepted objectives would be enhanced.

The second point, I think, is that while there's firm support for continuing lending to the emerging market countries, there's an understanding that emerging market countries some day are supposed to have emerged, and that there does come a point when the value added of this kind of lending certainly becomes less and less in normal circumstances. We debated at some length whether there should be some kind of a formal graduation process, which I take it the bank has favored off and on in the past. That idea was rejected in favor of a different, more market oriented approach that says as a country gets richer, as it gets stronger, why not charge them more. This has been a controversial matter, I know, within the World Bank. The process of cooperation has been interpreted to mean I guess the same lending for everybody, kind of a communistic system. That in the spirit of free enterprise and openness, we thought that it's appropriate to give incentives to rely less on these institutions by increasing the interest rate as they mature, which in effect means a smaller subsidy as time passes.

At the same time, we thought the lending should be confined when a fairly definite and useful purpose is served along the lines that I already mentioned, and that this kind of lending in effect will make money for the multilateral lending institutions if it's done appropriately and the middle income countries should help and have a more active process and more active role in the process of developing policies of the World Bank toward this lending at higher rates to the emerging market economies.

I would only make one other point, simply because it intrigued many members of the group as we discussed it. From looking at the experience of the Andean Development Bank, which is a multilateral lending institution without any so-called donor countries in it. They are all borrowing countries, so they have put together and pooled their credit ratings, in effect, and apparently has been successful. By pooling low credit ratings, they succeeded in making a somewhat higher credit rating, and have played a reasonably active role without any participation officially by the main creditor countries, and have continued, presumably, on a permanent basis and provided an additional kind of resource for these emerging market economies. That sounded to us like something that maybe the World Bank would want to explore and one of its several adjuncts as time passed. The recommendation was put rather tentatively, but we were impressed by the experience of the Andean Development Bank in particular.

So I will stop here, and I would encourage comments, questions, opposing points of view, even support for the point of view set forward.

You will talk now? I thought you were going to talk first, so I thought you had abdicated. The chauffeur will appear.

MS. BIRDSALL: Actually I was thinking the chauffeur was the wrong metaphor. You know, in my household my husband and my children who drive complain a lot that I'm a back seat driver, so I felt a little bit sometimes like a back seat driver, and Paul and Angel, just like my children and my husband – well, they pretended they listened to me, but they basically moved along and did what they knew they needed to do.

I would like to repeat our thanks to Paul and to Angel Gurria, who isn't here, as well as to my colleagues Peter Hakim and Shavid Burkey.

Let me just take a minute to fill in a little bit what Paul said. There are two sets of three points I'd like to make. Paul emphasized the notion that it makes sense for these multilateral banks to be lending in emerging markets because their access to capital is insecure and volatile, and sometimes costly in short term.

There were three other points we raised. One is that this lending, because it's bundled with policy dialogue, can be a vehicle for policy change. That seems in some ways like a fairly standard statement, but the fact is that there's a lot of tension in multilateral banks about the issue of conditionality, and in a sense this report is endorsing the notion that, done the right way, conditionality can make sense.

Second point that I'm not sure if Paul mentioned, these banks are a very good deal for US taxpayers and for the taxpayers of the other countries who are not borrowers. I invite you at your leisure to look in the report to see what I mean when I say that.

The third point we make, which was perhaps one of the ones that was discussed, has become a little bit more controversial, is that the lending of these banks to the middle income countries and to countries like China and India that have access to capital, does not in any way undermine their capacity to lend to the poorest countries of Africa, and others of the poorest countries in the world. There's been a lot of discussion of the idea that there is an opportunity cost, but that's just not the case. Indeed, in some respects you could say that the lending of these banks to the emerging market economies allows them, helps them, supports them indirectly, and through the income it generates supports their financial sustainability in a way that enables them to carry out their mission in the poorest countries of the world.

The other three points I wanted to refer to are in the area of what the commission said should be done in order to make the banks more agile and more appropriate for a changing world in which these emerging markets do have – they are part of a larger global marketplace. Paul referred to the issue of graduation, and the idea that there might be a change in the way the loans are priced, which could create a mild incentive for graduation.

