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PRDDR - Governance
December, 1990 - January, 1991

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The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 27-Jan-1991 09:53am EST

TO: ALEXANDRA TRZECIAK

(ALEXANDRA TRZECIAK @A1@PARIS)

FROM: Rainer Steckhan, LA2DR

(RAINER STECKHAN@A1@VAX12)

EXT.: 38074

SUBJECT: CG Nicaragua

Governance

This is the first time to my knowledge that an opposition leader has set in a Centralamerican CG - by the way, the opposition was also represented at the Rome meeting on Nicaragua in June 1990 which the Italians chaired.

We are helping Nicaragua define an adjustment program . Given the incredibly difficult economic (and political) situation very tough adjustment measures are required which require broad support in Nicaragua. The Government of Nicaragua has embarked on an effort to seek such support through a program of "concertation" with the opposition, trade unions etc. So it was only natural that the Government decided to invite the leaders of the Government Coalition and opposition in Parliament to the CG. The leader of the opposition spoke both at the Rome and at the Paris meetings broadly in support of an economic adjustment program and external assistance therefor. Donors welcomed Sergio Ramirez' participation.
Give my best regards to Arthur Fell.

Governance file



The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 14-Nov-1990 12:53pm

TO: Paul Isenman
TO: Alexander Shakow

(PAUL ISENMAN)
(ALEXANDER SHAKOW)

FROM: Sarwar Lateef, EXTIE

(SARWAR LATEEF)

EXT.: 38212

SUBJECT: Governance: Directors Steering Group

Paul:

Directors' Steering Group:

Burki,
Ismael Serageldin
Koch-Weser
Wyss
Dervis
Bottelier
Johannes Linn
Isenman
Shakow
Goldberg

Working Group

Rigo
Lamb
Landell-Mills
Wai
Nankani
Huang
Hinds
Sagasti
Colaco
Chaudhri
Mary Shirley
Samuel Paul
Coralie Bryant

Any comments and suggestions?

CC: Geoffrey B. Lamb
CC: Coralie Bryant

(GEOFFREY B. LAMB)
(CORALIE BRYANT)

CONFIDENTIALFORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP		DATE: 1/16/91	
NAME		ROOM NO.	
Mr. P. Isenman			
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APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
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FOR ACTION		PREPARE REPLY	
INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS:			
I am in training this morning. Could your sec'y. please show these changes to Geoff Lamb. Thanks			
FROM:		ROOM NO.:	EXTENSION:
Sarwan Lateef		T-8-101	31760

**ISSUES OF "GOVERNANCE" IN BORROWING MEMBERS -
THE EXTENT OF THEIR RELEVANCE UNDER THE BANK'S ARTICLES OF AGREEMENT**

**Memorandum of the
Vice President and General Counsel**

November 30, 1990

15/1
PAUL

See pages 39,
51
52

- I have offered two alternative formulations on p 39. (fraternizing with opposition parties)
- On public expenditures, I have tried to retain IS's concerns on the right of governments to formulate their own budgets while reflecting the reality SL

ISSUES OF "GOVERNANCE" IN BORROWING MEMBERS -
THE EXTENT OF THEIR RELEVANCE UNDER THE BANK'S ARTICLES OF AGREEMENT

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"If these institutions are to win the full confidence of the suspicious world, it must not only be, but appear, that their approach to every problem is absolutely objective and oecumenical, without prejudice or favour. [If the malice of the bad fairy Carabosse were to prevail, her curses will run as follows]: you two brats shall grow up politicians; your every thought and act shall have an arrière-pensée; everything you determine shall not be for its own sake or on its own merit but because of something else"]

Speech of Lord Keynes before the Inaugural Meeting of the Boards of Governors of the Fund and the Bank, 1946.

"Noneconomic considerations, particularly of a powerful moral character, may make decisions on some occasions appear, to some or even many members, to be applications of the maxim *dura lex sed lex* (hard law, but law). If some application of the law of the Fund is too hard to be acceptable to the membership, procedures for amendment exist under the Articles."

"... The swimmer who goes out too far may seem to be waving but is drowning. The Fund that swims out too far, even in a moral cause, will risk drowning. It will have lost the full confidence of its members. It will be less able to promote universal prosperity. That task is the Fund's moral cause."

Sir Joseph Gold, IMF Survey 146, 148 (May, 1983)

"There is a limit to 'institutional elasticity', i.e. the extent to which institutions created and still used for other purposes can be 'stretched' in order to get them to perform human rights functions, especially when those functions are accomplished at the expense of their manifest functions".

Professor Michael Riesman, "Through or Despite Governments: Differentiated Responsibilities in Human Rights Programs", 72 Iowa Law Rev. 391, 395 (1987).

ISSUES OF "GOVERNANCE" IN BORROWING MEMBERS -
THE EXTENT OF THEIR RELEVANCE UNDER THE BANK'S ARTICLES OF AGREEMENT

I. INTRODUCTION

Political stability and sound economic management have long been recognized, in the literature of the World Bank¹ and elsewhere, as basic prerequisites for economic development. However, the Bank has traditionally deemed political considerations to be generally irrelevant to its operations in deference to explicit provisions in its Articles of Agreement which prohibit it from taking such considerations into account in its decisions. Some departure from this tradition may be evolving. Reference to such considerations as being relevant to the Bank's business first appeared most explicitly in a major study on Sub-Saharan Africa which identified "governance" as a basic issue in the development strategy for this region.² This approach may have later been strengthened by provisions in the recently concluded Agreement Establishing the European Bank for Reconstruction and Development (EBRD)³ limiting the operations

¹The term "World Bank" or "Bank" is used here to mean both the IBRD and IDA, unless the context suggests otherwise. Examples of early recognition of such factors are referred to later on in this paper.

²World Bank, Sub-Saharan Africa - From Crisis to Sustainable Growth. A Long Term Perspective Study (first published in November 1989). Some of the "governance" issues mentioned in the study were addressed earlier in an implicit manner in the Bank's work on institutional development and public sector management.

³For a detailed comparative study of this Agreement and the full text of the EBRD basic documents, see Shihata, The European Bank for Reconstruction and Development (1990).

of this new institution to some of its members which meet certain criteria that may readily be characterized as political in nature. Most importantly, the Bank's increasing concern with issues of governance in its borrowing members seems to have come as a logical last step in its gradually expanding involvement in policy reform through adjustment lending, which has been extended to social sectors.

Regardless of its motivations and causes, the above concern has already evoked considerable interest, and controversy, among Bank staff, with some concluding that the "time has come for the Bank to take on the issue of governance head-on" and others cautioning that "the strength and credibility of the Bank lies in its apolitical status as a quintessential technocracy, one whose exclusive concern is with economic efficiency." Some Executive Directors and members of the Bank's Senior Management are also referring now to the issue of governance with different degrees of emphasis or concern. It therefore seems important before the debate goes further to try to establish the legal framework for the Bank's dealing with this issue, as a necessary prelude to any future analysis of the manner in which the Bank may take it on operationally. The Bank can only act legally if it does so within its mandate, as defined in its Articles of Agreement, much as it can only act physically within its resources and capabilities.

While the resource limitations are outside the scope of this paper, its purpose is to establish a legally sound framework for treating the issue of governance in the Bank's work. In doing so, it should clarify the appropriate legal limits for the Bank addressing this issue under its Articles of Agreement

as they stand at present. It would be a grave contradiction if the Bank were to allow itself to interfere in issues of governance of its members beyond what is legally consistent with its mandate as defined by the rules which govern its own activities.

II. RECENT EMERGENCE OF GOVERNANCE ISSUES IN DEVELOPMENT FORA

The present concern with governance issues seems to have resulted from basic developments in several regions in which the Bank operates, especially in Sub-Saharan Africa and Eastern Europe. It is a concern which, apparently, has been evolving in any event through the Bank's expanding adjustment lending and its research (economic and sector) work.

1. Bank Studies on African Development - The Sub-Saharan Africa Long Term Perspective Study of 1989

A year ago, the Bank published a landmark study on the development of Sub-Saharan Africa.⁴ This study was preceded by earlier Bank reports including Accelerated Development in Sub-Saharan Africa (1981), Toward Sustained Development in Sub-Saharan Africa (1984) and more specific reports on administrative reform in some African countries. These earlier reports emphasized the need for institutional development and public sector reform and attributed Africa's economic problems mainly to economic management factors. The 1989 study, following the same theme, provided, however, a more comprehensive treatment of development issues in Sub-Saharan Africa and spelled out for the

⁴See supra note 2.

first time the question of governance as a central issue to be addressed and corrected.

Quoting Senegal's President Diouf's dictum that "Africa requires not just less government but better government"⁵ and noting that "many governments are wracked by corruption and are increasingly unable to command the confidence of the population at large,"⁶ the 1989 study proposed a strategic agenda for Africa in the 1990s. It predicted, however, that "none of [this strategy's] measures will go far, nor will much external aid be forthcoming, unless governance in Africa improves."⁷ The study emphasized as relevant aspects in this improvement process the accountability of leaders to their peoples, the transparency of transactions, the proper administration of public funds and the overhauling of procurement procedures.⁸ It called for respect of due process,⁹ cautioned against the proliferation of administrative regulations,¹⁰ and emphasized the importance of reforming the civil service.¹¹ The study further explained that a "simple and transparent legal framework properly enforced is indispensable for the long term success of an enterprise"¹² and pointed out the importance of

⁵Id. at 55.

⁶Id. at 3.

⁷Id. at 15.

⁸Id.

⁹Id. at 22.

¹⁰Id.

¹¹Id. at 55-57.

¹²Id. at 143.

establishing the rule of law, rehabilitating the judicial system, ensuring "independence for the judiciary, scrupulous respect for the law and human rights at every level of government, transparent accountability of public monies, and independent public auditors responsible to a representative legislature, not to an executive."¹³ In all, the study emphasized that a crisis of governance underlies the litany of Africa's development problems and defined governance in this context as "the exercise of political power to manage a nation's affairs."¹⁴ It concluded from this that systematic efforts were required "to build a pluralistic institutional structure, a determination to respect the rule of law, and vigorous protection of the freedom of the press and human rights."¹⁵

It should be noted that this study, which is quoted here in some detail because of its importance in the evolution of the issue of governance in the Bank, explicitly referred to a popularly felt need for a "political renewal" in Africa.¹⁶ It addressed the continent's well known ills and suggested appropriate solutions for consideration by all concerned parties and not merely specific measures for the Bank to adopt in its operations. In his introduction to the study, the Bank's President for his part highlighted in general terms the importance of "good governance", defining it more narrowly in terms of "a public service that is efficient, a judicial system that is reliable and an

¹³Id. at 192.

¹⁴Id. at 60.

¹⁵Id. at 61.

¹⁶Id. at 192.

administration that is accountable to its public."¹⁷ He also made clear that this was "a study by the staff of the World Bank" and that "the judgments in it do not necessarily reflect the views of the Board of Directors or the governments they represent."¹⁸

2. The Agreement Establishing the EBRD

On May 29, 1990, forty countries, including all the 12 EC countries, 11 other "European countries", 9 non-European countries (including Japan and the U.S.) and 8 Central and East European countries (including the Soviet Union) as well as the EEC itself and the European Investment Bank, signed the Agreement Establishing the European Bank for Reconstruction and Development. This important event took place in the context of the historic political and economic changes which Central and Eastern European countries were undergoing; indeed the establishment of the EBRD is intrinsically connected with the political and economic restructuring of Central and Eastern Europe. Thus, the political motivation behind the creation of EBRD and its political goals are explicitly expressed throughout its charter.¹⁹ The preamble of the EBRD Agreement captures this political orientation by emphasizing "the fundamental principles of multiparty democracy, the rule of law, respect for human rights and market economics."

¹⁷Id. at xii.

¹⁸Id.

¹⁹See particularly, Article 1 (Purpose), Article 2 (Functions) and Article 8 (Recipient Countries and Use of Resources).

The EBRD Agreement itself leaves no doubt as to its specific mandate in support of the transformation of the economic system of countries which show commitment to certain specified political principles.²⁰ While economic progress and reconstruction may be an objective to which the EBRD will ultimately contribute, the purpose for which the EBRD was established is to assist Central and Eastern European countries to evolve from their one-party political systems of command economies to a system based on free market economics and multiparty democracy, and to support private sector development required for this transition.²¹ As a consequence of this purpose, the pursuit of structural and sectoral reform, including demonopolization and privatization, is mentioned as a function of the EBRD to be pursued in all its activities, rather than as an authorized form of its lending.²²

As elaborated below, the IBRD was created for a different purpose: to assist its members in the transition from a wartime to a peacetime economy, and in the reconstruction and development of their territories. Because of the EBRD's specific mandate as an instrument in the economic and political transformation of Central and Eastern Europe, its charter, unlike those of the IBRD and the IDA, does not include a specific provision prohibiting it from engaging in political activities or from being influenced by the political character of its members in its decision-making.

²⁰ See Shihata, supra, note 3, at 3.

²¹ See Article 1 of the EBRD Agreement.

²² See Article 2, Paragraph 1 of the EBRD Agreement, and the comment on Article 13(ii) in the Chairman's Report on the Agreement, published in Shihata, supra note 3 at 170-171.

3. Gradual Expansion in the Scope of World Bank Adjustment Lending.

The Bank introduced structural adjustment lending in 1980 in response to the acute balance of payments crises in many of its borrowing member countries in the late 1970s. The aim of the early operations was structural adjustment addressing the countries' macroeconomic policies. Gradually, adjustment lending expanded and deepened through sector adjustment operations.²³ In the last few years, sector adjustment operations have become the dominant adjustment lending instrument focusing on sectoral investment programs, policies and institutions as a "key determinant of supply response".²⁴ Throughout the 1980s, adjustment lending commitments represented some 18 percent of total IBRD lending and 12 percent of IDA lending.²⁵

This evolution of Bank lending has come as a response to the lessons learned from the Bank's experience. It reflected the Bank's conviction that the policy environment is as important, if not more so, as the physical and institutional framework in inducing growth and development. Recognizing that early adjustment loans were often too optimistic about the implementation capacity of governments and their commitment to reform,²⁶ the Bank has directed its attention to measures that enhance government implementation capabilities

²³ See, Interim Report on Adjustment Lending para.35 (R88-15) [Interim Report].

²⁴ Id. at para. 119.

²⁵ Report on Adjustment Lending II: Policies for the Recovery of Growth, Annex 5.2, table 5.3 (R90-51, March 26, 1990) [RAL II] (published as Adjustment Lending Policies for Sustainable Growth 70, Policy and Research Series 14). In terms of net disbursement during the decade, adjustment lending has accounted for 33% of total IBRD disbursement and 12% of IDA's. Id.

²⁶ Interim Report, supra note 23, at para. 55.

and to what the Report on Adjustment Lending II (RAL II) called the "political economy of adjustment".²⁷

To ensure the borrowing countries' implementation capacity, conditionality has concentrated on institutional changes in macro-economic and financial management, sectoral restructuring and policy reforms, enhancement of public sector efficiency and constraints in public sector management.²⁸

Specifically, the conditionality for institutional reform has in some cases touched upon the overall organization of civil service, the size of public administration and the size and structure of the public sector. Loan agreements have been reached between the Bank and governments whereby disbursements of the loan would be made only if the government took action to reduce the number of civil servants, restructure ministries, and liquidate public enterprises or restructure them or offer them for sale. In many instances, the measures required extensive legislative changes, particularly in the areas of labor regulation, investment, taxation and generally in what has become known as the "enabling business environment."

In the pursuit of unleashing the forces of growth, reducing obstacles to investment and making government more efficient, conditionality has thus evolved from macro-economic measures to detailed reforms affecting the public administration itself. Typically, the progression seems to have aimed towards

²⁷RAL II, paras. 4.61-4.76.

²⁸Interim Report, supra note 23 at paras. 63-72

reducing the size of government in productive sectors and its control over the economy.

The RAL II Report, while stating that the Bank must vigorously avoid interfering in politics, considered that the cost of failure was too great for the borrowing countries and the Bank "to ignore the potential contribution of a better understanding of the reality of political economy of adjustment".²⁹ Such an understanding has prompted the Bank, according to the Report, to design programs that are credible because experience shows that "when credibility is low, a structural adjustment program may entail larger than anticipated social and economic costs since the investment response will be insufficient to restore growth".³⁰ The Report further emphasized the need to be aware of the importance of the timing of reform measures, not only in terms of their political and economic viability,³¹ but also in terms of their design and presentation.³² Furthermore, the Report suggested that, in developing a program, it was important to identify the groups that benefit from adjustment and those adversely affected by it; compensation measures could thus be appropriately targeted and could contribute to the political viability and economic efficiency of the program.³³

²⁹RAL II, at para. 4.61.

³⁰Id. at para. 6.22.

³¹Id. at para. 4.64.

³²Id., at para. 4.75.

³³Id. at paras. 4.67-4.68.

Increased awareness of the importance of the political context of structural reforms to ensure their success, has led some outside commentators on adjustment lending in Sub-Saharan Africa to argue that aid agencies may have established an "informal governance" for Africa.³⁴

It may be recalled in this context, as explained in detail in the legal memorandum on "Authorized Purposes of Loans Made or Guaranteed by the Bank" issued in 1988, that structural adjustment lending is legally based on the "special circumstances" exception provided for in Article III, Section 4(vii) of the Bank's Articles of Agreement.³⁵ In that memorandum, adjustment operations were described as operations which "assist a country in its attempt to create the conditions and incentives needed for the investment of capital for productive purposes by helping it in this context to reduce a serious deterioration in its balance of payments or by meeting financial needs resulting from or associated with the reform process".³⁶ In this context, such operations would readily serve the Bank's purposes and fall within its mandate. As the memorandum explained, "a loan made or guaranteed by the Bank cannot [in a defensible legal sense] be

³⁴In a recent seminar on "Beyond Autocracy in Africa", working papers were presented under the heading "The Informal Governance of Africa by Aid Agencies". One of the papers described aid agencies as "now part of the structure of governance" and another concluded by saying that "structural adjustment as a political and policy-formulating process raises the most profound issues about governance in Africa and whose real responsibility it has become". See The Carter Center of Emory University, *Beyond Autocracy in Africa, Working Papers for the Inaugural Seminar of the Governance in Africa Program*, 115, 124 (February 17-18, 1989).

³⁵See Legal Memorandum of the General Counsel, SecM88-517, May 10, 1988.

³⁶Id. at para. 18.

described simply as a payment to induce the recipient government to do what the Bank believes to be in its best interest or as a 'price' for policy reforms".³⁷

The same reasoning has been applied to sectoral adjustment operations through which the Bank finances general imports. If quick disbursement was required to meet the objective of a loan more efficiently, the "negative list" approach was deemed defensible provided that there was a serious gap in the country's balance of payments that needed to be reduced or an established cost for the adjustment that needed to be financed, so that the government may be able in either case to proceed with the proposed policy reforms.³⁸

While none of the above suggests that the Bank has a mandate to introduce political reform or to question the political form of the governments it purports to assist, perceptions, coupled at times with vague statements, within and outside the Bank, have tended to give the impression that all issues of governance in borrowing countries may have become part and parcel of the Bank's concern, if not its direct business.

³⁷ Id. at para. 17.

³⁸ Id. at para. 20.

III. EXCLUSION OF POLITICAL CONSIDERATIONS IN THE BANK'S ARTICLES - ITS
MEANING AND SCOPE IN THE CONTEXT OF THE INSTITUTIONS'S EVOLUTION

1. The Bank's Authorized Purposes

The purposes of the Bank are listed in the first Article of its charter.³⁹

According to Article I of the IBRD's Articles of Agreement, these purposes are:

- "(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.
- (ii) To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
- (iii) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories.
- (iv) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

³⁹While the purposes of the Bank are exhaustively stated, the functions which allow the Bank to serve such purposes may be expanded as deemed necessary or desirable. Such expansion has been authorized in the Bank practice under the Bank's "implied powers." This is explicitly recognized in the Articles of IDA (Article V, Section 5(vi)) and other Bank affiliates.

- (v) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

The Bank shall be guided in all its decisions by the purposes set forth above."