I wanted to mention that the commission also recommended much more emphasis on disclosure, on public debate while loans are being discussed, including policy loans. This relates to the whole issue of conditionality and to the ongoing discussions about transparency. Here I would like to mention that we can be pleased that our commission member, who is the president of Oxfam America, signed the report, and the gentleman, Adam Lerrick**,** who was the chief staff person in preparing the report of the Meltzer commission a year ago, also signed the report. So in a sense I suppose we're all hoping that with that kind of consensus on some issues, joined by those two people, we will see some progress on some of the tough issues like disclosure and transparency.

The other thing is we recommended independent third party evaluation. These things respond to the growing criticism of the banks in terms of are they really effective in accomplishing what they're supposed to accomplish. Finally, we also, as Paul alluded to, the commission is very clear that lending into crises is appropriate, and we recommended that the banks make an effort to expand their activities with the private sector, including direct lending to the private sector, in an age in which the banks can solve, help private agents address the problem of country risk. Of course that lending has to be done in a way that ensures that the banks are not taking on more commercial risk than is appropriate, that they're not substituting for the kinds of risks that we expect private agents to take.

On the other hand, given that these markets are still vulnerable, that it takes a long time for countries to get into a position where creditors and investors feel that there's enough history of credibility that it's worth risking their money at low rates. It can make sense for the banks to play a role in catalyzing more private investment.

Now before we turn to questions, and that's when Paul comes back up, I would like to invite Colin Bradford to make a remark. He's one of the commission members who was able to be here today. I think he probably wants to say something about this governance issue which Paul alluded to, what should be the role of these emerging markets and the changing role of the banks in a changing world

MR. BRADFORD: Well, thank you very much. I guess I'm the doorman in this particular operation. I guess I would like to thank our two chairmen, but especially Paul

Volcker, for helping to keep a focus on the relationship of the MDBs with the emerging market economies. He was being urged by some commissioners, including myself, to broaden the scope, and he's wisely stuck to a narrower view because I think what you get here is a very crisp understanding of how important the emerging market economies are to the world economy, and how important the MDBs are to them.

If you look back -- I'll be very cryptic and very short. If you look back over the last 30 years in the world economy, you see three oil shocks – three shocks. The oil shock, the interest rate shock, and the capital flow shock. The MDBs, including the Fund, have played a vital role precisely in relation to these large emerging market economies in shepherding the world economy through these shocks. And that has been a vital thing for the world economy itself, and has really transformed the world economy into one in which these economies pluralize the global economy.

The second thing is, if you look to the future, it's clear that the population and market size of these economies are the future – China, India and Africa alone would be 50 percent of the world's population by the year 2020. So having a means by which the rest of the world is engaged with these vitally important economies is absolutely crucial. I think the commission, having addressed that issue and addressed it professionally, makes some considerable difference in what is I think a fairly heated debate going on in Washington.

I wish to end with just one point regarding which I don't intend to be a caustic point, but we had a very animated discussion, given the breadth of views on the commission, but I do wish to say that we had one commission member who based his views on the multilateral development banks, and especially the World Bank, based on 120 days of interviews in the World Bank. And I looked around the room and I thought, there are 120 years of multilateral development bank experience in this room, and I think that's the kind of experience too that you get from this particular report.

MS. BIRDSALL: Paul, will you come up and take questions?

Q I am from the IMF. I just want to say that I find the argument that the emerging markets have an unreliable access to capital markets as an argument for further lending a little weak because if the problem is really unreliability, probably what has to be done is improve access and make it more reliable, more permanent. But further lending alone, I don't see how this can be improved. In fact, it could make it even worse because the stock of debt will be increased and the risk will be increased.

I think that this probably called for further instruments on the part of the multilateral banks. For example, the issue of guarantees. I notice that in the report the issue of guarantees takes about half a paragraph or one paragraph and one footnote. I would think that the issue of guarantees for this country, or the supply of some instruments could make creditors more safe or more sure of the capability to repay, which would be much more effective than increasing lending.

This is technical, but the question is, to what extent – what is your view really on the issue of guarantees? Because the way that it is treated in the report, I find it pretty marginal, and is there a reason for that?