Article I of IDA's Articles of Agreement reads:

"The purposes of the Association are to promote economic development, increase productivity and thus raise standards of living in the less-developed areas of the world included within the Association's membership, in particular by providing finance to meet their important developmental requirements on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans, thereby furthering the developmental objectives of the International Bank for Reconstruction and Development (hereinafter called "the Bank") and supplementing its activities.

The Association shall be guided in all its decisions by the provisions of this Article."

In reading the above provisions, it is important to note the following points:

- i) The mandates of both institutions, though drafted in general terms, are limited ones; they do not envisage supra-national organizations with powers exceeding their defined purposes. In the case of the IBRD, the mandate is basically concerned with matters of investment needed for the reconstruction and development of members' territories. It establishes a role for the Bank in facilitating capital investment for productive purposes and in encouraging the development of productive facilities and resources. It envisages that such development will assist in raising productivity, the standard of living and conditions of labor. It also gives the Bank a role in promoting private foreign investment through its financing. And it envisages its encouragement of international investment as an instrument in the promotion of the growth of

international trade and the maintenance of equilibrium in balances of payments. Furthermore, the Bank's mandate, always emphasizing finance for productive purposes, mentions specifically restoration of war affected economies and development in less-developed member countries. In the case of IDA, the mandate is also limited to the promotion of economic development and the increase of productivity in the less-developed members, particularly through concessional finance, with a view to raising standards of living. These mandates have been broadly understood throughout the Bank's history in a manner which has enabled it to finance, in addition to typical investment projects, technical assistance, human resource development and various other activities directly related to economic development. Their interpretation in the 1980s as enabling the Bank to assist members in dealing with their balance of payments problems in the context of the implementation of agreed economic and social reforms represents, as explained above, the greatest expansion hitherto introduced in the Bank's practice.

ii) The above-quoted provisions of the IBRD and IDA charters specifically mention that each of these institutions "shall be guided in all its decisions" by the purposes specified in the first Article of its charter. Identical language in the IMF Articles has been authoritatively read as forbidding the Fund from taking political considerations into account⁴⁰ (which, in the case of the Bank, is explicitly mentioned elsewhere in the Articles).

⁴⁰ See Gold, Political Considerations Are Prohibited by Articles of Agreement When The Fund Considers Requests for Use of Resources, IMF Survey 146 (1983).

iii) In both the IBRD and the IDA, other provisions in their respective Articles require them to provide their financing for "specific projects", except in "special circumstances".⁴¹ This requirement further explains the financial character of the institutions and the particular need to insulate them from broader political considerations which should be irrelevant to the financing of specific projects. However, other forms of financing are authorized in special circumstances, and the explicit provisions of the Articles of each institution exclude political considerations from all their decisions. In the case of the IMF, which does not finance specific projects and has a broad mandate related to the members' monetary and exchange policies, Article IV, Section 3(b) of the Fund's Articles, which deals with surveillance over exchange rate arrangements and requires the Fund to adopt specific principles for the guidance of all members, specifies that "[t]hese principles shall respect the domestic social and political policies of members".⁴²

2. Prohibition of Political Activities

The Articles of Agreement of both the IBRD and the IDA include three, almost identical provisions meant to insulate these institutions from political

⁴¹For the definition of these terms and their application in practice see the legal memoranda: Project and Non-Project Financing under the IBRD Articles, SecM84-1053, December 21, 1984.; Authorized Purposes of Loans Made or Guaranteed by the Bank, SecM88-517, May 10, 1988.

⁴²As referred to supra note 40, Sir Joseph Gold, the noted former General Counsel of the Fund, wrote that in view of the provisions of the Article dealing with the Fund's purposes, political considerations are prohibited when the Fund considers requests for use of its resources and not only when it adopts the principles guiding members with respect to the Fund policies regarding surveillance over the exchange rate policies. See also, J. Gold, Legal and Institutional Aspects of the International Monetary System, Selected Essays, Legal Structure of the Par Value System 537 et seq. (1979).

intervention by their members and to prohibit them from taking non-economic considerations into account. These are, respectively and in the order they appear in the Articles, Article III, Section 5(b); Article IV, Section 10; and Article V, Section 5(c) of the IBRD Articles and Article V, Section 1(g); Article V, Section 6; and Article VI, Section 5(c) of the IDA Articles. These provisions read as follows:

- "The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations." (Article III, Section 5(b), IBRD)
- "The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I." (Article IV, Section 10, IBRD)
- "The President, officers and staff of the Bank, in the discharge of their offices, owe their duty entirely to the Bank and to no other authority. Each member of the Bank shall respect the international character of this duty and shall refrain from all attempts to influence any of them in the discharge of their duties." (Article V, Section 5(c), IBRD)

The above-cited provisions are particularly instructive in the following respects:

- i) They intentionally cover all decisions by the institutions involved. The draft of Article IV, Section 10, of the IBRD Articles, submitted to the Bretton Woods Conference, as originally prepared by the U.S. Treasury, limited the prohibition related to the political character of the members to "decisions with respect

to applications for loans".⁴³ This language was changed in the Drafting Committee of the Bretton Woods Conference to refer to decisions generally. The report of the Committee explained this change by the fact that "the Paragraph as it stood selected for special attention one of the several purposes set forth in Article I," a selection which was found to be unjustified.⁴⁴

ii) The quoted provisions impose six separate but inter-related requirements:

(a) Arrangements must be made by the Bank to ensure that the proceeds of any loan made, participated in or guaranteed by it, will be used "with due attention to considerations of economy and efficiency" and "without regard to political or other non-economic influences or considerations." Indeed, the conditions mentioned in the Articles for making or guaranteeing loans by the IBRD (Article III, Section 4) and IDA (Article V, Section 1) are all of a financial or technical character and are non-political in nature.

⁴³Initially, the language was limited in the draft prepared by Harry D. White of the U.S. Treasury dated April 1943 (Part IV, 13) (unpublished) to "decisions to grant or withhold loans"; it was then changed to "decisions with respect to applications for loans" in the later U.S. draft of September 16, 1943, the U.K. draft of June 25, 1944, the combined U.S./U.K. draft of June 30, 1944 and the draft distributed at the Bretton Woods Conference as Doc. 169 SA/2 of July 6, 1944. See, Prohibition of Political Activities Under the IBRD Articles of Agreement and its Relevance to the Work of the Executive Directors. Legal Memorandum of the Vice President and General Counsel, SecM87-1409, December 23, 1987.

⁴⁴ 1 Proceedings of the Bretton Woods Conference 567, 569-570 (1948).

(b) The Bank, including all its organs,⁴⁵ and especially its officers (meaning its more senior staff)⁴⁶ are forbidden from interfering in the "political affairs" of members.

(c) The Bank and especially its officers are equally forbidden from being influenced in their decisions by "the political character" of the member or members concerned. This means that, under the Articles, the political character of the member is irrelevant for the purposes of the decisions of the institution.

(d) The only considerations which, under the Articles, are relevant to the decisions of the Bank and its officers are those which qualify as "economic considerations." Such considerations must be weighed impartially. This latter requirement is particularly important to ensure the uniform treatment of members in similar economic circumstances and is derived from the principle of equality of states, enshrined in the U.N. Charter (Article 2 (1)) and high in the minds of the original drafters of the Articles who envisaged universal membership in the institution.⁴⁷

(e) The President and the staff of the Bank owe their

⁴⁵ See for details the legal memorandum referred to in note 43 above.

⁴⁶ Id. at 2.

⁴⁷ Accord, Gold, supra note 40, at 147.

duty only to the Bank. Clearly, this requirement does not apply to the Governors and Executive Directors who, while required to act for the benefit of the institution and its members as a whole,⁴⁸ are also appointed or elected by members and may be expected to express the views of such members.⁴⁹

(f) Finally, each member of the Bank is required to respect the international character of the duty of the President and the staff by refraining from all attempts to influence them to act under non-economic considerations or to weigh economic considerations in other than an impartial manner.

The above six requirements raise difficult questions as to (i) what is meant by "political affairs", "political character" and "economic considerations" in the context of the Articles' provisions, (ii) the extent to which these provisions should be read as assuming that economic and political considerations are invariably isolated from each other and (iii) whether it is realistic to assume that inter-governmental agencies such as the IBRD and the IDA could in fact insulate their decisions from political considerations.

⁴⁸ See the legal memorandum cited supra note 43, at 2-3 and Gold, supra note 42, at 241-243 and 276.

⁴⁹ Id.

First: Meaning of the Terms "Political" and "Economic" in the Context of the Bank's Articles:

The Bank's Executive Directors have the power to decide on any question of interpretation of the provisions of the Articles of Agreement subject to possible review by the Board of Governors at the request of any member (Article IX, IBRD; Article X, IDA). In their discharge of this function, the Executive Directors take into account the legal analysis provided by the General Counsel as well as other relevant considerations.

The legal interpretation of treaty provisions such as the Bank's Articles is subject to general rules of international law developed through centuries of state practice, judicial precedents and scholarly works. Such "customary rules" have been codified in two articles of the 1969 Vienna Convention on the Law of Treaties.⁵⁰ The general rule in this respect is that a treaty should be interpreted "in good faith in accordance with the ordinary meaning" to be given to its terms, not in the abstract, but "in their context" and in the light of the "object and purpose" of the treaty.⁵¹ The "context" should, for this purpose, comprise the text "including its preamble and annexes", any agreement made between all the parties in connection with the conclusion of the treaty,

⁵⁰ Articles 31 and 32 of the Convention on the Law of Treaties of May 23, 1969, entered into force on January 27, 1980, 1155 U.N.T.S. 331 (1980) [the Vienna Convention]. Documents of the U.N. Conference on the Law of Treaties, Vienna, March 26 - May 24, 1968 and April 9 - May 22, 1969, Official Records, Documents of the Conference, U.N. Document A/conf. 39/11/Add.2, p. 293. A third Article, Article 33, deals with interpretation of treaties authenticated in two or more languages and is not relevant here.

⁵¹ Article 31(1) of the Vienna Convention. See also Commentary of the International Law Commission (ILC) on draft Article 27 (which became Article 31), 1966 ILC Yearbook 40-41, para. 12.

and any "instrument" made by one or more parties and accepted by the other parties as related to the treaty. Subsequent agreements between the parties regarding the interpretation or application of the treaty and subsequent practice in the application of the treaty which establishes the agreement of parties regarding its interpretation, as well as any relevant rules of international law applicable in the relations between the parties should also be taken into account. A "special meaning," rather than the "ordinary meaning" should, however, be given to a term "if it is established that the parties so intended".⁵² Recourse to "supplementary means of interpretation" such as the preparatory work of the treaty and the circumstances of its conclusion, is not to be done as "an investigation ab initio into the intentions of the parties,"⁵³ but may be made in order to "confirm the meaning" resulting from application of the above-mentioned rules or to "determine the meaning" when the interpretation according to such rules "(a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable".⁵⁴ The interpretation doctrine codified in the Vienna Convention is, thus, both "objective" and "purposive". It relies on the language of the text as written, but tries also to serve the text's objective. Such interpretation may however be complemented, if the need arises, by looking at the intention of the parties as well as at the parties' subsequent practice.

⁵²Article 31 (4) of the Vienna Convention.

⁵³ILC Commentary on Article 28 (which became Article 32), supra note 51, at 42, para. 18.

⁵⁴Article 32 of the Vienna Convention.

Both "economy" and "politics" are words of Greek origin. Initially, they had clearly distinct meanings, "economy" being a reference to the management of the household and "politics" a reference to the matters of city, state, government and public policies.⁵⁵ This distinction has lost its original clarity, at least in part, with the extension of the term "economy" to the state and the subsequent emergence of the term "political economy". Notwithstanding its occasional use in recent Bank documents in a sense which emphasizes the influence of politics on economic decision-making, "political economy" has been otherwise understood to mean generally "the art or practical science of managing the resources of a nation so as to increase its material prosperity",⁵⁶ and ordinarily means in more recent use, "the theoretical science dealing with the law that regulates the production and distribution of wealth."⁵⁷ "Economy" in this latter sense is "political" only in the dictionary sense of "belonging to the state or body of citizens; its government and policy."⁵⁸ The term

⁵⁵ For the meanings of each of these terms and their evolution, see, The Compact Edition of the Oxford English Dictionary, Vol I at 831 and Vol II at 2228. "Economy" is derived from two Greek words which mean "house" and "management" and has been used in English to mean "management of a house", "management generally", "the art or science of managing a household", "the manner in which a household or a person's private expenditure is ordered", as well as "the rules which control a person's mode of living; regimen; diet" before its use in the wider sense of the "administration of the concerns and resources of any community or establishment with a view to orderly conduct and productiveness; the art or science of such administration". Id. at 831.

⁵⁶ Ibid. The term seems to be used in recent Bank documents in the manner typically used in so-called neo-classical economists' writings.

⁵⁷ Id. Specialized dictionaries, while reflecting this general sense, highlight the concern of economics with the allocation of scarce means among competing ends through the processes of production, substitution or exchange, see, The Dictionary of Economics (The Economist Books, Hutchinson, 129 (1989), Nemmers, Dictionary of Economics and Business 157 (1978); Dictionary of Economics and Financial Markets 71-72 (Gilpin ed. 5th ed., 1986).

⁵⁸ Oxford English Dictionary, supra note 55, at 2228.

"political" has other meanings, however, which are more pertinent in the context of the Bank's Articles. Since these Articles recognize the relevance of economic considerations but exclude political ones, they must assume a clear distinction between the two. The more relevant meaning of the excluded political factors should therefore be found in what the Oxford Dictionary defines as "belonging to or taking a side in politics or in connection with the party system of government; in a bad sense, partisan; factions"⁵⁹ as well as "the political principles, convictions, opinions or sympathies of a person or party."⁶⁰ This would include many issues which fit under what has been called "the art and practice of running a country or governing",⁶¹ but should exclude, for the purposes of the Bank's Articles, such typical economic and technical issues as the "management of money or the finances"⁶² or more generally the efficient management of the country's resources. Such latter issues, while they may have obvious political connotations, readily represent "economic considerations", both in ordinary language and in the Articles' context.

Second: Possible Entanglement of Economic and Political Considerations:

Economic considerations may be easy to insulate from political ones in the context of the financing of specific projects, the main function of the Bank under its Articles. The Articles assumed that project feasibility would not be judged by the staff's or the Executive Directors' partisan political preferences

⁵⁹ Id.

⁶⁰ Id.

⁶¹ P.H. Collin, *Dictionary of Government and Politics* 154 (1988).

⁶² *Oxford English Dictionary*, supra note 55, at 831.

but by technical, economic considerations such as the project's financial and economic rates of return.⁶³ But economic considerations in their broad sense do extend to the manner in which the state manages its resources, and may thus become difficult to isolate from political considerations, especially in "policy based" lending. To ensure that economic considerations will prevail in all the Bank's decisions, the Articles provided that a "competent committee" consisting of an expert selected by the governor in whose territories the project is located and "one or more members of the technical staff of the Bank" would carefully study every loan proposal and recommend it accordingly.⁶⁴ As a further safeguard, they provided for the establishment of an Advisory Council of not less than seven persons "including representatives of banking, commercial, industrial, labor and agricultural interests, and with as wide a national representation as possible," to "advise the Bank on matters of general policy."⁶⁵

The authors of the early drafts of the IBRD Articles, and particularly the two main progenitors, Harry D. White of the U.S. and Lord Keynes of the U.K.,

⁶³One basic assumption made by the Articles which has not materialized in fact, was that the main business of the Bank would be in the form of guaranteeing or participating in loans made by private lenders who, it was further assumed, would naturally be driven by financial and economic motives, not by political ones.

⁶⁴See Article III, Section 4(iii) and Article V, Section 7 of the IBRD Articles of Agreement, and Article V, Section 1(d) of IDA's. Emphasis added. The committee mentioned in these provisions is referred to in Bank practice as the "Statutory Committee".

⁶⁵Article V, Section 6 of the IBRD Articles (which has no counterpart in the IDA Articles). Such an Advisory Council has not been convened since 1950, however. Experience with the first Council led the Executive Directors to request a further study which does not seem to have been made as yet.

were indeed cognizant of the possible interaction between economic and political factors. They meant, nevertheless, to emphasize the impartiality of the institution when it came to political ideologies and interests, and to highlight instead its apolitical character and universality. In his first drafts, Mr. White provided that the Bank and its officers "shall scrupulously avoid interference in the political affairs of any member;" this emphasis remained in the draft submitted to the Bretton Woods Conference.⁶⁶ Lord Keynes added another paragraph to the latter draft stipulating that the Bank would act "in strict impartiality".⁶⁷ The draft of what is now Article IV, Section 10 of the IBRD Articles was accepted at Bretton Woods without any debate on its content; its scope was only broadened to cover all the Bank's decisions, as explained earlier.

Third: How Realistic is the Prohibition of Political Considerations in an Inter-Governmental Institution?

This question was raised during the preparation of the provisions of the Article prohibiting political considerations and excluding political influence (Article IV, Section 10 of the IBRD Articles of Agreement), and later on in the U.S. Congressional Hearings which preceded approval of the Bretton Woods Act. The fact that it was not raised in the Bretton Woods Conference itself, or in

⁶⁶See Document 169 SA/2 dated July 6, 1944, Article V, Section 11 (U.S. IV, 19). Proceedings of the Bretton Woods Conference, supra note 44, at 190-91. Emphasis added.

⁶⁷Id. at 202. Emphasis added. Later on, on the occasion of the Inaugural Meeting of the Fund and Bank at Savannah, Georgia, in March 1946, Lord Keynes warned that "[i]f these institutions are to win the full confidence of the suspicious world, it must not only be, but appear, that their approach to every problem is absolutely objective and oecumenical without prejudice or favour." Quoted in R.F. Harrod, *The Life of John Maynard Keynes* 632 (1951).

the Board of the Bank when it approved the charters of all the Bank affiliates, where almost identical language is used,⁶⁸ is significant in indicating that member states agreed to obligate themselves to insulate these financial institutions from political considerations in order to protect them, and their members, from the vagaries of politics in their varied and broad membership.

In early 1944, before the draft submitted to the Bretton Woods Conference was finalized, the U.S. Treasury prepared a "Questions and Answers" paper explaining its earlier draft articles which included the original provisions against political activities.⁶⁹ The last question in this document was phrased as follows: "Will it be possible for the Bank to avoid making loans based chiefly on political considerations?" Interestingly, the document provided the following answer which is quoted here in full:

"The Bank is designed to be an international economic agency to facilitate productive international investment without regard to political considerations. In deciding on loan applications, the Bank is not to be influenced by the political character of the country requesting the credits. This provision is part of the general requirement that the Bank shall scrupulously avoid interference in the political affairs of member countries (IV-19).

The greatest assurance that the operations of the Bank will be based exclusively on economic considerations is given in the provisions of the proposal. The Bank may guarantee, participate in, or make loans only for a specific project or program that has been investigated by a competent committee and has been approved as one that will increase the productivity of the borrowing country and for

⁶⁸See Articles V, Section 6 of IDA's Articles of Agreement, Article III, Section 9 of the IFC's Articles and Article 34 of the MIGA Convention. For reasons related to MIGA's business, this latter Article prefaces the provision requiring that only economic considerations be taken into account (in Article 34) by the phrase "without prejudice to the right of the Agency to take into account all the circumstances surrounding an investment."

⁶⁹U.S. Treasury, Questions and Answers on the Bank for Reconstruction and Development (February 24, 1944).

the servicing of which the prospects are favorable (IV-1-c). The investigating committee is to consist of experts selected from the technical staff of the Bank and one expert selected by the country applying for the loan. With these requirements, no loan can be made to a country for other than purely economic purposes, and the standards which prospective borrowers must meet are those which protect the economic interest of lender and borrower.

The character of the Bank's operations should give further assurance that political considerations will not affect the decisions of the Bank. The greater part of the Bank's operations will be directed toward encouraging and facilitating international lending by private investors. While the Bank would generally be prepared to guarantee or participate in loans approved by the technical committees, it would exert no pressure on private investors to undertake such loans. It is reasonable to assume that private investment institutions would not give weight to political factors, except as the stability of the government of the borrowing country affects the risk element in all foreign loans. There is thus a further check by private investors on all loans guaranteed or participated in by the Bank.

The international character of the Bank is also a protection against loans made for political purposes as previously discussed in the answer to Question 15. The Bank itself can have no policy outside the purely financial sphere. So far as concerns individual member countries, they do undoubtedly have important international political interests. However, it would be quite difficult for any member country to utilize the Bank for the purpose of furthering its political interests. Each member country is represented on the Board by one member, and no country can cast more than 25 percent of the aggregate votes (V-1). Furthermore, the Board is expected to consult with the Advisory Council on matters of general policy. The Council is to consist of men of outstanding ability, whose primary concern would be with economic and financial rather than with political matters. (V-5).

It remains true that the possibility always exists that pressure will be exerted to induce the Bank to extend foreign credits because they are politically necessary. So far as possible, the draft proposal is designed to minimize such influences in international lending. We recognize, however, that no set of rules will of itself completely eliminate political considerations and that proper limitation of the Bank's activities depends ultimately on the character of the men responsible for its operations.

This does not imply that international loans for political purposes have no justification. Obviously, there will be instances when loans may properly be made to aid a friendly government. But such loans should not be made with the aid or encouragement of the Bank which is exclusively concerned with international investment

for productive purposes, nor should such loans be made with funds provided by private investors. Where loans must be made for political purposes, the funds should be provided by the interested government or governments, without requiring either the Bank or private investors to assume the risks inherent in such loans."⁷⁰

A similar reply was given by the U.S. Secretary of the Treasury, when asked during the Senate Hearings by Senator Taft whether he thought that "when a Board is set up, composed of the great nations and the small nations of the world, they are not going to be affected by politics about the making of a loan to a nation?"⁷¹ When addressing the practicality of this matter Secretary Morgenthau emphasized again that "the institutions will carry out their work as far as it is humanly possible to do it and - it depends on the people running it - on a strictly business basis."⁷²

It is noteworthy that while questions were raised regarding the practicality of insulating the Bank from political interventions by members and their representatives, the importance of preserving the international and apolitical character of the duties of the President and staff has never been called into question. Such an international character can hardly be maintained, however, if members do not honor their duty, also stipulated in the Articles,

⁷⁰Id. at 75-77. Emphasis added. The provisions of the earlier draft referred to in this answer which mentioned the expert committee and the Advisory Council have survived in the Bank's Articles (Article III, Section 4(iii) and Article V, Section 7 on the loan committees, and Article V, Section 6 on the Advisory Council), unlike the provision regarding the maximum votes a country could cast. The purpose of the latter provision has been served, however, through the allocation of shares and the provision on "preemptive rights".

⁷¹See Senate Hearings on H.R. 3314 (B) June 1945, at 15.

⁷²Id. Emphasis added.

to refrain from attempts to influence the President and staff in the performance of their work.

The practice of the Bank may have seen instances where the ideals of the Articles have not always been fully met and where political considerations may have influenced Bank decisions in varying degrees of subtlety. Executive Directors may have also voted at times on politically motivated instructions. The Bank's General Counsel, past and present, have stated that there was no legal remedy available to the Board to challenge a vote on the basis of unexpressed political motivations.⁷³ None of this, however, changes what is stated in the Bank's Articles. Nor does it provide a legally acceptable basis for its violation.

3. Political Considerations of Possible Relevance Due to their Direct Economic Effect or to Binding International Obligations

The Bank and its officers are thus required not to interfere in the political affairs of members and to take only economic considerations into account. Yet, internal or external political events may have significant direct economic effects which, due to their economic nature, may properly be taken into consideration in the Bank's decisions. Situations may also develop where political events lead to the creation of obligations for the Bank or its members which cannot be ignored in the Bank's decisions. Both areas require clarification in order to establish their consistency with the Articles' provisions.

⁷³ See the legal memorandum referred to supra note 43, at 6.

i) The degree of political instability of the government of a member requesting a loan and of the security of its territories could be such as to affect the development prospects of the country including its prospective creditworthiness. Political changes may also affect the borrower's ability to keep its commitments under a loan agreement or the ability of the Bank to supervise project implementation or to evaluate the project after its completion. As a result, partial or full foreign occupation of the country's territories or civil strife in such territories cannot be deemed irrelevant to the Bank's work simply because they are of a political nature. Bank lending in such circumstances may run counter to the financial prudence required by the Bank's Articles (Article III, Section 4(v)). It may also threaten the standing of the Bank in financial markets or otherwise adversely affect its reputation as a financial institution. Indeed, the Bank has long recognized that it "cannot ignore conditions of obvious internal political instability or uncertainty which may directly affect the economic prospects of a borrower."⁷⁴ This position has been consistently upheld by the Bank's Legal Department, most recently in the Legal Memorandum of December 23, 1987.⁷⁵ It is important to recall, however, that in such situations the Bank would still be taking into account relevant economic considerations; political events would represent only the historical origins or the causes which gave rise to such considerations.

ii) In addition to the above practical possibilities, other situations may arise where the Bank becomes legally bound to pay due regard to factors which

⁷⁴The World Bank, IDA and IFC - Policies and Operations 43 (April, 1968).

⁷⁵Referred to supra note 43, at 4 and 6.

are basically political in nature. Members of the Bank which are also members of the U.N. are required by the U.N. Charter (Article 48) to carry out Security Council decisions "directly and through their action in the appropriate international agencies of which they are members." Members' obligations under the U.N. Charter prevail over their other treaty obligations, including their obligations under the Bank's Articles of Agreement, by force of an explicit provision in the U.N. Charter (Article 103). The Bank itself is bound, by virtue of its Relationship Agreement with the U.N., to take note of the above-mentioned Charter obligations assumed by its members and to "have due regard for decisions of the Security Council under Articles 41 and 42 of the U.N. Charter"⁷⁶ (which cover the binding measures that the Security Council may take to maintain international peace and security). The resultant inability of the Bank to lend to a member country which is subject to embargo measures imposed by the Security Council falls into this type of situation. The Bank's Board of Governors, by a resolution dated September 13, 1951,⁷⁷ unilaterally undertook to have the same due regard for the U.N. General Assembly resolutions made pursuant to its "Uniting for Peace" resolution of that year⁷⁸ (presumably on the basis that such resolutions were equivalent to Security Council decisions taken

⁷⁶Article VI(1) of the Agreement Between the United Nations and the International Bank for Reconstruction and Development, Nov. 15, 1947, 16 U.N.T.S. 346 (see also 394 U.N.T.S. 222 for the similar agreement with IDA).

⁷⁷Resolution No. 64 adopted by the Board of Governors at Sixth Annual Meeting, World Bank, Sixth Annual Meeting of the Board of Governors, Summary Proceedings 26 (1951).

⁷⁸"Uniting for Peace" Res. 377 (V), 5 U.N. GAOR, Supp. 20 (A/1775) 10-12, Resolution adopted on the Report of the First Committee (1950).

under Articles 41 and 42 of the U.N. Charter).⁷⁹

It should be noted in this respect that the Bank refused, when the occasion arose in the 1960s,⁸⁰ to extend the same treatment to other resolutions of the U.N. General Assembly, which are normally deemed to be recommendations,⁸¹ invoking in this respect its Articles' provisions prohibiting political activities as well as the provisions of the Bank's Relationship Agreement with the U.N.⁸² Under this latter Agreement each organization is prevented from presenting formal recommendations to the other without reasonable prior consultation. Furthermore, the U.N. "recognizes that the action to be taken by the Bank on any loan is a matter to be determined by the independent exercise of the Bank's own judgement in accordance with the Bank's Articles of

⁷⁹The controversial "Uniting for Peace" Resolution was adopted to enable the General Assembly to act as organ for the maintenance of international peace and security when the Security Council fails to fulfil this task due to the exercise of the veto power by one of the five permanent members.

⁸⁰For a detailed account of this episode, prompted by the adoption of the U.N. General Assembly of resolutions in 1966 requiring the Bank not to give financial assistance to South Africa and Portugal, see, Shihata, The World Bank and Human Rights - An Analysis of the Legal Issues and The Record of Achievement 17 Denv. J. Int'l L. Pol. 43 et seq. (1988); Kneller, Human Rights, Politics and the Multilateral Development Banks, 6 Yale Studies in World Public Order 362 (1980); Marmorstein, World Bank Power to Consider Human Rights Factors in Loan Decisions, 13 J. Int'l. L. & Ec. 113 (1978); Whiteman, 14 Digest of International Law 1004 et seq. (1970); Bleicher, U.N. v IBRD: A Dilemma of Functionalism, 24 Int'l Organization 31 (1970).

⁸¹For a recent treatment of the legal nature of U.N. General Assembly resolutions, a controversial subject in certain respects, see, 62/2 Annuaire de l'Institut de Droit International, Premiere question: The elaboration of general multilateral conventions and of non-contractual instruments having a normative function or objective - Resolutions of the General Assembly of the United Nations, M.K. Skubiszewski, Rapporteur, 65-126 and Resolution adopted, 274 et seq. (1987).

⁸² See supra note 76.

Agreement." The Agreement explicitly provides that "[t]he United Nations recognizes, therefore, that it would be sound policy to refrain from making recommendations to the Bank with respect to particular loans or with respect to terms or conditions of financing by the Bank." The Bank has recognized only that the U.N. and its organs "may appropriately make recommendations with respect to the technical aspects of reconstruction or development plans, programmes or projects."⁸³ These latter provisions are also consistent with Article 1 of the same Agreement which states that "[b]y reason of the nature of its international responsibilities and the terms of its Articles of Agreement, the Bank is, and is required to function as, an independent international organization." Indeed, under its own Articles of Agreement (Article V, Section 8) the Bank is required to cooperate with any general international organization, such as the U.N., provided that "[a]ny arrangements for such cooperation which would involve a modification of any provision of this Agreement may be effected only after amendment to this Agreement under Article VIII".

While the Bank's position on this matter has prevailed in the context of the controversy which arose in the 1960s over lending to South Africa and Portugal, it may be interesting to note that the U.N. Legal Counsel at the time contended that the prohibition of political activities under the IBRD Article IV, Section 10, did not relate to criteria involving the international conduct of a state affecting its fundamental obligations under the U.N. Charter and that what was prohibited was interference in the internal political affairs of the

⁸³Article IV (3) of the Relationship Agreement, supra note 76. Emphasis added.

Bank members and discrimination against a member because of the political character of its government.⁸⁴ However, there was no disagreement during that episode that internal political affairs which have no serious international dimensions were outside the scope of the Bank's work.

The latter remark is of particular interest with regard to the issue of human rights violations and their effect on Bank lending. At least one member of the Bank has enacted legislation authorizing and instructing its Executive Director in the Bank (and in a number of other international financial institutions) to "oppose" any loan or other form of financial or technical assistance to any country with "a pattern of gross violations of internationally recognized human rights" or which "provide refuge to individuals committing acts of international terrorism by hijacking aircraft," unless, in all such cases, "such assistance is directed specifically to programs which serve the basic human needs of the citizens of such country."⁸⁵ However, the Bank's practice, which may have been recently subject to some interruption in the Bank's Board, has been to the effect that the degree of respect paid by a government to political

⁸⁴See 21 U.N. GAOR 4-20, U.N. Doc. A/C. 4 SR1653 (prov. ed. 1966). A similar position has been upheld by Bleicher, supra, note 80, at 31 and Marmorstein, supra note 80, at 127-31, but not by Kneller, supra note 80, at 418-21.

⁸⁵See Section 701 (a) and (f) of the International Financial Institutions Act, as amended, in U.S. Senate, U.S. House of Representatives, Legislation on Foreign Relations through 1988 at 153-56 (1989). For the legislative history of this provision, see Shihata, supra note 80 at 45 et seq. The history of PL95-118 makes clear that the U.S. Executive Director can "oppose" by abstaining, voting "present" or taking any action other than voting "yes". See Senate Conference Report No.95-363 at 101 (July 26, 1977).

and civil rights (as opposed to economic rights),⁸⁶ cannot be considered in itself a basis for the Bank's decision to make loans to that government. Violation of political rights may, however, reach such proportions as to become a Bank concern either due to significant direct economic effects or if it results in international obligations relevant to the Bank such as those mandated by binding decisions of the U.N. Security Council.

IV. THE BANK'S MANDATE IN RELATION TO ASPECTS OF GOVERNANCE IN ITS BORROWING MEMBER COUNTRIES

1. Defining the Issue

In its full sense, "governance" covers the manner in which a community is managed and directed, including the making and administration of policy in matters of political control as well as in such economic issues as may be relevant to the management of the community's resources;⁸⁷ it conveys the same meaning as "government" which is a "more modern word for governance".⁸⁸ There is thus some overlapping between the meanings given to the words "governance"

⁸⁶ See a clear distinction between the two categories of human rights in the two separate conventions prepared by the U.N. to ensure their protection: the International Covenant on Economic, Social and Cultural Rights, Dec. 16, 1966, 993 U.N.T.S. 3 and the International Covenant on Civil and Political Rights, Dec. 16, 1966, 999 U.N.T.S. 171. See also United Nations, Human Rights: a compilation of international instruments 3 et seq. (4th ed, 1983).

⁸⁷ See several definitions to this effect in the Oxford Dictionary, supra note 55, at 1181 and in Webster's New International Dictionary of the English Language 1083 (2nd Edition, 1948).

⁸⁸ The Concise Oxford Dictionary 530 (5th ed. 1964); more recent dictionaries simply refer to the definition of "government", see e.g. Webster's Ninth New Collegiate Dictionary, 529 (1990). The more comprehensive dictionary cited supra note 55, at 1181 states that "in the main [the word 'government'] may be considered to have superseded governance."

and "economy",⁸⁹ and more so between the meanings of "governance" and "politics".⁹⁰ Each of these three words no doubt evoke in their broad meanings questions which may readily fit under the other. Not only is "the political agenda full of economic issues",⁹¹ the economic agenda inevitably raises political questions and the governance agenda is full of both types of issues.

The possible broad meanings of "governance" and the different intentions of those who call on the Bank to take it into account indicate the importance, as well as the difficulty, of drawing a clear distinction between two sets of aspects of governance: (a) those which are related to the Bank's purpose as stated in its Articles and are not excluded by provisions in these Articles and (b) such other aspects which represent prohibited "political considerations." Notwithstanding the difficulty of making this distinction, it has to be made by the Bank, if it is to take certain governance issues in its borrowing members into account while avoiding the risk of violating its Articles. An appropriate distinction may also obviate the need for the amendment of the Articles from the viewpoint of those Bank members who attach at present particular importance to governance issues in borrowing countries.

The remaining part of this memorandum is meant to enable the Executive Directors to agree on ways in which the Bank may address certain aspects of governance without having to face either of the above-mentioned possibilities.

⁸⁹See, e.g., definitions in the Oxford Dictionary, supra note 55, at 831 and 1181.

⁹⁰Id. at 831 and 2228.

⁹¹Samuelson & Nordhaus, *Economics* 11 (1989).

It is perfectly clear that the Bank's purpose is not to substitute itself for the peoples and governments of its borrowing member countries in deciding how these countries are to be governed. This might be a task for a world government, not the World Bank. Nor do the Bank's purposes allow it and its staff to be involved in the political reform of its borrowing countries, no matter how badly needed such a reform may be. The issue at hand is simply to identify aspects of governance which are relevant to the Bank's work and may therefore defensibly fall within its mandate, and aspects which are clearly political considerations which cannot be taken into account without breaching the Bank's Articles. Such identification will make it possible for the Bank to determine the governance issues it may formally take up in its dialogue with borrowing countries and appropriately address in its operations, and the issues it should ignore in its work. High risks are involved in failing to make a correct distinction in this respect.

Before attempting to make such a distinction, it may be important to separate this matter from another issue with which it may be confused, that is the Bank's freedom to acquire relevant knowledge of the political situation in its borrowing members and to gain insight as to the underlying social and cultural factors behind such a situation. Acquiring this knowledge is not only legitimate; it is essential for the Bank's ability to provide useful advice on policy reform in the economic and social sectors. Without it, the Bank's assessment of the feasibility and effects of this type of reform may be grossly distorted. For instance, in areas such as the reform of the legal and regulatory framework for private sector activities, lack of such knowledge could easily lead to misguided advice with long term economic consequences. Knowledge

of the political situation may also be necessary in the assessment of the country's creditworthiness and of the ability of a certain government to carry out its obligations under a specific loan or of the Bank's ability to supervise the project to be financed by the Bank. ~~[Developing such knowledge should not however mean, in my view, permitting Bank staff to enter into a dialogue with the political parties in the country concerned without the concurrence of the government, as seems to have been recently suggested in a Bank document.]~~⁹² The Bank should be careful, in building up its knowledge of the political situation, not to interfere, or give the impression of interfering in the political affairs of its members. ^{High profile} ~~Unchecked~~ contacts with political parties, especially opposition parties, may easily give this impression, unlike the contacts with experts and professional associations. ⁹²

2. Aspects of Governance Beyond the Bank's Mandate

The earlier discussion in this memorandum and the clarification of the six requirements provided for in the Bank's Articles in respect of political considerations⁹³ should make it clear that the following activities are legally prohibited by the Bank's Articles and thus may not be carried out under the guise of promoting "good governance":

⁹² See OED, Annual Review of Evaluation Results 6-26 (1990) where it states: "The Bank needs not only to be familiar with the programs of the competing parties or groups in a member country, but also to maintain a low-keyed contact with them all, to assure broader understanding of the Bank's views, appreciate the views and programs of the country's competitors for power, and help assure continuity in the lending program."

⁹³ See supra pp. 16-20.

ALTERNATIVELY,
THOUGH LESS PREFERRED:
RETAIN SENTENCE BEGINNING
"DEVELOPING SUCH"
BUT SUBSTITUTE
"KNOWLEDGE" FOR
"CONCURRENCE"

i) The Bank should not be influenced by the "political character" of the member. It should therefore be of no relevance to the Bank if the country concerned is a member of a particular political bloc or professes a particular political ideology. It should be immaterial to the Bank if the country is a kingdom or a republic, follows a Western-style or another form of government or has a parliamentary or a presidential system. There is no evidence that economic growth would be achieved only under a political system which is more familiar to the Bank staff or is ideologically preferred by certain of its members. On the contrary, rapid economic growth has taken place "within a variety of political systems and with quite different ranges of public policies".⁹⁴ Regardless of how simplistic it may be to attempt to introduce political transformation through the conditionality of external lending, such conditionality would not in my view be consistent with the explicit provisions of the Bank's Articles of Agreement.

The general prohibition stated above is subject to the qualification mentioned earlier in this memorandum. Economic considerations are relevant to the Bank's decisions, even when they have political causes or origins. The linkage between such economic considerations and political factors cannot be presumed, however. It must be clearly established in each case where it is alleged to exist, as will soon be explained further.