MS. BIRDSALL: Well, first let me clarify that the report does not advocate necessarily an increase, an increase in the secular trend of lending from the multilaterals. Mario, on the guarantees we do say it's the right direction to take. There are difficulties in inducing countries to ask for guarantees as opposed to loans at the moment because of the way the guarantees are priced. I think it's an important next step myself personally. This is not what the commission says, but it's an important step for the multilaterals to figure out a way to have more instruments like guarantees that would help catalyze private money as you're suggesting.

But more to the point is the idea that the standard lending of the banks is meant to address issues like judicial reform and building up education systems, which ultimately create the environment which ultimately is the one that will attract local as well as foreign investors. That is a legitimate activity, and it can complement other efforts of the kind you're suggesting to catalyze private money in the short run.

Q [Inaudible.]

MS. BIRDSALL: I must say -- is this working? I have to say that it's already decades ago that I didn't understand the argument, but I certainly don't understand an argument now about catalyzing private sector flows when we know that there are billions if not hundreds of billions of dollars that are prepared in highly risk-adjusted systems from distressed securities to junk bonds to venture capital to private equity to go into these countries. So unless it's the bank's actual projects, I think that the role for the catalyst, if it ever had a role, has really been overtaken by events.

On the IFC, I thought the report – the report itself said on page 17, the problem is that returns are vulnerable to government and regulatory risk. The bank can lend to private sector, co-finance are guaranteed, but it's the government guarantee of performance to the bank that becomes the key. So it seems to me there that when they go on to say that we should have more lending to the private sector by an IFC that it's a non sequitur because what you really want is the private sector to go in and make its commercial judgments, and to the extent that it has performance issues on the government, you want the bank to be there to guarantee government performance. But the bank should be able to receive a counter guarantee from that country that it will meet its own sovereign performance requirements.

Therefore, if there ever were a pull on the guarantee, it would not turn into a null claim for the bank. It would turn into a claim that the bank had with that government that had actually made its performance standards.

I'm going on a little longer, but I'm going on because I think there's – for my taste there's a lot of political correctness. I go back and I say, if Paul had Giuliani start another two terms and he had his choice, and Giuliani could either invest in the debtor equity of Morgan Stanley, Chase Morgan, CitiTravelers, Goldman Sachs, or he could give them a city in which there was good public health, good judicial systems, good transportation systems, et cetera, which is it that they really want?

I think that the private sector needs from the World Bank and the MDBs strong public sectors. I don't think that the argument that the private sector needs from the World Bank some help being the private sector really holds water.

MR. VOLCKER: That's a pretty articulate view. Anybody else want to get in on this one?

Q Peter Woicke from the IFC. I think you fall into the trap too soon that the institutions are there in the countries, and that's what I've always wrestled with with the developed world, that it just takes years and years and years to build these institutions. In the meantime we have to find a way to help these developing countries build infrastructure. If you don't have these right institutions to channel the money into the right way, to do the performance you were talking about, nothing will happen. And that's why I think we have to be more proactive through the private sector, and perhaps a little bit more innovative to help the private sector to build these institutions.

I'm not agreeing with Alan Meltzer on that, that everything should be outsourced to the private sector because I think in the meantime we have to build institutions. But I think it is wrong to assume that the institutions are there. Yes, they are here in the United States, they are in Germany and France. It will take years to build them. That's the experience of the multilaterals. And that's where I think the private sector has to be encouraged in the meantime.

You talk about this issue of private sector flows, et cetera. The experience right now is, yes, direct investments are growing. Not rapidly. Growing in the developing countries, but actual debt flows, we are at the situation of '91, '92. These countries need debt. The private sector needs that as well. That's why I think the private sector is important.

MS. BIRDSALL: Let me add a little bit. I don't think it's an either/or. Of course I agree with Jessica about Giuliani ought to be borrowing to improve the public sector in New York and so on. But I think that we underestimate historically the relevance of private sector demands for good government in countries like the US and other OECD countries. It can be more of an organic process in which private investors, private lenders, because they want to be competitive, push governments to develop appropriate regulatory structures. It is not as if you just kind of get everything perfect and then the money comes in.

The second point I'd make is, from my own experience at the Inter-American Development Bank there is no question that the process in which a multilateral gets engaged in lending to a private agent can be a vehicle for working with a government to make a concession set up appropriate, to deal with the environmental and all the issues that surround a particular transaction, attracting private investment. That can become a model in a particular country, a vehicle for learning how to do it in the future.