⁹⁴Pyne, Aspects of Political Development 34 (1966). The same conclusion has been recently confirmed by extensive research. See Sirowy & Inkeles, The Effects of Democracy on Economic Growth and Inequality: A Review, 25/1 Studies in Comparative International Development 126-157 (1990).

ii) The Bank should not interfere in the domestic or foreign partisan politics of any member. It should not favor one political party over another or one of competing political candidates in national or provincial elections. It should deal with the government in charge and act impartially with regard to the different political factions in the country, even if the Bank staff happens to believe that a certain faction is likely to be more understanding of Bank policies. And it should not attempt to influence the direction of the political foreign policy of the borrowing country.

iii) The Bank, as coordinator of foreign assistance for a given country, should not act on behalf of donor countries in influencing the recipient country's political orientation or behavior. It should concentrate on maximizing the effectiveness of aid efforts, avoiding duplication and inconsistencies and enhancing the volume and quality of assistance. Such beneficial role which is appreciated by both donors and recipients should not, in other words, result in giving the Bank staff a different, unauthorized role as political messengers for donor governments. Nor should it allow the political preferences or ideals of bilateral donors to color the Bank's own judgments and decisions. A clear line has therefore to be drawn between the Bank's coordinating role, which must be guided only by considerations of aid effectiveness and efficiency, and any conduct which makes the Bank a source of political influence or pressure.

iv) More generally, the Bank should not allow political factors or events (no matter how appealing they may seem to be) to influence its decisions unless, as explained earlier, it is established that they have direct and obvious economic effects relevant to its work. This judgment must be reached as a result of the

objective analysis of the Bank's staff, not in response to political pressure from a member or members or in application of unestablished development doctrines or theories. The staff have to establish the case for the direct economic effect in a clear and uncontroversial manner. For it to be taken into account, such economic effect has to be preponderant; a question which is traditionally considered as "political" cannot be turned into an economic issue just because of minor possible economic effects. It should be recalled that it is only the economic considerations which are relevant to the decisions of the Bank, as Article IV, Section 10 of the Bank's charter explicitly stipulates. To ensure consistency with this provision, when these considerations are associated with political actions or flow from political events, they have to be of such impact and relevance as to make them a Bank concern. Even then, the Article's provision requires the Bank to weigh such economic considerations impartially in order to achieve the Bank's purposes, not in order to satisfy political preferences or ideals.

v) Equally important, the staff should not build their assessment on the possible reaction of any Bank member to their analysis. Interference by Bank members in the staff analysis would form an undue attempt to influence the staff's discharge of their international duty and is explicitly prohibited under the Articles. In particular, the Bank should not take a position for or against lending to a particular member or for a particular project simply because such member or project is likely to be favored or opposed by other members. Each Executive Director is free to vote on loan proposals as he may deem fit; he is not to interfere, however, with the way the President, officers and staff prepare such proposals for submission to the Board. Consultation with Executive

Directors on proposed loans or policies should not be taken as an occasion to impose a position on the President or staff as to whether the proposal should be made or on the specific features of such a proposal. The President should be able to decide what position to take in light of the consultation, realizing that it is the Board as a whole which will finally decide on the matter. Attempts by a member or members to impose a certain position before a specific proposal was submitted to the Board in a formal meeting would not, in my view, be consistent with the Articles' requirement of non-intervention in the discharge of the duties of the President and staff.

3. Aspects of Governance Consistent with the Bank's Mandate

One key to determining the aspects of "governance" which are relevant to the Bank's work and consistent with its mandate is to be found in a definition given to this term in contemporary English which sums up what is mostly intended by those who use it in the Bank. This is the meaning of "good order",⁹⁵ not in the sense of maintaining the status quo by the force of the state (law and order) but in the sense of having a system, based on abstract rules which are actually applied and on functioning institutions which ensure the appropriate application of such rules. This system of rules and institutions is reflected in the concept of "the rule of law", generally known in different legal systems and often expressed in the familiar phrase of a "government of laws and not of

⁹⁵See Oxford Dictionary, supra note 55, at 831. According to Webster's Dictionary, supra, note 87, at 1083, the word means also "good conduct"; "self-control".

men".⁹⁶

Concern for rules and institutions is particularly relevant to a financial institution which at present does not only finance projects but is also deeply involved in the process of economic reform carried out by many of its members. Reform policies cannot be effective in the absence of a system which translates them into workable rules and makes sure they are complied with. Such a system assumes that: a) there is a set of rules which are known in advance, b) such rules are actually in force, c) mechanisms exist to ensure the proper application of the rules and to allow for departure from them as needed according to established procedures, d) conflicts in the application of the rules can be resolved through binding decisions of an independent judicial or arbitral body and e) there are known procedures for amending the rules when they no longer serve their purpose.

The existence of such a system is a basic requirement for a stable business environment; indeed for a modern state. In its absence, the elements of stability and predictability, so basic to the success of investment, will be lacking and the fate of enterprise, like that of individuals, will be left to the whims of the ruling individual, family or elite. Such absence will also

⁹⁶This phrase seems to be derived from the Massachusetts Constitution (Part the First, Article XXX) of 1780 which spelled out the principle of separation of powers "to the end [the government] may be a government of laws, and not of men." It has since been quoted in many decisions of the U.S. Supreme Court, beginning with its decision in Marbury v. Madison, 5 U.S. 137; 2 L Ed. 609, February 1803. The concept is known in other legal systems as well under appellations such as the "supremacy of law", although not always tied in other systems to the separation of powers principle. It has played a particularly important role in the evolution of the natural law doctrine and in the Islamic legal system, among others.

reflect a general lack of social discipline which could render meaningless any process of economic reform.⁹⁷

A system which has the basic elements explained above addresses the processes of the formulation and application of rules, rather than their substance. Such processes are meant to serve several objectives, among which the economic objective figures prominently. The substance of rules will of course reflect the policies of each government and should be based on its choices and convictions. The Bank may assist, if requested, in the design of policies related to its fields of competence and its mandate. It is also free to condition the disbursement of its loans on the adoption of agreed economic policies. This is different, however, from the above-mentioned institutional process for the formulation and application of rules as a prerequisite of economic reform and stability.

The emphasis placed on rules and institutions should not be seen as a call for excessive regulation or for rigid procedures. On the contrary, experience shows that such excesses lead to abuses of power and invite corruption and evasion, with negative effects on the development process. Rather, an appropriate system of a rule of law only ensures that both the application of

⁹⁷This point is well summarized in G. Myrdal, The "Soft State" in Underdeveloped Countries, 15 UCLA L. Rev. 1118 (1968) where he defines "soft development" as "a general lack of social discipline.., signified by many weaknesses: deficiencies in.. legislation and, in particular, in law observance and enforcement; lack of obedience to rules and directives handed down to public officials on various levels; frequent collusion of these officials with powerful persons or groups of persons whose conduct they should regulate; and, at bottom, a general inclination of people in all strata to resist public controls and their implementation." Id. at 1120.

and departure from existing rules should follow processes that are not only known in advance but also provide safeguards against arbitrariness and subjectivity.

Nor should this approach to governance issues be seen as unduly legalistic. The requirements of a system of rules and institutions and in particular the issue of compliance with the rules,⁹⁸ are complex matters which require multi-disciplinary studies which the Bank will do well to undertake, if it is to give the issue of governance adequate attention. They represent such important prerequisites of sustainable development, especially in market economies,⁹⁹ as to warrant further elaboration here through examples.

⁹⁸ Published writings on compliance include contributions by lawyers, sociologists, economists, anthropologists and others. They identify, inter alia, issues of knowledge of the rules, opportunity and capacity to obey them, likelihood of apprehension, perceived severity of sanctions, example given by officials and elite, perceptions of non-compliance by others, feelings of guilt, moral acceptability, fairness of the rules, economic interest, reciprocity, inducement, social habits, degree of popular participation in rule-making, etc. See generally, Securing Compliance: Seven Case Studies (M.L. Friedland ed. 1990); M. Posner, Economic Analysis of Law (1986); R.B. Seidman, The State, Law and Development (1978); O.R. Young, Compliance and Public Authority (1979); Compliance and the law (Krislov, Boyum, Clark, Shaefer & White eds. 1972).

⁹⁹ This is best illustrated in the writings of Max Weber where he stressed the relationship between "rational law" and economic development especially in the industrialization of Western countries. See M. Weber, Economy and Society (1968) (English translation of Wirtschaft und Gesellschaft, first published in 1921). See also Friedmann, Legal Rules and the Process of Social Change, 19 Stanford Law Review 791 (1967): "A market economy and a free society both impose upon the legal system a high demand for operational certainty in parts of the law which regulate important aspects of the conduct of everyday life and everyday business." Id. at 792.

Examples of Relevant Issues of Governance

Both in its investment lending and in its lending in support of economic policy reform, and especially in the context of the latter, the Bank may thus address issues of governance, other than those excluded above, to the extent it deems relevant to the success of the project or program involved. The following main aspects of relevant governance issues will illustrate how this subject may appropriately be addressed in the Bank's policy dialogue and in its loan conditionality. It should be made clear that while these aspects are consistent with the general framework elaborated above, they stand short of the broader coverage of governance which has appeared in some Bank staff papers and which, in my judgment, exceeds the Bank's mandate. All the following aspects relate to the degree and quality of the state's intervention in running the economy and are deemed to have a direct effect on investment prospects. They cover governance as a question of "good order" in the management of a country's resources through rules and institutions, rather than the exercise of political power to manage its affairs generally.

i) Civil Service Reform. The Bank has long been involved in institution building and human resource development and is increasingly called upon to enhance its activities in these areas. Concern for an efficient and honest civil service represents another aspect of this involvement. It is axiomatic that the effective management of a country's economy depends not only on the policies it follows but also on the institutions which translate these policies into action. Support of civil service reform may in certain cases take the form of assisting a country in reorganizing its administrative structures or studying its decision-making processes. It may even go into the restructuring of its

entire civil service with a view to introducing efficiency or eliminating or reducing corruption in a situation where the deterioration of civil administration has reached unusual dimensions. The direct relevance of a sound and efficient civil service to the success of state enterprises as well as private sector development is well established.¹⁰⁰ Civil service reform may thus be assisted by Bank loans both in the form of project or non-project lending. If such assistance is deemed by the Bank to be required for the implementation of economic reform and the promotion of investment and is provided at the request of the country, it obviously cannot represent an unauthorized interference in the country's political affairs.

ii) Legal Reform. The Legal Department paper on the Role of Law in Private Sector Development, circulated to the Executive Directors last year,¹⁰¹ has shown the importance of having an appropriate legal system, properly administered and enforced, for creating an environment conducive to business development. The transformation of economies from command to market systems cannot in particular be successfully achieved in the absence of workable, comprehensive legal infrastructures.¹⁰² In an earlier treatment of this subject

¹⁰⁰World Bank, World Development Report 1983 at 101 et seq. and B. Nunberg & J. Nellis, Civil Service Reform and the World Bank, PRE Working Paper Series 422 (May 1990).

¹⁰¹The Role of Law in Private Sector Development; Implications for the Bank's PSD Action Program, Discussion Paper, Legal Department (November 1989).

¹⁰²This point is clearly made in the Bank's papers on reform in socialist economies. See, e.g., From Socialism to Private Market Economy: Issues and Preliminary Lessons of Experience (August, 1990). A book on the Principles of Soviet Law published in the 1920s quoted Stalin as stating that "As the market declines, legal regulation and law itself lose their importance". Quoted in Izdebski, Legal Aspects of Economic Reform in Socialist Countries, 37 Am. J.

I had the occasion to point out that:

"The legal system may be generally unresponsive to the needs of important parts of the community, including the business community. Laws and regulations may be complex, deficient, unwritten or non-existent. Rule-making, whether in the form of legislation, regulations or minor decrees and directives may not be based on comprehensive data and analysis and are often influenced by vested interests and inter-personal considerations. The civil service in charge of administering the laws and regulations may be poorly trained and motivated. Delays, red tape, uncertainty and corruption can result. The court system and judiciary may follow protracted procedures resulting in unreasonable delays and may be unable to enforce judgements. No system of commercial arbitration may exist. Even minor commercial disputes may remain unresolved for years. The local legal and accounting professions may be underdeveloped or, given the excesses of the regulatory framework, may perceive their role as agents of avoidance or evasion of binding rules. This situation makes investment decisions more difficult and costly for domestic and foreign investors alike."¹⁰³

Legal reform requires profound knowledge of the economic and social situation in the country involved and can only be useful if it is done by the country itself in response to its own felt needs. The Bank may favorably respond to a country's request for assistance in this field, if it finds it relevant to the country's economic development and to the success of its lending strategy for the country.¹⁰⁴

Comp. L. 703, 705 (1989).

¹⁰³ Shihata, Law and the Development Process, 9 *The Bank's World* 12 (March, 1990).

¹⁰⁴ See recent examples in credits: Cr. No. 2162 (Central African Rep.) SAL III, July 2, 1990; Cr. No. 2090 (Senegal) SAL IV, February 9, 1990; Cr. No. 2023 (Benin) SAL, May 26, 1989; Cr. No. 2005 (Ghana) SAL II, May 1, 1989. The Bank is financing a comprehensive package of legal assistance in Guinea under Cr. 1963GUI, Nov. 29, 1988, and is administering a UNDP project in Laos which includes a component for the development of its legal framework for business activity.

The importance of legal reform to economic development is not limited to the stability it confers on contractual transactions and the predictability it gives to the treatment of property rights and management-labor relations; it extends to the essential requirement in any orderly economic activity of having workable rules and making sure they are objectively complied with.

iii) Accountability for Public Funds. When governments work in the absence of an adequate system of public procurement, accounting and auditing, substantive policies and rules can easily miss their social targets and become instead means for the exploitation of the public to the benefit of bureaucrats. The laws on the books will bear little relation to the norms actually followed and the officials responsible for their application will become part of a self-serving circle of beneficiaries. Attempted reforms will prove to be counter-productive and may only provide further opportunities for abuses and corruption. The phenomenon is only too familiar in many countries and the Bank's experience leaves no doubt as to the importance of public accountability for its reversal.

The Bank is therefore justified, indeed required, to make sure that proper accounting and disclosure procedures are followed and that adequate auditing, internal and external, is available for every endeavor in which it is involved. If it is addressing adjustment of the macroeconomic framework as a whole through a lending operation, it should be concerned, for the success of such operation, with the procedures needed to ensure "economy and efficiency", especially in the procurement of goods and services and in the auditing of public funds. These are not only matters that are mentioned in the Articles as requirements in the use of the Bank's loan proceeds, they are cited as counterpart to the political

considerations which are not to be taken into account.¹⁰⁵

Need agreement

iv) Budget Discipline. Proper budgeting processes are necessary to rationalize and control public expenditures. Through budgetary planning and execution governments translate their policies into action. Budgets do therefore raise important questions of economic policy. They also reflect at times major political choices. The Bank may take up the issue of budget discipline as a technical matter in its dialogue with a country with a view to improving that country's public finance management, rather than choosing for it how to spend its public funds. The Bank may also introduce conditionality in its adjustment loans to ensure that the processes of budget adoption and implementation will minimize waste and enhance growth. These are economic objectives which fit well under the Bank's mandate, even though they are closely related to the political arena. In fact, the Bank's concern for budget discipline may cause it to

provide advice or, where appropriate, to introduce loan conditions related to ^{investment} ~~the size of the public expenditures~~ ^{program},^{*}

strengthening budgetary planning and implementation, providing adequate ^{ascertaining that allocations for key selected key sectors are appropriate,} information on revenues and expenditures, and ensuring that public expenditures

will be put to effective use. Considerations of cost-effectiveness, ^{and poverty reduction} and economic efficiency, should guide this exercise. However, the Bank cannot, in my view,

substitute for the constitutionally responsible government in setting ^{overall} the budgetary priorities. These are to be determined by the political bodies which

are in charge of this function and constitutionally accountable for it. To state otherwise, would, in my view, deny governments the essence of appropriate governance and deprive them of a powerful tool in shaping the future of their

¹⁰⁵ See Article III, Section 5(b), quoted supra at p. 17.

societies. For its part, the Bank can of course provide advice on how this process may best enable the country to achieve its development objectives. Such advice has recently led in several instances to agreement between the Bank and certain borrowing governments, in the context of adjustment loans, on such matters as tax collection, government expenditures on certain fields, ^{the size of the public investment program, X} wage levels, the role of the central bank, etc. The Bank may also take into account, in determining its country lending strategies, the manner in which governments establish their budget priorities.

Borderline Cases

The above examples illustrate types of governance issues which may present themselves as "economic considerations" to be taken into account in the Bank's operations. Other issues of a similar character may exist and should be considered on their merits. The Bank is best advised to consider each issue with the greatest caution, lest it should find itself involved in areas prohibited under its Articles of Agreement. As several issues have both economic and political aspects, the judgment may depend on the degree of importance of each of these aspects in the case at hand. A matter which involves partisan politics or is traditionally considered political in nature should not, in my view, be of concern to the Bank, simply on account of some minor or doubtful economic effects.

One difficult subject, in this respect, is that related to popular participation as a general requirement. The Bank seems to have realized the advantages of ensuring adequate participation of the people affected by or benefitting from certain projects in the design and implementation of such

projects. It now requires consultation with local non-governmental organizations (NGOs) with respect to environment projects and plans and often provides for popular participation in social projects and rural development programs.

The Bank is also increasingly called upon, mainly by NGOs in developed countries,¹⁰⁶ to condition its lending on having a system of popular participation in rule-making generally or on the "democratization" of borrowing countries. While popular participation and democratization are indeed important goals which developing countries are generally trying to achieve, it is not clear how these goals may, in the abstract, become an operational concern for the Bank. There may be some cases where the Bank staff reach the firm conclusion that compliance with relevant rules in a given community is not possible without a measure of popular participation in the making of such rules. In such cases the Bank's concern with the issue of compliance may substantiate its pursuit in the policy dialogue with a given country of a form of popular participation in the making of such relevant rules taking into account the country's cultural values and its stage of development. However, to insist, as a general proposition that each borrowing country should have a Western-style democratic form of government cannot in my view be reconciled with the Articles' requirement that neither the Bank nor its officers should be influenced by the political character of its members or interfere in their political affairs.

¹⁰⁶This has most recently been evidenced by the discussions of the Bank/NGO Committee during its meeting in Washington, D.C. on October 31-November 1, 1990.

V. CONCLUSION

This memorandum makes it clear that not all issues related to "governance" of its borrowing members fall within the Bank's mandate and that such governance becomes an issue of concern to the Bank only in its strict sense of the good order required for a positive investment climate and for the efficient use of resources.

The Bank is not authorized to interfere in the partisan politics of its members or to be influenced by a member's political ideology or character or form of government. Indeed, the Bank is prohibited from taking political factors into account in its decisions. However, when such political factors lead to direct and obvious economic results relevant to the Bank's work, the Bank may properly take such results into account as economic considerations which only happened to have political causes or origins. In such situations, the effect on the Bank will be more in terms of whether or how to make its new lending commitments or to disburse under existing loans, rather than in terms of allowing the Bank to interfere in, let alone to "govern", the country's political affairs.

The main purpose of this memorandum is to distinguish between different issues of governance and to orient the treatment of this subject in the Bank towards the governments' process of establishing well functioning rules and institutions for the efficient management of the countries' resources -- a process which should go hand in hand with the investment of capital for productive purposes. Such a process would ensure that the economy is run according to a set of objective rules which are known in advance and are

actually in force, that there are procedures in place for amending the rules and for allowing departures from them when required and that there are efficient institutions for the application of these rules and for resolving disputes which may arise in this process. The memorandum clearly explains that the Bank may as a result address issues like legal reform in a borrowing country, the reform of its civil service and other institutions as well as the need for accountability and discipline in the use of public funds and, more generally, objectivity and efficiency in the rules and procedures related to the management of resources.

Activities with possible economic and political aspects may raise difficult questions. These should be considered with great caution with a view to limiting the Bank's attention to the economic aspects including such processes as may be clearly required for the efficient allocation and utilization of resources under objective criteria. It is not only that the Bank staff may not have adequate knowledge in the political arena and are not accountable to the people of the country for their advice and actions regarding the political affairs of Bank members; the Bank's Articles simply prohibit their interference in such matters. The distinction made in this memorandum, the concept of functioning rules and institutions introduced above and the Legal Department's clearance under the Bank's normal procedures should be helpful in providing guidance as to the appropriate framework for Bank action.

The Bank's role as coordinator of the assistance provided by the donor community to a particular country, a role which is practiced with respect to aid dependent Sub-Saharan African countries in particular, may place the Bank in a

situation where it has to advise the country about the current thinking of its donors. It should be careful, however, not to act in this respect as the conveyer of political messages and not to allow the political orientations of bilateral donors to influence its own decision-making processes.

The Bank, it should be recalled, is a financial institution which borrows and lends; it should be concerned with its financial strength and its standing in the market. This requires it, on the one hand, to avoid the vagaries of partisan politics and, on the other hand, to be careful that its funds are lent only for sound and efficient uses. Technical considerations of economy and efficiency, rather than ideological and political preferences should guide the Bank's work at all times. This was the intention of the drafters of the Articles and is the explicit message of the Articles' provisions.

There may, of course, be views favoring the involvement of the Bank in a broader set of issues including such attractive matters as political reform and democratization. These views cannot in my judgement be satisfied without an amendment of the Articles of Agreement which would broaden the Bank's purpose and dispose of the provisions prohibiting political activities. The Bank, it has been said, cannot be all things to all people. It is indeed an international organization, the legal capacity and the mandate of which are limited by the purposes stated in its Articles and by the provisions excluding political considerations. It cannot venture to act beyond its purposes and statutory prohibitions without the risk of acting ultra vires (beyond its legal powers). While the Executive Directors have the power to interpret the Articles of Agreement subject only to a possible review by the Board of Governors if a

member so requests,¹⁰⁷ they cannot, in my view, correctly interpret the Articles which explicitly prohibit political activities as authorizing such activities.