So this is a process where I don't think it should be one or the other. Paul was justifiably concerned that this report not seem to be supporting a sort of moral hazard approach to the world in which we were saying, do everything to help out the private sector deal with government misbehavior. I hope that what we found was the right compromise between the reality that Peter's referring to and the fact that the public sector does need to be appropriate. There has to develop the mind of environment that makes investment a good idea.

MR. VOLCKER: It's a very difficult area. It has plagued policy for many years. I think it is very difficult, how you get the kind of participation you want to get the benefits, institution-building or otherwise, without in effect providing a guarantee, which you don't want to do. It's not called a guarantee, but if you do have a big enough private sector, that's the implicit – public participation, implicit understanding of the private lender. And that's why he wants it, is he thinks he's got a guarantee, even though the paper doesn't say so.

Q We wanted to make sure we had your views on this as well, because at least I respect them a great deal.

I'm Paula Stern, and my question is reflective of my past experience at the US International Trade Convention, where we dealt with many, many cases of imports coming from countries where there is excess worldwide capacity. This is an issue that continues to this day.

I may be asking this out of naiveté in terms of your conditionality. The references to your conditionality, the references to your transparency and review and public debate have very general concerns expressed, and ultimately the objective was the increased standard of living for all, at least from what I saw in the executive summary.

Is that increased standard of living for all in the particular country that is wishing to lend, or is it a global take? Did you take into account, or should one have the World Bank and its facilities take into account what the impact is of a loan in a particular country for a particular project, only thinking about that particular country and its development, or should there be a concern for global capacity issues?

I'm asking this both because this is a topic d'jour in the steel industry today. We had a conversation here, and it's clearly at the top levels of the administration's interest, and of course because we've seen this not only in steel but also aluminum and elsewhere.

MR. VOLCKER: There isn't any excuse for the World Bank coming, or any other multilateral institution, in these emerging market countries and providing a new steel mill, or whatever. You go in there when it's got some value added in terms of some institutional building purpose, public purpose, or this new phrase that I learned when I'm no longer involved in these things, global public goods – GPG. That's apparently the slogan in Washington these days. We're all in favor of global public goods.

But I don't think we said that every loan has to have a visible and direct payoff for global public good, but some of them will. And they should. But they ought to have a payoff, I think pretty generally, in terms of national public – NPGs, national public goods. Does that phrase exist? Maybe even regional public good. That they shouldn't be a purely commercial kind of purpose.

Now you can argue, and we tried to deal with this, that that's all fine, but if we spend money for schools or poverty program or some institutional building, the government will go spend that money on a steel mill. And there is some kind of possibility of that sort, which we tried to explain why we thought that is a controllable diversion. I think that's a problem but it's not an overwhelming problem, I think if you were to insist upon the kind of policies that we're talking about.

Q I was going to suggest that maybe the metaphor you wanted, Nancy, is the student teacher metaphor. You're the teacher. Now we'll see whether the student can give a good lecture. That has nothing to do with my previous experience.

It did strike me that one of the most interesting things in this report, at least from my reading of it, is the attempt to treat the issue – I agree with both lines on this. One is there's a role for emerging market lending, and one reflection of that ought to be in really looking at the pricing.

One of the big issues in the pricing is, the way Paul referred to it – I'm not sure I would have said communistic, but the sort of one price for all approach. I think it's nice the way you blended that, or suggested the blending of that issue with the governance issue because in fact the history of the postwar era is one in which countries should emerge not just economically and financially, but also in terms of their political role in society, and when you have sharp divisions of being class A, class B countries and so on, that is something which makes the problem cross over the line, and then cross back, which is one of the ways I think about this problem. So I think that's a very nice example. I might add that actually the IDB has some also examples, though it's impolitic to do that. That's why you didn't cite those examples.

There are some other examples, and it does seem to me that that might be one way to deal with that half of the overall problem, so I congratulate you.

MR. VOLCKER: My goodness. We won't probe you any further.

Q The rationale for lending to emerging markets that you put in the paper, it's that the volatility and instability in access to private capital markets. My question is, in certain situations, if the reading of the situation is that supporting a government in financing in an unsustainable position, which would be the policy of the multilateral development banks. For example, some people think and write that the debt position of Argentina is already unsustainable.