Amendment of the Articles is an intentionally onerous process which requires, in addition to the approval of the Board of Governors, further approval by member states acting by a high majority of their number and an even higher majority of their votes.¹⁰⁸ Unless such approvals are obtained and the Articles are amended for the purpose of engaging the Bank in the political reform of its members, a highly controversial proposition, the Bank may not, in my view, exceed the framework outlined in this memorandum for addressing governance issues.

¹⁰⁷ See Article IX of the IBRD Articles of Agreement and Article X of IDA's.

¹⁰⁸ See Article VIII of the IBRD Articles of Agreement and Article IX of IDA's. In the IBRD, following the Board of Governors' approval, proposed amendments must be approved by 60% of the members having 85% of the total votes. In IDA, the same requirement applies except for the latter percentage, which is 80%.

NOTE ON WORK IN PROGRESS ON GOVERNANCE

Purpose

1. This note summarizes PRE-led work in progress on governance, and is intended to inform PC members of issues being addressed and proposed outputs. The paper from LEG delimits broad areas for Bank action on governance. Within this framework, the cross-complex work program described in this note will define major operational issues of governance and explore possible Bank responses. An issues paper is being produced for early senior management consideration, followed by a fuller paper for PC and Board review within this fiscal year. A schedule is set out at the end of this note.

Key Areas of Work

2. The Bank is increasingly encountering "governance" problems in its everyday operations -- most obviously in Africa, where the Region has pioneered work on governance, but in fact across all regions. The Bank has tried for a long time to address some aspects of governance through public sector reform and institutional development efforts, and by encouraging greater local and NGO participation in development processes. But there are some important areas, discussed in the LEG paper, where we have not so far done very much. This gray area involves the economic impact of the exercise of governmental power and authority. How should we come to grips with this operationally, beyond what we are already doing in public sector management and economic policy reform?

3. In determining the potential role of the Bank in each of these areas, the overriding criteria should be that Bank action should not involve overt political choices (e.g. in favor of multi-party democracy, etc.), and that the problems addressed --e.g. state enterprise accountability, participation in poverty programs, reduction of government corruption -- should be both operationally important and tractable to some form of Bank intervention. The emphasis will be on identification of good practice appropriate to specific situations, rather than on breaking new ground. Three lines of work are being explored:

- Increasing information and openness in the conduct of public business. Traditional Bank concerns include publication of accounts, auditing, and greater budgetary transparency. More broadly, the Bank has been trying to encourage governments to "go public" with their reform programs -- and associated undertakings to the international community -- to build ownership of reforms and increase their staying power. Even in established activities such as the scrutiny of public expenditure, more systematic concern for openness may ultimately involve the Bank more directly in hitherto closed issues, for example military expenditure.
- Strengthening institutional accountability and pluralism. What role should the Bank play in dealing with accountability more broadly, than the traditional concern with public accounting and auditing, hard budget constraints for state enterprises, etc? Striking the right balance between accountability and autonomy of state

enterprises is an example on the borderline between such public sector management concerns and governance. At a broader level LAC, for example, is helping parliaments in Argentina and Chile to strengthen oversight of economic policy and management. Better accountability is also a critical way to get at the problem of corruption -- which for many people is the crux of bad governance. Rooting out corruption additionally requires reducing pervasive and arbitrary controls which enhance government power, provide opportunities for rent-seeking, and inhibit the development of plural and independent social and economic institutions.

- Providing a predictable framework for economic activity, as the LEG paper indicates, is a key requirement of good governance. There could be more explicit Bank support for development of secure and openly enforceable legal frameworks and administration of justice (especially relating to property rights and contracts). Within that overall system of law and due process, it is also important to improve the quality and predictability of government behavior -- to reduce capricious policy changes, and to eliminate arbitrariness and harassment in government conduct, particularly towards the private sector.

4. Another major area is participation. Here the Bank has done a lot in recent years, especially with respect to community and NGO participation in projects. But there are wider issues. One is inclusion of potentially excluded communities and groups (women, poor people, etc.) in decision-making. Another is strengthening participation, capacity and accountability at lower levels of government (e.g. working with local NGOs and improving local government), especially given the key role they play in poverty programs, safety nets and the management of infrastructure investments. This is an area the Bank is only beginning to deal with on any scale -- the new urban policy paper, for example, moves strongly in this direction.

Organization of the Work Program

5. PRE has primary responsibility for producing the proposed Board discussion paper. The paper will be prepared in close collaboration with Operations and Legal, which are represented on the task force responsible for organizing the work and consulting Bankwide. The task force will be guided by a steering group of Directors.

Schedule

Note on work in progress	to PC	December 17
Issues paper	to PC	February 26
Discussion paper	to PC	April 15
Board seminar		to be decided

.

DRAFT

December , 1990

To All Staff:

Follow-up to the Attitude Survey

In early October, in my first comments on the Attitude Survey, I said that I would react in more detail by the end of the year, especially in the areas of communications and career development, on which staff concern is strong. This note announces a number of steps which we are taking now in response to the Survey. Other actions will follow in the next few months, following further consideration of Institutional issues and the completion of Survey follow-up at the work group level.

Like most people working in the Bank Group, I am very proud of this institution, and I had no doubt after reading the Survey results that our strengths are much more important than our weaknesses. However, in meetings since then with the President's Council (twice), with Directors and Vice Presidents, with the Chief Personnel Officers and with the Executive Committee of the Staff Association, I have stressed that we cannot sit back on our "positives" and hope that the "negatives" will go away. We need to work hard to correct important weaknesses in the organization, and it will take time -- more than a matter of weeks and months -- to do that. There are no "magic" or "instant" solutions to some of these problems, but at the same time they are too important to be considered intractable.

The Survey provides us with a wealth of information, which we have only begun to digest and which will guide Management about staff views for a long while yet. So far, however, the most significant outcome of our further analysis is that there are only minor differences among staff -- whether grouped by grade, gender, occupation, or nationality -- with respect to most Institution-wide issues. This not only confirms the depth and breadth of the aggregate results but also suggests that follow-up actions can be general, too, rather than aimed at particular groups of staff.

Communications. In expressing dissatisfaction with upward and downward communications, you are obviously not asking for more written circulars. Instead, you want us to "tell it as it is", even if this means simply discussing the constraints on the Institution, internally and externally. Furthermore, you want to see management behavior which backs up the written and spoken word. If we stress the importance of "people management", you want to see Vice Presidents and Directors as approachable and considerate of the human element in the office as you expect your

Division Chiefs to be. If we seek staff views on important subjects, you want some detailed sense of how they were taken into account and you want to see us change our minds now and then in response to strong and sensible reactions to specific proposals. To reflect the diversity of our efforts, you want to see line managers -- as someone told me at a recent staff lunch -- celebrating a particularly successful mission, or the completion of an economic or sector study, rather than just the approval of a complex loan by the Board.

Ultimately, these small but critical aspects of management behavior are more important than formal or written communications, and all managers need to keep reminding themselves of this. However, we also need to share insights and experience more regularly across the Institution. With this in mind, I have decided on the following practical steps:

- I will convey my thoughts directly to you more often, either through notes like this or videotapes of meetings which I think will be of interest to you, especially regarding recent developments in the world and how I see them affecting the Bank Group's objectives and priorities.
- I will circulate a daily log of my meetings and activities to the Executive Vice Presidents, Senior Vice Presidents and Vice Presidents (and I am asking them to do the same within their own units), as a means of achieving a broader understanding of issues under consideration.
- Decisions of the President's Council, Operations Committee, Finance Committee and PRE Committee on important issues will be shared promptly with Division Chiefs via the All-in-1.
- I have also asked the Senior Vice Presidents and Vice Presidents to meet regularly and informally with managers in their own units and in other Vice Presidencies or Complexes, as well as with task managers, team leaders and administrative secretaries, to exchange views and experience.

None of these initiatives on its own will be sufficient to achieve the necessary results, but taken together -- and in combination with spontaneous efforts elsewhere in the Institution to "open up" our management processes and share critical information -- I believe that we can achieve a much broader understanding of our goals and our constraints in pursuing them as completely and as quickly as we sometimes would like.

Career Development. This is not only a critical issue for the organization: it is almost a raw nerve. Almost everyone regards promotion as the most important form of professional recognition; but most staff

also are pessimistic about their prospects for promotion in the light of slow growth in the organization, low turnover and, more disturbingly, inadequate evidence of equity and objectivity in promotions actually made. The first two factors are difficult to change, but the third is something which is well within our control.

I am pleased to report that Personnel staff and the Staff Association have recently collaborated on a joint task force on career development. They have produced an initial set of recommendations, which are specific and concrete, and they intend to make further suggestions in the next several months. They want it made clear that responsibility for career development is shared by managers and staff, that it benefits the Institution as well as the individual, and that it must involve processes which are open and understandable. They have suggested that we promote reassignments across major organizational units more actively; make the Vacancy Information Service (VIS) more effective and credible; facilitate developmental assignments inside and outside the Bank Group; strengthen procedures for internal and external training; enhance the work of the Career Advisory Program; make information on career paths and promotion criteria more comprehensive and widely available; review the operation of Bank-wide panels; and experiment with new forms of staff recognition -- not as a substitute, but rather as a supplement, for promotions and rotations. The report of the Group is available from the Personnel Teams, the Staff Association and your managers. Mr. Alisbah has invited comments on the report but indicated that he intends to accept the Group's recommendations, unless he hears strong views to the contrary.

I also want to commend Mr. Eccles and the Support Staff Action Steering Group for their very careful preparation of proposals to facilitate career progress and job satisfaction for the large number of our colleagues at Levels 11-17. Their recommendations will be considered and, I hope, widely discussed during the next month.

These steps should deal with many of your concerns, but they do not address directly the two factors which staff said in the Survey most inhibit their advancement: aspects of the job grading system and the way managers make their selection decisions. On these matters, I want to take two further steps:

- I am asking the Personnel-Staff Association task force which is looking at career development issues to examine a recent review of the job grading system prepared by Personnel staff and let us have their own assessment of the strengths and weaknesses of the system. I am also asking them to consult as widely as possible on the subject, especially among Division Chiefs and within the Staff Association. I expect to hear from them by the end of March 1991.

- I would also ask all managers to pay careful attention to the manner in which they reach their selection decisions, and to seek advice from the Personnel Teams on appropriate "best practices". A great deal of staff frustration would be avoided if simple courtesy and consideration (such as advising candidates whether they have been shortlisted or not, and if not, why not) were a matter of course rather than an exceptional practice. In a large organization, a small amount of thoughtfulness can go a very long way.

Stress. In October, I mentioned my concern about the large number of you who are experiencing undue tension in your jobs, with negative effects on your health and outside life. As this is a complex subject and it has been a recurrent feature of Surveys within the Bank Group, even within otherwise "satisfied" and healthy work groups, I did not intend to say much more about it until follow-up discussions in the work groups were complete. However, many of you have raised the matter with me or Bilisel Alisbah during the last three months, and I want to share a few thoughts with you on the subject.

First, most staff take pride in being hardworking and expect deadlines to be tighter, now and then, than they would prefer. What causes stress to build up to uncomfortable levels is when work is always rushed or special effort is taken for granted. There is no aggregate Institutional solution to this problem. It can only be corrected at the work group level, through thoughtful management of individual work programs and intelligent responses to the unforeseen. Managers need to draw the line, with themselves and with their own managers, when work requirements become so consistently large as to affect individuals or the work group adversely.

Second, staff need to be encouraged -- not just allowed -- to take regular leave, and preferably for extended periods. The build-up in leave credits in parts of the Bank Group suggests that the necessary balance between work program needs and the health and good humor of our staff is not being struck successfully, and senior managers -- not just work group managers -- need to be concerned about this. The situation is so serious that we are considering changing the maximum carryover of leave from 60 to 75 days and increasing incentives to use it more regularly.

Third, budget procedures are quite clearly a source of concern and are seen to entail a disproportionate effort in a large number of work groups. We need to look again at ways of simplifying the budget process, and I have asked Mr. Picciotto to canvass views on how this could be done. On this subject, too, I expect to receive suggestions by the end of March.

I know that many of you are interested in follow-up on other Institutional subjects. Mr. Alisbah will be coordinating further work in interpreting the Survey data and, where necessary, proposing remedial

action. This additional work, together with the results of follow-up at the work group level, will be considered by the President's Council in the Spring, and we would expect to issue a full progress report to you in May/June 1991.

In the meantime, please convey your views to us, directly or through your managers and Personnel teams, on matters of Institutional concern, and we will take them into account in considering other steps in response to the Survey results. We have a large agenda to work on, but just as important as our service to our member countries are efforts within the organization to release latent talent and energy and recognize the considerable commitment which we are making as individuals, not just as an institution, to promoting the well-being of people in developing countries.

Allow me to wish all of you and your families a very peaceful holiday and a promising start to 1991.

1/10

✓
Paiso / Keith

Server needs to
be an ~~an~~ internal
distrib. list for anything
on governance. He is
PRD's task manager
~~of~~ on this. Alex should
get most of the stuff to
P



Record Removal Notice

File Title PRDDR - Governance - December 1990 - January 1991		Barcode No. 1088041		
Document Date 01/08/1991	Document Type Memorandum			
Correspondents / Participants From: R. Picciotto CPBVP To: Mr. Ibrahim F. Shihata, LEGVP				
Subject / Title Governance				
Exception(s) Attorney-Client Privilege				
Additional Comments		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group. <table border="1"><tr><td>Withdrawn by Salma Berrada El Azizi</td><td>Date July 31, 2025</td></tr></table>	Withdrawn by Salma Berrada El Azizi	Date July 31, 2025
Withdrawn by Salma Berrada El Azizi	Date July 31, 2025			

The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 19-Dec-1990 03:34pm

TO: Paul Isenman

FROM: Geoffrey B. Lamb, PRDPD

EXT.: 32544

SUBJECT: WT/BBC meeting on governance

Neither you nor Wilfried has had a chance to report back on decisions, if any taken as a result of Wilfried's meeting with Conable. Do we go with the 2-page legal opinion option? With or without a PRE note (which Alex opposes on the grounds that it would open up the substantive issues)?

If there is a clearish outcome, we'd promised the working group an EM, which Corky cd. send...even if there isn't, she probably shd. still send out an update, come to think of it.

CC: Coralie Bryant

(CORALIE BRYANT)

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PRDDR

TOWARDS IMPROVING GOVERNANCE

Bank experience in policy reform and adjustment has brought to the fore consequential questions about the quality of governance in many borrowing countries.¹ The malfeasance of governments -- capriciousness which signals that neither the rule of law nor economic performance are worthwhile goals -- impoverishes citizens, undermines economic performance, and erodes prospects for future productivity. As a result governance itself has become an issue for development institutions.

The Bank has long addressed some aspects of governance through public sector reform, institutional development and capacity building work, and by encouraging greater local and NGO participation in development processes. The overriding criteria for Bank action has been that the problems addressed are both operationally important and tractable to some form of Bank intervention. Even when work in these areas deepened knowledgeability about governmental problems, there was a reluctance to be more candid about the adverse impact of poorly

¹. This draft issues paper --substantially changed from earlier drafts - was in progress when word was received that the PC would prefer that there be one discussion paper and no issues paper. Nevertheless, with the thought that our discussions might be helped by more specific and operational focus, I am circulating this short paper. It grows out of the PC note (authored by Geoffrey Lamb), Sarwar's paper, and comments on Sarwar's paper received from Gobind Nankani and Mary Shirley (and some comments on one summary from Paul Isenman.) Obviously it is also influenced by Francisco Sagasti's paper, I. Shihata's paper, and the accountability paper by Sam Paul.

Paul -

FYI -- and
comments if possible -
CB

Send em
to Carky Goff
+ Sarwar

Wrong
word?

not a personal agenda,
practical, not an ideological
exercise, but a practical
exercise in governance,
which will make a difference
to the world.

why?

performing governments upon economic development. The Long Term Perspective Study on Africa, however, signalled the change. As the LTPS concluded:

"Underlying the litany of Africa's development problems is a crisis of governance... Because countervailing power has been lacking, state officials in many countries have served their own interests without fear of being called to account....The leadership assumes broad discretionary authority and loses its legitimacy. Information is controlled and voluntary associations are coopted or disbanded. This environment cannot readily support a dynamic economy. At worst, the state becomes coercive and arbitrary. These trends can, however, be resisted....Dedicated leadership can produce a different outcome. It requires a systematic effort to build a pluralistic institutional structure, a determination to respect the rule of law, and vigorous protection of the freedom of the press and human rights."

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This message was reinforced in the foreword to the report by Mr. Conable:

"Private sector initiative and market mechanisms are important, but they must go hand in hand with good governance - a public service that is efficient, a judicial system that is reliable, and an administration that is accountable to its public."

For the international community interest in this issue has been spurred on by the historic changes underway in Eastern Europe. As these, in turn, follow on the democratization processes which have

occurred in Latin America, and in East Asia (Korea and the Philippines) it is increasingly apparent that the time is at hand to re-examine the role of the Bank in improving governance in borrowing countries.

The past decade has witnessed significant changes as well in the role of government - changes in expectations about that which it should do in relationship to, for example, the environment - and changes in the demands for that which they should not do in relationship to the private sector. It is not just that the role of government is being reduced; it is also simultaneously being changed. The precise manner of that shift in role and function varies not only by country, but by sector. Governments are assuming a different, less direct, and yet fundamentally important new role in relationship to markets, the private sector, and the factors of production in every productive sector. This new role will be as facilitator, enabler - providing the frameworks conducive to growth. While privatization, for example, of public enterprises will continue, there will be new roles to take in anti-trust regulation, consumer protection, and public finance and new policy instruments needed in fiscal, regulatory, and monetary policy.

Purpose and Scope

The purpose of this paper is to position the Bank for a more effective role in the 1990s in improving the performance of governance as it impacts upon economic development. This calls for exploring the possibility of extending the scope of the Bank's work in this area beyond its present primary focus on public sector reform, institutional development, and increasing beneficiary participation, while staying

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well within the Bank's mandate.

Governance ~~has~~ three distinguishable parts:

1. nature and form of the political regime (democratic, dictatorial, single party, multi/party);
2. processes by which power and authority are exercised (in particular in regard directly or indirectly to economic decision making)
3. capacities to design, formulate, and implement policies and programs (including administrative capacities in the private as well as public sector).

The first part is not legally within the Bank's purview, proscribed as it is by the Articles of Agreement. Further, there is little empirical evidence that particular forms of government result in better economic development. The third part, as noted, has for some time been the subject of Bank attention. This paper addresses the second part -- and within that part, focuses directly on openness, accountability, and predictability. In each instance it looks at how that issue affects economic performance, what institutions are involved, and what could be done by the Bank.

This second part -- the processes by which power is exercised -- directly impacts a country's economic development. If power is used to serve the interests of a narrow elite, if public resources are misappropriated for private benefit, if the public's confidence in the legal system is eroded, if there is no confidence in the government's capacity to deal rationally with economic issues, the behavior of

No. Different PWS Mon.

Different question.

5

economic actors is adversely affected. Or, if security expenditures are used to maintain internal control rather than any real external threat and "law" is the whim of personal power, investment opportunities suffer along with human rights.

The area to be explored, therefore, covers the interaction of political power and authority with the management of the economic development process and covers the main processes by which power and authority is exercised either directly in the economic sphere or with significant consequences for the development prospects of

countries. For the purposes of this paper, it is proposed to focus specifically on three tractable parts of governance: increasing information and openness in the conduct of public business, strengthening institutional accountability and pluralism, and providing a predictable framework for economic activity.

Definitions

Webster's unabridged dictionary defines governance as the "exercise of authority, control, management, power of government." Governance can also mean "rule, sway, regime, direction, command."

Fowler's Dictionary of Modern English Usage (1965) says of the word: "governance has now the dignity of archaism, its work being done, except in rhetorical and solemn contexts, by government and control"

Certain words are described in Fowler's dictionary as archaism's and such reference, where nothing more is said, is intended to "give warning that the word is dangerous, except in the hands of an experienced writer who can trust his sense of congruity." The

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appropriateness of this warning becomes clear when one sees how this word is being used both inside and outside the Bank.

In defining what falls within the Bank's mandate, we can draw on Mr. Shihata's paper "Issues of Governance in Borrowing Countries" (November 9, 1990) in which he provides judgement on what falls within, and without, the Bank's mandate as specified in the Articles of Agreement.

The three relevant provisions in the Articles of Agreement (Annex 1), Mr. Shihata points out, cover all decisions by the Bank, not just lending. He concludes that the following injunctions apply:

- (i) "The Bank should not be influenced by the political character of the member." Its membership of a political block, political ideology, or the nature and form of its government should be "of no relevance to the Bank."
- (ii) The Bank should not interfere in the domestic or foreign partisan politics of any member state.
- (iii) The Bank should not allow political factors to influence its decisions. Two exceptions are noted here. First, when such political factors have a significant economic impact (as when the degree of political instability or extent of civil war directly affects "the development prospects of the country including its prospective creditworthiness.") Second, the Bank must give "due regard for decisions of the

Security Council under Articles 41 and 42 of the UN Charter" (which cover binding measures taken by the Council to maintain international peace and security).

In regard to the traditional Bank practice of ignoring a governments performance on human rights, Mr. Shihata adds that violations may reach such proportions as to become a Bank concern either due to their significant direct economic effects, or as violations of international obligations relevant to the Bank such as those mandated by binding UN Security Council regulations. One aspect of the joint PRE-Leg collaboration will address the question whether people who lack property have economic rights. International ligation on property rights (including intellectual property rights) has grown with the increase in international investment and trade. What legal rights have those who have no property? While there are various international covenants, they have but limited legal standing and hence the question needs careful research.²

ISSUES

Increasing Information and Openness

Traditionally the Bank has been concerned with the publication of accounts, auditing, and greater budgetary transparency. Following experience with structural adjustment the Bank has endeavored to

². See, for example, the "International Covenant on Economic, Social and Cultural Rights" in A Compilation of International Instruments, United Nations, (ST/HR/1/REV.3) 1988.

encourage governments to go public with the reform programs and to build ownership of reforms so that they might have greater sustainability.

All of these steps are integral to generating greater openness in governance.³

The Bank's concern for open economies has its counterpart in open politics -- and for the same reasons. Just as closed economies harbor distortions, and provide opportunities for rent seeking, so do closed politics. Competitiveness in public discourse catches mistaken assumptions, clarifies choices, and may surface unintended consequences for economic policy choices. Further, an absence of discourse invites corruption as those who perceive their only source of influence is through bribery.

Increasing access to information is fundamental for competitiveness to occur, and efficiencies to become possible. Increasing access to information is closely related to accountability -- to which we will turn next -- and in this area the bank and others have been helped along by the advances made in telecommunications and the spread of the computer, fax machine, and electronic mail. Previously closed polities have not been able to close their borders to these technological changes. More people are in communication across national boundaries, learning about events and developments within their countries from external sources than ever before. Even national models forecasting economic events can be second guessed by highly skilled and

³. For a detailed discussion of the related issues see Joan Nelson, Economic Crisis and Policy Choice (Princeton Univ Press, 1990) - a book that grew out of a larger long term study that included, inter alia, attention to the political economy of adjustment and its management.

What is
"openness"
in
governance?
A new
political
agenda
for
the Bank.

able private citizens. Much of this change is already underway, yet it also provides opportunities for international institutions to further the advance of knowledge and support increased levels of technology transfer to increase openness in economic and financial information. *UBW*

✓ The Bank's more traditional concern with financial accounts, auditing, and procurement systems is another area warranting more attention. Sometimes, unfortunately, in these more traditional areas progress has been uneven; sometimes the pressure to lend overcomes the pressures to enforce audit requirements. In many countries, government accounts have not been audited in years. Sometimes the record for parastatals is worse, with successive bank loans to parastatals without requisite audits performed. Sometimes these problems occur because there are incapacities in the offices of auditor generals, and a reluctance to sub-contract work to private auditors. Private auditing firms are short of trained accountants. Training facilities at local universities are underfunded and poorly staffed; training curriculum is limited to less useful auditing of inputs rather than attention to outputs. The scope for Bank supported innovation, spread of best practice, and institutional development is significant.

✓ Further, there is much that the Bank can do to help borrowers improve the quality of, and access to, financial and economic information in order to enhance the public policy debate. Economic and financial data series can be assembled systematically and regularly published. Processes for public procurement can be regularized and made publicly available. There remains a real need for capacity development within many borrowing countries for the collection and dissemination of

public documents, library systems, and data reference collections.

Institutional Accountability and Pluralism

Traditional polities in many different parts of the world and with widely different socio/legal traditions often have some form or another of holding accountable rulers and chiefs, though the precise form varied across epochs and cultures. Sometimes modern governments poorly recombine traditional values and hence may be even less formally accountable than their less modern predecessors. When scale and size increase, and modern governments delink too rapidly from deeply held local indigenous values, they are apt to be both less legitimate and less accountable.

Improving accountability at the national or local government level means, for the purposes of this paper, encouraging governments to be answerable to publics for the quality --or lack thereof -- of their economic performance.⁴ Sometimes citizens and indigenous institutions lack the information to voice the questions that lead to accountability; other times they lack the opportunity, or forum; frequently they lack the security of knowing they will not be punished. Hence information, forum, and legal safeguards -- all three are important to securing accountability.

Most specifically accountability requires having in place

⁴. Frequently in this paper local governments can be considered as part of the discussion, although in general they lag behind the national governments in resources, capacities, and power. Further, the issue of decentralization is closely related to the issues discussed. For an operationally useful guide to decentralization in economic policy reform and sector investment see Jerry Silverman, Public Sector Decentralization, Africa Region, Division Study paper No 1, Nov 1990 (red cover)

financial accounting and auditing, regular reporting on the performance of economic and social activities undertaken by government, including the performance of public enterprises, and ready citizen access to relevant information, (disclosure rules, publication). Further, the process for making decisions should be widely understood. These factors should become the ordinary entitlements of citizens.

Accountability takes, as Sam Paul has reminded us, many forms.⁵ There is parliamentary accountability -- the classic form -- in which civil servants report to ministers who in turn report to parliament and are subject to legislative reviews. There are public account committees, or, in other instances, congressional oversight committees - - where their staffing influences their capacity as much as their legal mandate. (There is also professional accountability where professional norms influence behavior, most notably in medicine, law, engineering.) And there is legal accountability in the right of citizens to sue the state for redress under certain circumstances, and to sue corporations or private sector entities for malfunctioning goods and services. Unfortunately this kind of accountability is not readily affordable by most, and hence is less useful for our purposes.

There is also accountability that comes through the force of public opinion, through the activities of pressure groups, media coverage, nongovernmental organizations, research institutions, and social communications. These institutions and the institutional pluralism that they bring about can bring public official to account for

⁵. See Sam Paul, "Accountability in Public Services, Exit, Voice and Capture" (August, 1990, CECPS)

their choices. Here the relationship with the changed nature of international communication comes to the fore for satellite TV broadcasting is breaking the monopoly of state controlled media in many states. Yet even more locally, the electronic networks among NGOs is empowering those groups to ask questions and bring public scrutiny to bear in many new ways.⁶

The Bank has already made significant contributions to institutional pluralism in its work with NGOs, its more general work on institutional development, and its commitment to expand beneficiary participation. Greater strengthening of accountability may mean moving into previously unoccupied areas. Here the new programs of LAC in strengthening new democracies in Chile and Argentina by strengthening the parliamentary oversight functions in economic policy making are especially noteworthy.

Providing A Predictable Environment for Economic Activity

Historically governments have had authority to establish legal systems and ensure their implementation. Unfortunately, however, too few developing country governments have made substantial progress in this area. Too often judicial systems may even be used for harassment, rather than the encouragement of production. Capricious policy changes are then underscored with arbitrariness in the administration of justice as that system is politicized. That combination creates powerful

⁶. See Sheldon Annis article on Mexico City in Lewis et al, Strengthening the Poor: What Have We Learned? (ODC, 1988)

disincentives for commercial, financial, and economic activities.

This situation has led to the need for more explicit Bank support for the development of secure and enforceable legal frameworks and judicial systems. At minimum there should be more provision for enforceable contracts and protection of property rights. Such a predictable environment is conducive, if not central, to the expansion of entrepreneurial behavior, investment, or other productive enterprises.

Creating a predictable environment is a challenging collection of tasks rooted in the causes of instability. Yet some parts of the task can be done, as countries as widely different as Botswana, Malaysia, and Costa Rica illustrate. Each of these countries have developed an impartial administration of justice characterized by effective legal and court systems and found them instability-inducing, providing the climate needed not only for reduced social tensions, but enhanced opportunities for private sector development.

As the Bank has programs with universities, or more generally is active in capacity building, much more can be done to expand possibilities for predictability. Certain kinds of degree programs -- MBAs, MPAs -- and some kinds of graduate education -- law and journalism -- might be encouraged. Independent research institutions and professional associations could be encouraged -- e.g. regional associations of economists. In policy dialogue with country leaders, opportunities should be developed to point to the role that independent research, consulting, and policy analysis institutions can assume.

GOVERNANCE

President's Council
Monday, Dec. 17
9:30
F/T
Gov.

The World Bank/IFC/MIGA
OFFICE MEMORANDUM

DATE: 15-Dec-1990 09:44pm

TO: Ibrahim Shihata (IBRAHIM SHIHATA)

FROM: Robert Picciotto, CPBVP (ROBERT PICCIOTTO)

EXT.: 30202

SUBJECT: GOVERNANCE

* Your paper is extremely interesting, well documented and clear about the limits of Bank involvement in governance. If I may say so, it is extremely well written. When it is finalized, it should be disseminated widely to staff.

* The conclusions, however, are not surprising. The articles are explicit and must be respected -- not only by the staff but also by the Executive Directors. The last point ought perhaps to be elaborated further.

* Any effort at justifying Bank political involvement in support of multiparty democracy on the grounds that it is a prerequisite of development will have to contend with the counterexample of East Asian authoritarian regimes which managed to rapidly lift their citizens out of poverty. WHILE DEVELOPMENT MAY LEAD TO DEMOCRACY THERE IS REVERSE CAUSAL RELATIONSHIP.

* To be non-political is, however, different from being apolitical, defined by Webster (among other things) as "having no political significance". Whether we like it or not, the Bank has political significance. Indeed, it is the increased influence of the Bank which has made the issue of governance so topical and sensitive.

* In this context, your paper may go too far in espousing a direct Bank role in espousing the "rule of law" especially since the concept is defined explicitly in contrast to the "rule of men" (footnote 96, p.44). IF THE RULE OF LAW IS NOT CONSISTENT WITH DICTATORSHIP (AND A CHANGE IN POLITICAL REGIME IS OUT OF BOUNDS) HOW CAN WE PUSH FOR THE RULE OF LAW ? I would suggest that the linkages you establish between economic development, stability and the rule of law (defined in contradistinction to rule of men) is almost as risky as the loose connection which many Bank staff are trying to make between development and democracy.

* Similarly, PRE's note appears to suggest that increasing information in the conduct of public business, promoting pluralism and participation, helping in the improvement of the administration of justice, etc. are in themselves legitimate areas for Bank involvement. THIS GOES MUCH TOO FAR AS IT COULD

LEAD TO THE BANK PROMOTING A FREE PRESS UNDER ADJUSTMENT LOANS,
FINANCING PRISONS UNDER INVESTMENT PROJECTS OR PROVIDING ADVICE
TO POLITICAL PARTIES AS PART OF ESW. I hope this is not intended.

* Finally, I am delighted that good budgeting is highlighted as important both in your paper and in PRE's note. I have long viewed this aspect as a sorely neglected aspect of our public investment reviews and our capacity building technical assistance. I would like to offer PBD's input in this field as I have been encouraging Bank budget staff to involve themselves on occasion with the application of their professional trade to Bank member countries -- and, on a modest scale, they have begun to do so at the invitation of Country Departments.

CC: Paul Isenman

(PAUL ISENMAN)

The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 16-Dec-1990 12:17pm

TO: Wilfried Thalwitz (WILFRIED P. THALWITZ)

FROM: Paul Isenman, PRDDR (PAUL ISENMAN)

EXT.: 33957

SUBJECT: Geoff is right on the attached. I meant governance, not
participation. It was a slip of the "pen".

CC: Geoffrey B. Lamb (GEOFFREY B. LAMB)

The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 16-Dec-1990 11:13am EST

TO: Paul Isenman

(PAUL ISENMAN)

FROM: Geoffrey B. Lamb, PRDPD

(GEOFFREY B. LAMB)

EXT.: 32544

SUBJECT: More on governance for the PC

Paul --

I note that you said to WT that we're talking about participation to the Staff Assn in January. I presume you meant governance...

CC: Lynette Alemar

(LYNETTE ALEMAR)

The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 15-Dec-1990 06:01pm

TO: Wilfried Thalwitz (WILFRIED P. THALWITZ)

FROM: Paul Isenman, PRDDR (PAUL ISENMAN)

EXT.: 33957

SUBJECT: More on Governance for the PC

Sarwar (task manager) and I saw Ibrahim Shihata's paper in draft and made some comments. In general we have no problems with it. It is certainly wordy, but its conclusions are generally reasonable. There are a couple of problems to raise if no one else does: on p. 53, he condemns as unsuitable for the Bank both pushing democracy (rightly) and pushing participation (wrongly). Our experience in a number of sectors indicates the importance of participation for achievement of project objectives; in fact Moeen recently circulated a paper on this done by David Beckman of EXT). Ibrahim notes at the top of p.53 that we "often provides for populat participation in social projects and rural development programs." It then goes on to language that is much too restrictive, limiting participation to: "cases where the Bank staff reach the firm conclusion that compliance with relevant rules in a given community is not possible without a measure of popular participation".

Similarly, on p. 51 he more or less bars agreements on PEPs/PIPs. The point is that saying we need an agreement on a PIP before we support it (particularly with fully fungible adjustment assistance) does not mean that we "substitute for the constitutionally responsible government in setting the budgetary priorities." (he then goes on to provide a too-small loophole, noting on p. 52 "agreement..in...adjustment loans. on...government expenditures in certain fields".

I suppose that the loopholes he provides are enough from a legalistic point of view, but they would send precisely the wrong message to staff.

Our work is essentially complementary to his paper, as spelled out in the two page note attached to it. By the way, as a part of the follow-up with the Staff Association on the results of the attitude survey, Alex and I met them to discuss two-way communication on institutional priorities, etc. One result is that we will have open meetings from time to time on issues of widespread interest. The first of these will be on participation, sometime in January.

CC: Geoffrey B. Lamb
CC: Johannes Linn

(GEOFFREY B. LAMB)
(JOHANNES LINN)

CC: Sarwar Lateef

(SARWAR LATEEF)

The World Bank/IFC/MIGA
OFFICE MEMORANDUM

DATE: 16-Dec-1990 05:01pm

TO: Wilfried Thalwitz

(WILFRIED P. THALWITZ)

FROM: Johannes Linn, CECDR

(JOHANNES LINN)

EXT.: 37458

SUBJECT: LEG's paper on governance

You may find Mary Shirley's comments on the above paper of interest.

The main question I would raise at the PC tomorrow is how narrowly some of the guidelines are to be interpreted in practice. If interpreted literally, it would get us pretty much out of the role of assisting government in setting policy and public expenditure priorities and attaching conditionality to our lending relating to such priorities. I cannot believe that Mr. Shihata had this in mind. Perhaps the test of economic rationale which is emphasized throughout the paper (but not in the section dealing with public expenditure priorities, pp. 51-2) should be properly emphasized here.

CC: Paul Isenman

(PAUL ISENMAN)

CC: Mary Shirley

(MARY SHIRLEY)

CC: Penny Chokechaitanasin

(PENNY CHOKECHAITANASIN)

The World Bank/IFC/MIGA
OFFICE MEMORANDUM

DATE: 26-Nov-1990 03:27pm EST

TO: See Distribution Below

FROM: Mary Shirley, CECPS

(MARY SHIRLEY)

EXT.: 37483

SUBJECT: RE: LEG's paper on Governance

I have read Leg's paper and found it a very clever piece indeed. It shows, in my opinion justifiable, concern about the Bank going too far and becoming vulnerable to accusations of playing partisan politics. It tries to define rather narrowly what governance activities the Bank can get involved in under the present articles of agreement.

In summary it calls for the Bank to avoid the partisan politics side of governance or issues of human rights except where we can show that these factors will have a major impact on the country's credit worthiness, its ability to carry out its obligations under Bank projects or the Bank's ability to supervise. The staff must prove major economic effects; minor effects are not enough. These economic effects must be direct and obvious and the staff must establish the case for them in "a clear and un-controversial manner."

The paper goes on to argue that it is within the Bank's mandate to change processes of adoption and application of rules but not the substance of the rules themselves. For example, we can work to improve budget procedures but not to change budget priorities; the latter is government's responsibility. (The implication is that it is government which is responsible to the people, not the Bank, and we should not impose ourselves between the lines of responsibility -- even where the government is not in fact strictly accountable. So if the government puts a high priority on building an army or a church instead of schools we should not try to impose new priorities.) As this example shows, if strictly applied the paper would exclude the Bank from doing things it is already doing, such as changing government's budget priorities.

Of course reasonable people will disagree about what these guidelines mean in practice. Can we really impose anything on a government? Is refusing to lend to a government with a "bad" set of budgetary priorities imposing our will? But I think the interesting point of the paper is the stress on the economic test. Not only would such a test protect us from becoming politicized or pushing an ideology, it will help us make the case to governments about why poor governance is bad in terms that officials may be more willing to listen to than purely moral

arguments.

Yet here too there are many ways to interpret the paper's strictures. What constitutes a major -- versus a minor -- economic effect? If a government excludes minorities from purchasing its state owned enterprises and uses this as an excuse for not selling them, is this a major effect? Would we be justified in arguing for equal treatment for minorities in order to reduce the budget deficit? How large would the deficit have to be to justify an intervention? The paper offers no answers to such questions. The work that Sarwar Lateef is doing will have to begin to help staff draw the line between governance issues the Bank can deal with and those it cannot. This paper, which aims toward a very narrow field of acceptable activity, in fact leaves a lot to interpretation.

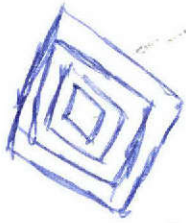
(By the way I have been meeting with Sarwar and giving comments on his draft issues paper.)

DISTRIBUTION:

TO: Johannes Linn	(JOHANNES LINN)
CC: Andrew Steer	(ANDREW STEER)
CC: Paul Isenman	(PAUL ISENMAN)
CC: Vittorio Corbo	(VITTORIO CORBO)
CC: Phi Anh Plesch	(PHI ANH PLESCH)
CC: Penny Chokechaitanasin	(PENNY CHOKECHAITANASIN)

17/17 - P <

Governance:



Nothing different. Everything different.

→ Budget discipline
Donor coord

→ Participation: econ rights
disenfranchised.

Tim - Board wants it.

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Ibrahim:

is question of judgment
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Ernie =

Very good

Ibr:

Combine with PRE paper.

Up to Board to reach conclusion.

Leg Opinion + Policy

→ Issues paper March.

→ Very good. Excell. collab. { more:
Legal opinion plus other.

~~Good paper~~

Partly legal, partly not. Go with our
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? Want for our paper.

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The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 14-Dec-1990 03:12pm

TO: Wilfried Thalwitz
TO: Paul Isenman

(WILFRIED P. THALWITZ)
(PAUL ISENMAN)

FROM: Geoffrey B. Lamb, PRDPD

(GEOFFREY B. LAMB)

EXT.: 32544

SUBJECT: Governance PC meeting

1. At Monday's PC meeting on governance, it's likely that the President will raise the issue of when the Shihata paper shd be sent to the Board -- very soon, only as part of a package with the PRE-led discussion paper (i.e. around May), or delayed for a bit so that it can be modified if necessary in the light of our issues paper (due for PC delivery mid-February). My inclination, and I think that of EXC, is the last option.