If that's the reading of the institutions, what should they do? I mean, would you eventually be pushing the country to debt restructuring or something like that? Or throwing good money after bad? What is the answer to this kind of situation.

MR. VOLCKER: I'm not sure I understood the implications of all that question, but we're foursquare against throwing good money after bad money. I think in the report it's implied that you don't lend to these emerging nations unless you have a purpose, other than pure emergency lending and pure bailout kind of thing, that the motivating factor should be some of these things we were just talking about, if not global public goods then national public goods, and institution building and so forth and so on.

But the fact is you may have more leverage in getting some of those things done actually in the midst of a crisis when they need the money. That's not the only reason you would do it. Or you might do it whether or not they feel a felt need. You've got that purpose in mind and you have a need for money, you lend. Whether that makes sense in a macro context, I think is something that has to be considered, but it's not a question for the World Bank alone. I would think that's a question for the IMF, the US Treasury, other large lending countries. I don't think this is something – the World Bank hasn't got that kind of money anyway, or I don't think it should have that kind of money that in and of itself it's going to put enough money into these countries to deal by itself with even a big proportion of an emergency need. But it can be helpful because it's relatively long-term money, relatively stable money, and it's achieved some of the purposes.

But I would think the kind of question you raised is one that goes beyond the World Bank.

Q I think I agree with your report, but let me make a few comments that may not lead in that direction. I'm Sidney Weintraub from Center for Strategic and International Studies.

I don't know what percentage of World Bank, IDB, and the other banks' loans go to these emerging market economies, leaving that out, or leaving out the completely concessional, but it must be a very high percentage of the total. I don't know whether it's in the neighborhood of 80 percent, but it may be around there, 80 or 90 percent. You then rationalize, that's good because they're getting some profit which we can give to the poorer countries.

What you're saying implicitly, if there's no way that such funds could be loaned initially to these countries without waiting for the profit that we're lending now – we being the multilateral banks are lending now, the maximum they could to other than emerging market economies under the conditions of which the World Bank, the IDB lends. That's what you're saying implicitly, but nowhere do you demonstrate that. You assert it essentially.

You also make the point that the World Bank, IDB, other lending can apply conditions, although you want a different kind of condition. And implicit in that is that the private sector does not implicitly itself put conditions on the lending it gives. It won't go to certain countries unless they do certain things.

While I agree with you, I think the reasoning sort of breaks down in a few places as to why what you're recommending is the best way to use these resources.

MR. VOLCKER: Let me try to respond. How much do they go into the emerging? Seventy percent. Neither 80 or 90. It's only 70. It's a lot. It is predominantly to these emerging countries. I don't think there is any question, in the institutional interest of the bank and these other institutions, they think they make money on this stuff and therefore there's kind of an internal dynamic and incentive to lend. And the countries like it because they get basically subsidized money. So there is – I don't know that I'll call it an unholy alliance, but there's some kind of an alliance of incentive to do a lot of this lending.

I don't think our report should be interpreted as supporting that kind of an attitude. We were reacting, I think, to the opposite view, that because of this and other dangers, it just ought to be shut off. We definitely wanted to counter that view that there is no other purpose served in this lending other than profits for the institution, which presumably they use for other good purposes. That is a side effect of this lending, which we recognize in the report, and suggest that indeed it could be used for useful purposes, but it shouldn't drive the whole thing, which is one reason for reducing the subsidy for countries that are better developed, and insisting upon the kind of conditions that we talk about.

Now the other part of the question was?

MS. BIRDSALL: I didn't really understand. It was about the private sector.

MR. VOLCKER: Well, the private sector will insist upon these conditions. I just disagree with that. They occasionally may, but the private sector will insist upon a special deal for it, which is precisely what we don't want to encourage and incur. Private sector is perfectly willing in many cases to make the kind of a deal that is – I may be exaggerating, but they are not incapable of making the kind of deal that runs against the kind of general construal of law, transparency.

Q [Inaudible.]