2. Mr. Conable may also stress the need for a very consultative process for doing the governance Board paper, and ask how we propose to accomplish this. He may also ask how we will ensure an input from Operations management. The answers might be as follows:

(a) the working group is a cross-complex one, with strong representation from Operations (as well as Legal). We've also been conferring especially closely with the key governance people in the Africa Region, who've made most of the running on this. (Paul or I can chip in with further detail if necessary).

(b) as output begins, we (Paul) will convene a Steering Group of Directors to guide the task.

(c) guidance from senior Regional mgt on issues particular to thbeir Regions will be very welcome.

CC: Coralie Bryant
CC: Lynette Alemar

(CORALIE BRYANT)
(LYNETTE ALEMAR)

→ Pap. partic. vs. democ 53
→ Budget - PEPs - p 51
Gov't & priv not own

RECEIVED

90 DEC 13 PM 6:22

P R D D R

PRESIDENT'S COUNCIL MEETING

MONDAY, DECEMBER 17, 1990

9:30 a.m.

REVISED AGENDA

- * 1. Issues of "Governance" in Borrowing Members -
The Extent of Their Relevance Under the
Bank's Articles of Agreement
(Memorandum from Mr. Shihata dated November 30, 1990)
- * Note from PRE: Work in Progress on Governance

- * 2. Draft Letter to Staff from Mr. Conable: Follow-up to
the Attitude Survey
(Note from Mr. Alisbah dated December 12, 1990)

- * 3. Recruitment of Japanese Staff
(Memo from Mr. Alisbah dated December 10, 1990)

- ** 4. Oral Update by Mr. Conable on Joint Study on the
Soviet Economy (JSSE)

-
- * Document already distributed
 - ** No document

12/13/90

**ISSUES OF "GOVERNANCE" IN BORROWING MEMBERS -
THE EXTENT OF THEIR RELEVANCE UNDER THE BANK'S ARTICLES OF AGREEMENT**

**Memorandum of the
Vice President and General Counsel**

November 30, 1990

ISSUES OF "GOVERNANCE" IN BORROWING MEMBERS -
THE EXTENT OF THEIR RELEVANCE UNDER THE BANK'S ARTICLES OF AGREEMENT

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IN DEVELOPMENT FORA

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2. The Agreement Establishing the EBRD
3. Gradual Expansion in the Scope of World Bank
Adjustment Lending

III. EXCLUSION OF POLITICAL CONSIDERATIONS IN THE BANK'S ARTICLES -
ITS MEANING AND SCOPE IN THE CONTEXT OF THE INSTITUTIONS'S
EVOLUTION

1. The Bank's Authorized Purposes
2. Prohibition of Political Activities
3. Political Considerations of Possible Relevance Due to Their
Direct Economic Effect or to Binding International Obligations

IV. BANK'S MANDATE IN RELATION TO ASPECTS OF GOVERNANCE
IN ITS BORROWING MEMBERS

1. Defining the Issue
2. Aspects of Governance Beyond the Bank's Mandate
3. Aspects of Governance Consistent with the Bank's Mandate
 - Examples
 - Borderline Cases

V. CONCLUSION

"If these institutions are to win the full confidence of the suspicious world, it must not only be, but appear, that their approach to every problem is absolutely objective and oecumenical, without prejudice or favour. [If the malice of the bad fairy Carabosse were to prevail, her curses will run as follows]: you two brats shall grow up politicians; your every thought and act shall have an arrière-pensée; everything you determine shall not be for its own sake or on its own merit but because of something else".

Speech of Lord Keynes before the Inaugural Meeting of the Boards of Governors of the Fund and the Bank, 1946.

"Noneconomic considerations, particularly of a powerful moral character, may make decisions on some occasions appear, to some or even many members, to be applications of the maxim *dura lex sed lex* (hard law, but law). If some application of the law of the Fund is too hard to be acceptable to the membership, procedures for amendment exist under the Articles."

"... The swimmer who goes out too far may seem to be waving but is drowning. The Fund that swims out too far, even in a moral cause, will risk drowning. It will have lost the full confidence of its members. It will be less able to promote universal prosperity. That task is the Fund's moral cause."

Sir Joseph Gold, IMF Survey 146, 148 (May, 1983)

"There is a limit to 'institutional elasticity', i.e. the extent to which institutions created and still used for other purposes can be 'stretched' in order to get them to perform human rights functions, especially when those functions are accomplished at the expense of their manifest functions".

Professor Michael Riesman, "Through or Despite Governments: Differentiated Responsibilities in Human Rights Programs", 72 Iowa Law Rev. 391, 395 (1987).

ISSUES OF "GOVERNANCE" IN BORROWING MEMBERS -
THE EXTENT OF THEIR RELEVANCE UNDER THE BANK'S ARTICLES OF AGREEMENT

I. INTRODUCTION

Political stability and sound economic management have long been recognized, in the literature of the World Bank¹ and elsewhere, as basic prerequisites for economic development. However, the Bank has traditionally deemed political considerations to be generally irrelevant to its operations in deference to explicit provisions in its Articles of Agreement which prohibit it from taking such considerations into account in its decisions. Some departure from this tradition may be evolving. Reference to such considerations as being relevant to the Bank's business first appeared most explicitly in a major study on Sub-Saharan Africa which identified "governance" as a basic issue in the development strategy for this region.² This approach may have later been strengthened by provisions in the recently concluded Agreement Establishing the European Bank for Reconstruction and Development (EBRD)³ limiting the operations

¹The term "World Bank" or "Bank" is used here to mean both the IBRD and IDA, unless the context suggests otherwise. Examples of early recognition of such factors are referred to later on in this paper.

²World Bank, Sub-Saharan Africa - From Crisis to Sustainable Growth. A Long Term Perspective Study (first published in November 1989). Some of the "governance" issues mentioned in the study were addressed earlier in an implicit manner in the Bank's work on institutional development and public sector management.

³For a detailed comparative study of this Agreement and the full text of the EBRD basic documents, see Shihata, The European Bank for Reconstruction and Development (1990).

of this new institution to some of its members which meet certain criteria that may readily be characterized as political in nature. Most importantly, the Bank's increasing concern with issues of governance in its borrowing members seems to have come as a logical last step in its gradually expanding involvement in policy reform through adjustment lending, which has been extended to social sectors.

Regardless of its motivations and causes, the above concern has already evoked considerable interest, and controversy, among Bank staff, with some concluding that the "time has come for the Bank to take on the issue of governance head-on" and others cautioning that "the strength and credibility of the Bank lies in its apolitical status as a quintessential technocracy, one whose exclusive concern is with economic efficiency." Some Executive Directors and members of the Bank's Senior Management are also referring now to the issue of governance with different degrees of emphasis or concern. It therefore seems important before the debate goes further to try to establish the legal framework for the Bank's dealing with this issue, as a necessary prelude to any future analysis of the manner in which the Bank may take it on operationally. The Bank can only act legally if it does so within its mandate, as defined in its Articles of Agreement, much as it can only act physically within its resources and capabilities.

While the resource limitations are outside the scope of this paper, its purpose is to establish a legally sound framework for treating the issue of governance in the Bank's work. In doing so, it should clarify the appropriate legal limits for the Bank addressing this issue under its Articles of Agreement

as they stand at present. It would be a grave contradiction if the Bank were to allow itself to interfere in issues of governance of its members beyond what is legally consistent with its mandate as defined by the rules which govern its own activities.

II. RECENT EMERGENCE OF GOVERNANCE ISSUES IN DEVELOPMENT FORA

The present concern with governance issues seems to have resulted from basic developments in several regions in which the Bank operates, especially in Sub-Saharan Africa and Eastern Europe. It is a concern which, apparently, has been evolving in any event through the Bank's expanding adjustment lending and its research (economic and sector) work.

1. Bank Studies on African Development - The Sub-Saharan Africa Long Term Perspective Study of 1989

A year ago, the Bank published a landmark study on the development of Sub-Saharan Africa.⁴ This study was preceded by earlier Bank reports including Accelerated Development in Sub-Saharan Africa (1981), Toward Sustained Development in Sub-Saharan Africa (1984) and more specific reports on administrative reform in some African countries. These earlier reports emphasized the need for institutional development and public sector reform and attributed Africa's economic problems mainly to economic management factors. The 1989 study, following the same theme, provided, however, a more comprehensive treatment of development issues in Sub-Saharan Africa and spelled out for the

⁴See supra note 2.

first time the question of governance as a central issue to be addressed and corrected.

Quoting Senegal's President Diouf's dictum that "Africa requires not just less government but better government"⁵ and noting that "many governments are wracked by corruption and are increasingly unable to command the confidence of the population at large,"⁶ the 1989 study proposed a strategic agenda for Africa in the 1990s. It predicted, however, that "none of [this strategy's] measures will go far, nor will much external aid be forthcoming, unless governance in Africa improves."⁷ The study emphasized as relevant aspects in this improvement process the accountability of leaders to their peoples, the transparency of transactions, the proper administration of public funds and the overhauling of procurement procedures.⁸ It called for respect of due process,⁹ cautioned against the proliferation of administrative regulations,¹⁰ and emphasized the importance of reforming the civil service.¹¹ The study further explained that a "simple and transparent legal framework properly enforced is indispensable for the long term success of an enterprise"¹² and pointed out the importance of

⁵Id. at 55.

⁶Id. at 3.

⁷Id. at 15.

⁸Id.

⁹Id. at 22.

¹⁰Id.

¹¹Id. at 55-57.

¹²Id. at 143.

establishing the rule of law, rehabilitating the judicial system, ensuring "independence for the judiciary, scrupulous respect for the law and human rights at every level of government, transparent accountability of public monies, and independent public auditors responsible to a representative legislature, not to an executive."¹³ In all, the study emphasized that a crisis of governance underlies the litany of Africa's development problems and defined governance in this context as "the exercise of political power to manage a nation's affairs."¹⁴ It concluded from this that systematic efforts were required "to build a pluralistic institutional structure, a determination to respect the rule of law, and vigorous protection of the freedom of the press and human rights."¹⁵

It should be noted that this study, which is quoted here in some detail because of its importance in the evolution of the issue of governance in the Bank, explicitly referred to a popularly felt need for a "political renewal" in Africa.¹⁶ It addressed the continent's well known ills and suggested appropriate solutions for consideration by all concerned parties and not merely specific measures for the Bank to adopt in its operations. In his introduction to the study, the Bank's President for his part highlighted in general terms the importance of "good governance", defining it more narrowly in terms of "a public service that is efficient, a judicial system that is reliable and an

¹³Id. at 192.

¹⁴Id. at 60.

¹⁵Id. at 61.

¹⁶Id. at 192.

administration that is accountable to its public."¹⁷ He also made clear that this was "a study by the staff of the World Bank" and that "the judgments in it do not necessarily reflect the views of the Board of Directors or the governments they represent."¹⁸

2. The Agreement Establishing the EBRD

On May 29, 1990, forty countries, including all the 12 EC countries, 11 other "European countries", 9 non-European countries (including Japan and the U.S.) and 8 Central and East European countries (including the Soviet Union) as well as the EEC itself and the European Investment Bank, signed the Agreement Establishing the European Bank for Reconstruction and Development. This important event took place in the context of the historic political and economic changes which Central and Eastern European countries were undergoing; indeed the establishment of the EBRD is intrinsically connected with the political and economic restructuring of Central and Eastern Europe. Thus, the political motivation behind the creation of EBRD and its political goals are explicitly expressed throughout its charter.¹⁹ The preamble of the EBRD Agreement captures this political orientation by emphasizing "the fundamental principles of multiparty democracy, the rule of law, respect for human rights and market economics."

¹⁷ Id. at xii.

¹⁸ Id.

¹⁹ See particularly, Article 1 (Purpose), Article 2 (Functions) and Article 8 (Recipient Countries and Use of Resources).

The EBRD Agreement itself leaves no doubt as to its specific mandate in support of the transformation of the economic system of countries which show commitment to certain specified political principles.²⁰ While economic progress and reconstruction may be an objective to which the EBRD will ultimately contribute, the purpose for which the EBRD was established is to assist Central and Eastern European countries to evolve from their one-party political systems of command economies to a system based on free market economics and multiparty democracy, and to support private sector development required for this transition.²¹ As a consequence of this purpose, the pursuit of structural and sectoral reform, including demonopolization and privatization, is mentioned as a function of the EBRD to be pursued in all its activities, rather than as an authorized form of its lending.²²

As elaborated below, the IBRD was created for a different purpose: to assist its members in the transition from a wartime to a peacetime economy, and in the reconstruction and development of their territories. Because of the EBRD's specific mandate as an instrument in the economic and political transformation of Central and Eastern Europe, its charter, unlike those of the IBRD and the IDA, does not include a specific provision prohibiting it from engaging in political activities or from being influenced by the political character of its members in its decision-making.

²⁰See Shihata, supra, note 3, at 3.

²¹See Article 1 of the EBRD Agreement.

²²See Article 2, Paragraph 1 of the EBRD Agreement, and the comment on Article 13(ii) in the Chairman's Report on the Agreement, published in Shihata, supra note 3 at 170-171.

3. Gradual Expansion in the Scope of World Bank Adjustment Lending.

The Bank introduced structural adjustment lending in 1980 in response to the acute balance of payments crises in many of its borrowing member countries in the late 1970s. The aim of the early operations was structural adjustment addressing the countries' macroeconomic policies. Gradually, adjustment lending expanded and deepened through sector adjustment operations.²³ In the last few years, sector adjustment operations have become the dominant adjustment lending instrument focusing on sectoral investment programs, policies and institutions as a "key determinant of supply response".²⁴ Throughout the 1980s, adjustment lending commitments represented some 18 percent of total IBRD lending and 12 percent of IDA lending.²⁵

This evolution of Bank lending has come as a response to the lessons learned from the Bank's experience. It reflected the Bank's conviction that the policy environment is as important, if not more so, as the physical and institutional framework in inducing growth and development. Recognizing that early adjustment loans were often too optimistic about the implementation capacity of governments and their commitment to reform,²⁶ the Bank has directed its attention to measures that enhance government implementation capabilities

²³ See, Interim Report on Adjustment Lending para.35 (R88-15) [Interim Report].

²⁴ Id. at para. 119.

²⁵ Report on Adjustment Lending II: Policies for the Recovery of Growth, Annex 5.2, table 5.3 (R90-51, March 26, 1990) [RAL II] (published as Adjustment Lending Policies for Sustainable Growth 70, Policy and Research Series 14). In terms of net disbursement during the decade, adjustment lending has accounted for 33% of total IBRD disbursement and 12% of IDA's. Id.

²⁶ Interim Report, supra note 23, at para. 55.

and to what the Report on Adjustment Lending II (RAL II) called the "political economy of adjustment".²⁷

To ensure the borrowing countries' implementation capacity, conditionality has concentrated on institutional changes in macro-economic and financial management, sectoral restructuring and policy reforms, enhancement of public sector efficiency and constraints in public sector management.²⁸

Specifically, the conditionality for institutional reform has in some cases touched upon the overall organization of civil service, the size of public administration and the size and structure of the public sector. Loan agreements have been reached between the Bank and governments whereby disbursements of the loan would be made only if the government took action to reduce the number of civil servants, restructure ministries, and liquidate public enterprises or restructure them or offer them for sale. In many instances, the measures required extensive legislative changes, particularly in the areas of labor regulation, investment, taxation and generally in what has become known as the "enabling business environment."

In the pursuit of unleashing the forces of growth, reducing obstacles to investment and making government more efficient, conditionality has thus evolved from macro-economic measures to detailed reforms affecting the public administration itself. Typically, the progression seems to have aimed towards

²⁷RAL II, paras. 4.61-4.76.

²⁸Interim Report, supra note 23 at paras. 63-72

reducing the size of government in productive sectors and its control over the economy.

The RAL II Report, while stating that the Bank must vigorously avoid interfering in politics, considered that the cost of failure was too great for the borrowing countries and the Bank "to ignore the potential contribution of a better understanding of the reality of political economy of adjustment".²⁹ Such an understanding has prompted the Bank, according to the Report, to design programs that are credible because experience shows that "when credibility is low, a structural adjustment program may entail larger than anticipated social and economic costs since the investment response will be insufficient to restore growth".³⁰ The Report further emphasized the need to be aware of the importance of the timing of reform measures, not only in terms of their political and economic viability,³¹ but also in terms of their design and presentation.³² Furthermore, the Report suggested that, in developing a program, it was important to identify the groups that benefit from adjustment and those adversely affected by it; compensation measures could thus be appropriately targeted and could contribute to the political viability and economic efficiency of the program.³³

²⁹RAL II, at para. 4.61.

³⁰Id. at para. 6.22.

³¹Id. at para. 4.64.

³²Id., at para. 4.75.

³³Id. at paras. 4.67-4.68.

Increased awareness of the importance of the political context of structural reforms to ensure their success, has led some outside commentators on adjustment lending in Sub-Saharan Africa to argue that aid agencies may have established an "informal governance" for Africa.³⁴

It may be recalled in this context, as explained in detail in the legal memorandum on "Authorized Purposes of Loans Made or Guaranteed by the Bank" issued in 1988, that structural adjustment lending is legally based on the "special circumstances" exception provided for in Article III, Section 4(vii) of the Bank's Articles of Agreement.³⁵ In that memorandum, adjustment operations were described as operations which "assist a country in its attempt to create the conditions and incentives needed for the investment of capital for productive purposes by helping it in this context to reduce a serious deterioration in its balance of payments or by meeting financial needs resulting from or associated with the reform process".³⁶ In this context, such operations would readily serve the Bank's purposes and fall within its mandate. As the memorandum explained, "a loan made or guaranteed by the Bank cannot [in a defensible legal sense] be

³⁴In a recent seminar on "Beyond Autocracy in Africa", working papers were presented under the heading "The Informal Governance of Africa by Aid Agencies". One of the papers described aid agencies as "now part of the structure of governance" and another concluded by saying that "structural adjustment as a political and policy-formulating process raises the most profound issues about governance in Africa and whose real responsibility it has become". See The Carter Center of Emory University, *Beyond Autocracy in Africa, Working Papers for the Inaugural Seminar of the Governance in Africa Program*, 115, 124 (February 17-18, 1989).

³⁵See Legal Memorandum of the General Counsel, SecM88-517, May 10, 1988.

³⁶Id. at para. 18.

described simply as a payment to induce the recipient government to do what the Bank believes to be in its best interest or as a 'price' for policy reforms".³⁷

The same reasoning has been applied to sectoral adjustment operations through which the Bank finances general imports. If quick disbursement was required to meet the objective of a loan more efficiently, the "negative list" approach was deemed defensible provided that there was a serious gap in the country's balance of payments that needed to be reduced or an established cost for the adjustment that needed to be financed, so that the government may be able in either case to proceed with the proposed policy reforms.³⁸

While none of the above suggests that the Bank has a mandate to introduce political reform or to question the political form of the governments it purports to assist, perceptions, coupled at times with vague statements, within and outside the Bank, have tended to give the impression that all issues of governance in borrowing countries may have become part and parcel of the Bank's concern, if not its direct business.

³⁷Id. at para. 17.

³⁸Id. at para. 20.

III. EXCLUSION OF POLITICAL CONSIDERATIONS IN THE BANK'S ARTICLES - ITS
MEANING AND SCOPE IN THE CONTEXT OF THE INSTITUTIONS'S EVOLUTION

1. The Bank's Authorized Purposes

The purposes of the Bank are listed in the first Article of its charter.³⁹

According to Article I of the IBRD's Articles of Agreement, these purposes are:

- "(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.
- (ii) To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
- (iii) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories.
- (iv) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

³⁹While the purposes of the Bank are exhaustively stated, the functions which allow the Bank to serve such purposes may be expanded as deemed necessary or desirable. Such expansion has been authorized in the Bank practice under the Bank's "implied powers." This is explicitly recognized in the Articles of IDA (Article V, Section 5(vi)) and other Bank affiliates.

- (v) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

The Bank shall be guided in all its decisions by the purposes set forth above."