MR. VOLCKER: I think in a lot of cases – I'm being too blunt here. I guess there is a mutual distrust of what the interest of some of the leaders of some of these countries may be in terms of making and striking particular deals with particular people. I think the World Bank – a favorite example, which I think is not a black and white example, but so far as I know, the World Bank will insist upon, in project-type lending, competitive bidding and a lot of other rules and procedures that are very cumbersome for some private lenders and participants. If they do it, they clean up the process and do what we think is appropriate competitively in openness and all the rest. But it may be carried to the point that in some of these cases it's counter-productive actually because you turn off the private sector people.

You don't want to go entirely in the opposite direction and say it's all up to special deals with the leaders of the country and the private sector person. The truth is not all on either side.

MS. BIRDSALL: There's one thing I'd like to say about the first part of his question. You know, the issue – there's no problem of head room or sufficient capital to lend to the poorer countries that are not in this emerging market economy set. The constraint on lending to those countries is entirely having to do with either their policy shortcomings or their problems of absorptive capacity. The commission in no way was suggesting that it's important to somehow extract so-called profits from emerging market economies in order to be able to lend to poor countries. That's not the way it works.

In some respects the banks actually are worse off in the short run if it costs them money to make loans to emerging market economies, and some of the basis for that lending is not because of reflows. So I think the argument is just the one that Paul put, not really what you were building into your question.

I think we can take one more quick question and answer and then we should stop.

MS. GRAY: Thank you. I'm Cheryl Gray from the World Bank. Just a couple of very quick points. I didn't see them in the report. The first is, keep in mind the bank's mission is poverty reduction.   There are many hundreds of millions of very poor people in the countries that have access to capital markets. I don't know if you've mentioned that. This is not a subsidy. If you look at China, where of course 200 million people have been brought out of poverty, and a tremendous success story the last 20 years, but there's still many, many very poor people. Brazil, former Soviet Union getting worse, Indonesia until recently a middle income country. There are many, many poor people. That's one point I just wanted to mention that I didn't really see jump out of your report, although maybe it's there.

The second point is to mention on the differential pricing idea. I think it's fair to say, although I'm not the expert – we have other experts here more. As you get richer, the premium you pay to borrow goes down. So in a sense a fixed rate for the bank is less of a subsidy.

MS. BIRDSALL: We say that.

MS. GRAY: You do say that? I'm not sure that is enough, or if you really need differential pricing beyond that. And I guess the third point I really related to the first. I very much support the view that the main task of these organizations is to get governments that work effectively for creating business environment for the private sector. I think if you look at what's done that is a huge emphasis of all of the organizations. I think it's extremely important. I think it's a comparative advantage that other groups do not fill, and we're well on our way. And that is very much applicable to many of these middle income countries also, and we only have to turn to the former Soviet Union to see that. That's just an additional point that I wanted to make sure was taken into account.

MR. VOLCKER: On the last point, it was very much in our minds. I'm surprised it isn't in the report. If it's not in the report, that's because we made the report so short. (Laughter)

MS. BIRDSALL: Well, there's another interesting little twist on the issue of all the poor – so many poor people are in these economies. I think it sets up a little bit of – it's a weak argument in the face of the concern, if not the attack, in the Meltzer Commission report, in the sense that if a country like Brazil or Mexico or Turkey or any of these emerging market economies, once they borrow in the private market, they can set internal priorities to deal with poverty.

The issue is really that the multilaterals put into a bundle the money and the policy dialogues, the convening capacity to deal with poverty and institutional development in a way that creates a consensus within the country. That's what the private sector doesn't do. If we rest too much of the argument on the fact that there are many poor people in emerging markets, I think we leave those of us who believe in the overall story that this picture makes sense to have these banks lending in those countries, leave ourselves open. So that's why you'll see in the report the second argument that lending has to be a vehicle for policy change.

MR. VOLCKER: The professor has resumed the podium and done a terrific job.

MS. BIRDSALL: Thank you. Listen, I want to say one more thing. There were people putting fuel in the tank and keeping this vehicle going and I'd like to acknowledge them. First of all, my colleague from Carnegie Endowment, Brian Deese, and next to him Joe Savitsky and Rachel Menezes from our other two organizations. If they'd stand up for a minute, we can close by thanking them.

Professor Volcker, it was a pleasure, really.

[END OF EVENT.]