Article I of IDA's Articles of Agreement reads:

"The purposes of the Association are to promote economic development, increase productivity and thus raise standards of living in the less-developed areas of the world included within the Association's membership, in particular by providing finance to meet their important developmental requirements on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans, thereby furthering the developmental objectives of the International Bank for Reconstruction and Development (hereinafter called "the Bank") and supplementing its activities.

The Association shall be guided in all its decisions by the provisions of this Article."

In reading the above provisions, it is important to note the following points:

- i) The mandates of both institutions, though drafted in general terms, are limited ones; they do not envisage supra-national organizations with powers exceeding their defined purposes. In the case of the IBRD, the mandate is basically concerned with matters of investment needed for the reconstruction and development of members' territories. It establishes a role for the Bank in facilitating capital investment for productive purposes and in encouraging the development of productive facilities and resources. It envisages that such development will assist in raising productivity, the standard of living and conditions of labor. It also gives the Bank a role in promoting private foreign investment through its financing. And it envisages its encouragement of international investment as an instrument in the promotion of the growth of

international trade and the maintenance of equilibrium in balances of payments. Furthermore, the Bank's mandate, always emphasizing finance for productive purposes, mentions specifically restoration of war affected economies and development in less-developed member countries. In the case of IDA, the mandate is also limited to the promotion of economic development and the increase of productivity in the less-developed members, particularly through concessional finance, with a view to raising standards of living. These mandates have been broadly understood throughout the Bank's history in a manner which has enabled it to finance, in addition to typical investment projects, technical assistance, human resource development and various other activities directly related to economic development. Their interpretation in the 1980s as enabling the Bank to assist members in dealing with their balance of payments problems in the context of the implementation of agreed economic and social reforms represents, as explained above, the greatest expansion hitherto introduced in the Bank's practice.

ii) The above-quoted provisions of the IBRD and IDA charters specifically mention that each of these institutions "shall be guided in all its decisions" by the purposes specified in the first Article of its charter. Identical language in the IMF Articles has been authoritatively read as forbidding the Fund from taking political considerations into account⁴⁰ (which, in the case of the Bank, is explicitly mentioned elsewhere in the Articles).

⁴⁰ See Gold, Political Considerations Are Prohibited by Articles of Agreement When The Fund Considers Requests for Use of Resources, IMF Survey 146 (1983).

iii) In both the IBRD and the IDA, other provisions in their respective Articles require them to provide their financing for "specific projects", except in "special circumstances".⁴¹ This requirement further explains the financial character of the institutions and the particular need to insulate them from broader political considerations which should be irrelevant to the financing of specific projects. However, other forms of financing are authorized in special circumstances, and the explicit provisions of the Articles of each institution exclude political considerations from all their decisions. In the case of the IMF, which does not finance specific projects and has a broad mandate related to the members' monetary and exchange policies, Article IV, Section 3(b) of the Fund's Articles, which deals with surveillance over exchange rate arrangements and requires the Fund to adopt specific principles for the guidance of all members, specifies that "[t]hese principles shall respect the domestic social and political policies of members".⁴²

2. Prohibition of Political Activities

The Articles of Agreement of both the IBRD and the IDA include three, almost identical provisions meant to insulate these institutions from political

⁴¹For the definition of these terms and their application in practice see the legal memoranda: Project and Non-Project Financing under the IBRD Articles, SecM84-1053, December 21, 1984.; Authorized Purposes of Loans Made or Guaranteed by the Bank, SecM88-517, May 10, 1988.

⁴²As referred to supra note 40, Sir Joseph Gold, the noted former General Counsel of the Fund, wrote that in view of the provisions of the Article dealing with the Fund's purposes, political considerations are prohibited when the Fund considers requests for use of its resources and not only when it adopts the principles guiding members with respect to the Fund policies regarding surveillance over the exchange rate policies. See also, J. Gold, Legal and Institutional Aspects of the International Monetary System, Selected Essays, Legal Structure of the Par Value System 537 et seq. (1979).

intervention by their members and to prohibit them from taking non-economic considerations into account. These are, respectively and in the order they appear in the Articles, Article III, Section 5(b); Article IV, Section 10; and Article V, Section 5(c) of the IBRD Articles and Article V, Section 1(g); Article V, Section 6; and Article VI, Section 5(c) of the IDA Articles. These provisions read as follows:

- "The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations." (Article III, Section 5(b), IBRD)
- "The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I." (Article IV, Section 10, IBRD)
- "The President, officers and staff of the Bank, in the discharge of their offices, owe their duty entirely to the Bank and to no other authority. Each member of the Bank shall respect the international character of this duty and shall refrain from all attempts to influence any of them in the discharge of their duties." (Article V, Section 5(c), IBRD)

The above-cited provisions are particularly instructive in the following respects:

- i) They intentionally cover all decisions by the institutions involved. The draft of Article IV, Section 10, of the IBRD Articles, submitted to the Bretton Woods Conference, as originally prepared by the U.S. Treasury, limited the prohibition related to the political character of the members to "decisions with respect

to applications for loans".⁴³ This language was changed in the Drafting Committee of the Bretton Woods Conference to refer to decisions generally. The report of the Committee explained this change by the fact that "the Paragraph as it stood selected for special attention one of the several purposes set forth in Article I," a selection which was found to be unjustified.⁴⁴

ii) The quoted provisions impose six separate but inter-related requirements:

(a) Arrangements must be made by the Bank to ensure that the proceeds of any loan made, participated in or guaranteed by it, will be used "with due attention to considerations of economy and efficiency" and "without regard to political or other non-economic influences or considerations." Indeed, the conditions mentioned in the Articles for making or guaranteeing loans by the IBRD (Article III, Section 4) and IDA (Article V, Section 1) are all of a financial or technical character and are non-political in nature.

⁴³ Initially, the language was limited in the draft prepared by Harry D. White of the U.S. Treasury dated April 1943 (Part IV, 13) (unpublished) to "decisions to grant or withhold loans"; it was then changed to "decisions with respect to applications for loans" in the later U.S. draft of September 16, 1943, the U.K. draft of June 25, 1944, the combined U.S./U.K. draft of June 30, 1944 and the draft distributed at the Bretton Woods Conference as Doc. 169 SA/2 of July 6, 1944. See, Prohibition of Political Activities Under the IBRD Articles of Agreement and its Relevance to the Work of the Executive Directors. Legal Memorandum of the Vice President and General Counsel, SecM87-1409, December 23, 1987.

⁴⁴ 1 Proceedings of the Bretton Woods Conference 567, 569-570 (1948).

(b) The Bank, including all its organs,⁴⁵ and especially its officers (meaning its more senior staff)⁴⁶ are forbidden from interfering in the "political affairs" of members.

(c) The Bank and especially its officers are equally forbidden from being influenced in their decisions by "the political character" of the member or members concerned. This means that, under the Articles, the political character of the member is irrelevant for the purposes of the decisions of the institution.

(d) The only considerations which, under the Articles, are relevant to the decisions of the Bank and its officers are those which qualify as "economic considerations." Such considerations must be weighed impartially. This latter requirement is particularly important to ensure the uniform treatment of members in similar economic circumstances and is derived from the principle of equality of states, enshrined in the U.N. Charter (Article 2 (1)) and high in the minds of the original drafters of the Articles who envisaged universal membership in the institution.⁴⁷

(e) The President and the staff of the Bank owe their

⁴⁵ See for details the legal memorandum referred to in note 43 above.

⁴⁶ Id. at 2.

⁴⁷ Accord, Gold, supra note 40, at 147.

duty only to the Bank. Clearly, this requirement does not apply to the Governors and Executive Directors who, while required to act for the benefit of the institution and its members as a whole,⁴⁸ are also appointed or elected by members and may be expected to express the views of such members.⁴⁹

(f) Finally, each member of the Bank is required to respect the international character of the duty of the President and the staff by refraining from all attempts to influence them to act under non-economic considerations or to weigh economic considerations in other than an impartial manner.

The above six requirements raise difficult questions as to (i) what is meant by "political affairs", "political character" and "economic considerations" in the context of the Articles' provisions, (ii) the extent to which these provisions should be read as assuming that economic and political considerations are invariably isolated from each other and (iii) whether it is realistic to assume that inter-governmental agencies such as the IBRD and the IDA could in fact insulate their decisions from political considerations.

⁴⁸ See the legal memorandum cited supra note 43, at 2-3 and Gold, supra note 42, at 241-243 and 276.

⁴⁹ Id.

First: Meaning of the Terms "Political" and "Economic" in the Context of the Bank's Articles:

The Bank's Executive Directors have the power to decide on any question of interpretation of the provisions of the Articles of Agreement subject to possible review by the Board of Governors at the request of any member (Article IX, IBRD; Article X, IDA). In their discharge of this function, the Executive Directors take into account the legal analysis provided by the General Counsel as well as other relevant considerations.

The legal interpretation of treaty provisions such as the Bank's Articles is subject to general rules of international law developed through centuries of state practice, judicial precedents and scholarly works. Such "customary rules" have been codified in two articles of the 1969 Vienna Convention on the Law of Treaties.⁵⁰ The general rule in this respect is that a treaty should be interpreted "in good faith in accordance with the ordinary meaning" to be given to its terms, not in the abstract, but "in their context" and in the light of the "object and purpose" of the treaty.⁵¹ The "context" should, for this purpose, comprise the text "including its preamble and annexes", any agreement made between all the parties in connection with the conclusion of the treaty,

⁵⁰Articles 31 and 32 of the Convention on the Law of Treaties of May 23, 1969, entered into force on January 27, 1980, 1155 U.N.T.S. 331 (1980) [the Vienna Convention]. Documents of the U.N. Conference on the Law of Treaties, Vienna, March 26 - May 24, 1968 and April 9 - May 22, 1969, Official Records, Documents of the Conference, U.N. Document A/conf. 39/11/Add.2, p. 293. A third Article, Article 33, deals with interpretation of treaties authenticated in two or more languages and is not relevant here.

⁵¹Article 31(1) of the Vienna Convention. See also Commentary of the International Law Commission (ILC) on draft Article 27 (which became Article 31), 1966 ILC Yearbook 40-41, para. 12.

and any "instrument" made by one or more parties and accepted by the other parties as related to the treaty. Subsequent agreements between the parties regarding the interpretation or application of the treaty and subsequent practice in the application of the treaty which establishes the agreement of parties regarding its interpretation, as well as any relevant rules of international law applicable in the relations between the parties should also be taken into account. A "special meaning," rather than the "ordinary meaning" should, however, be given to a term "if it is established that the parties so intended".⁵² Recourse to "supplementary means of interpretation" such as the preparatory work of the treaty and the circumstances of its conclusion, is not to be done as "an investigation ab initio into the intentions of the parties,"⁵³ but may be made in order to "confirm the meaning" resulting from application of the above-mentioned rules or to "determine the meaning" when the interpretation according to such rules "(a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable".⁵⁴ The interpretation doctrine codified in the Vienna Convention is, thus, both "objective" and "purposive". It relies on the language of the text as written, but tries also to serve the text's objective. Such interpretation may however be complemented, if the need arises, by looking at the intention of the parties as well as at the parties' subsequent practice.

⁵²Article 31 (4) of the Vienna Convention.

⁵³ILC Commentary on Article 28 (which became Article 32), supra note 51, at 42, para. 18.

⁵⁴Article 32 of the Vienna Convention.

Both "economy" and "politics" are words of Greek origin. Initially, they had clearly distinct meanings, "economy" being a reference to the management of the household and "politics" a reference to the matters of city, state, government and public policies.⁵⁵ This distinction has lost its original clarity, at least in part, with the extension of the term "economy" to the state and the subsequent emergence of the term "political economy". Notwithstanding its occasional use in recent Bank documents in a sense which emphasizes the influence of politics on economic decision-making, "political economy" has been otherwise understood to mean generally "the art or practical science of managing the resources of a nation so as to increase its material prosperity",⁵⁶ and ordinarily means in more recent use, "the theoretical science dealing with the law that regulates the production and distribution of wealth."⁵⁷ "Economy" in this latter sense is "political" only in the dictionary sense of "belonging to the state or body of citizens; its government and policy."⁵⁸ The term

⁵⁵ For the meanings of each of these terms and their evolution, see, The Compact Edition of the Oxford English Dictionary, Vol I at 831 and Vol II at 2228. "Economy" is derived from two Greek words which mean "house" and "management" and has been used in English to mean "management of a house", "management generally", "the art or science of managing a household", "the manner in which a household or a person's private expenditure is ordered", as well as "the rules which control a person's mode of living; regimen; diet" before its use in the wider sense of the "administration of the concerns and resources of any community or establishment with a view to orderly conduct and productiveness; the art or science of such administration". Id. at 831.

⁵⁶ Ibid. The term seems to be used in recent Bank documents in the manner typically used in so-called neo-classical economists' writings.

⁵⁷ Id. Specialized dictionaries, while reflecting this general sense, highlight the concern of economics with the allocation of scarce means among competing ends through the processes of production, substitution or exchange, see, The Dictionary of Economics (The Economist Books, Hutchinson, 129 (1989), Nemmers, Dictionary of Economics and Business 157 (1978); Dictionary of Economics and Financial Markets 71-72 (Gilpin ed. 5th ed., 1986).

⁵⁸ Oxford English Dictionary, supra note 55, at 2228.

"political" has other meanings, however, which are more pertinent in the context of the Bank's Articles. Since these Articles recognize the relevance of economic considerations but exclude political ones, they must assume a clear distinction between the two. The more relevant meaning of the excluded political factors should therefore be found in what the Oxford Dictionary defines as "belonging to or taking a side in politics or in connection with the party system of government; in a bad sense, partisan; factions"⁵⁹ as well as "the political principles, convictions, opinions or sympathies of a person or party."⁶⁰ This would include many issues which fit under what has been called "the art and practice of running a country or governing",⁶¹ but should exclude, for the purposes of the Bank's Articles, such typical economic and technical issues as the "management of money or the finances"⁶² or more generally the efficient management of the country's resources. Such latter issues, while they may have obvious political connotations, readily represent "economic considerations", both in ordinary language and in the Articles' context.

Second: Possible Entanglement of Economic and Political Considerations:

Economic considerations may be easy to insulate from political ones in the context of the financing of specific projects, the main function of the Bank under its Articles. The Articles assumed that project feasibility would not be judged by the staff's or the Executive Directors' partisan political preferences

⁵⁹ Id.

⁶⁰ Id.

⁶¹ P.H. Collin, Dictionary of Government and Politics 154 (1988).

⁶² Oxford English Dictionary, supra note 55, at 831.

but by technical, economic considerations such as the project's financial and economic rates of return.⁶³ But economic considerations in their broad sense do extend to the manner in which the state manages its resources, and may thus become difficult to isolate from political considerations, especially in "policy based" lending. To ensure that economic considerations will prevail in all the Bank's decisions, the Articles provided that a "competent committee" consisting of an expert selected by the governor in whose territories the project is located and "one or more members of the technical staff of the Bank" would carefully study every loan proposal and recommend it accordingly.⁶⁴ As a further safeguard, they provided for the establishment of an Advisory Council of not less than seven persons "including representatives of banking, commercial, industrial, labor and agricultural interests, and with as wide a national representation as possible," to "advise the Bank on matters of general policy."⁶⁵

The authors of the early drafts of the IBRD Articles, and particularly the two main progenitors, Harry D. White of the U.S. and Lord Keynes of the U.K.,

⁶³One basic assumption made by the Articles which has not materialized in fact, was that the main business of the Bank would be in the form of guaranteeing or participating in loans made by private lenders who, it was further assumed, would naturally be driven by financial and economic motives, not by political ones.

⁶⁴See Article III, Section 4(iii) and Article V, Section 7 of the IBRD Articles of Agreement, and Article V, Section 1(d) of IDA's. Emphasis added. The committee mentioned in these provisions is referred to in Bank practice as the "Statutory Committee".

⁶⁵Article V, Section 6 of the IBRD Articles (which has no counterpart in the IDA Articles). Such an Advisory Council has not been convened since 1950, however. Experience with the first Council led the Executive Directors to request a further study which does not seem to have been made as yet.

were indeed cognizant of the possible interaction between economic and political factors. They meant, nevertheless, to emphasize the impartiality of the institution when it came to political ideologies and interests, and to highlight instead its apolitical character and universality. In his first drafts, Mr. White provided that the Bank and its officers "shall scrupulously avoid interference in the political affairs of any member;" this emphasis remained in the draft submitted to the Bretton Woods Conference.⁶⁶ Lord Keynes added another paragraph to the latter draft stipulating that the Bank would act "in strict impartiality".⁶⁷ The draft of what is now Article IV, Section 10 of the IBRD Articles was accepted at Bretton Woods without any debate on its content; its scope was only broadened to cover all the Bank's decisions, as explained earlier.

Third: How Realistic is the Prohibition of Political Considerations in an Inter-Governmental Institution?

This question was raised during the preparation of the provisions of the Article prohibiting political considerations and excluding political influence (Article IV, Section 10 of the IBRD Articles of Agreement), and later on in the U.S. Congressional Hearings which preceded approval of the Bretton Woods Act. The fact that it was not raised in the Bretton Woods Conference itself, or in

⁶⁶See Document 169 SA/2 dated July 6, 1944, Article V, Section 11 (U.S. IV, 19). Proceedings of the Bretton Woods Conference, supra note 44, at 190-91. Emphasis added.

⁶⁷Id. at 202. Emphasis added. Later on, on the occasion of the Inaugural Meeting of the Fund and Bank at Savannah, Georgia, in March 1946, Lord Keynes warned that "[i]f these institutions are to win the full confidence of the suspicious world, it must not only be, but appear, that their approach to every problem is absolutely objective and oecumenical without prejudice or favour." Quoted in R.F. Harrod, The Life of John Maynard Keynes 632 (1951).

the Board of the Bank when it approved the charters of all the Bank affiliates, where almost identical language is used,⁶⁸ is significant in indicating that member states agreed to obligate themselves to insulate these financial institutions from political considerations in order to protect them, and their members, from the vagaries of politics in their varied and broad membership.

In early 1944, before the draft submitted to the Bretton Woods Conference was finalized, the U.S. Treasury prepared a "Questions and Answers" paper explaining its earlier draft articles which included the original provisions against political activities.⁶⁹ The last question in this document was phrased as follows: "Will it be possible for the Bank to avoid making loans based chiefly on political considerations?" Interestingly, the document provided the following answer which is quoted here in full:

"The Bank is designed to be an international economic agency to facilitate productive international investment without regard to political considerations. In deciding on loan applications, the Bank is not to be influenced by the political character of the country requesting the credits. This provision is part of the general requirement that the Bank shall scrupulously avoid interference in the political affairs of member countries (IV-19).

The greatest assurance that the operations of the Bank will be based exclusively on economic considerations is given in the provisions of the proposal. The Bank may guarantee, participate in, or make loans only for a specific project or program that has been investigated by a competent committee and has been approved as one that will increase the productivity of the borrowing country and for

⁶⁸See Articles V, Section 6 of IDA's Articles of Agreement, Article III, Section 9 of the IFC's Articles and Article 34 of the MIGA Convention. For reasons related to MIGA's business, this latter Article prefaces the provision requiring that only economic considerations be taken into account (in Article 34) by the phrase "without prejudice to the right of the Agency to take into account all the circumstances surrounding an investment."

⁶⁹U.S. Treasury, Questions and Answers on the Bank for Reconstruction and Development (February 24, 1944).

the servicing of which the prospects are favorable (IV-1-c). The investigating committee is to consist of experts selected from the technical staff of the Bank and one expert selected by the country applying for the loan. With these requirements, no loan can be made to a country for other than purely economic purposes, and the standards which prospective borrowers must meet are those which protect the economic interest of lender and borrower.

The character of the Bank's operations should give further assurance that political considerations will not affect the decisions of the Bank. The greater part of the Bank's operations will be directed toward encouraging and facilitating international lending by private investors. While the Bank would generally be prepared to guarantee or participate in loans approved by the technical committees, it would exert no pressure on private investors to undertake such loans. It is reasonable to assume that private investment institutions would not give weight to political factors, except as the stability of the government of the borrowing country affects the risk element in all foreign loans. There is thus a further check by private investors on all loans guaranteed or participated in by the Bank.

The international character of the Bank is also a protection against loans made for political purposes as previously discussed in the answer to Question 15. The Bank itself can have no policy outside the purely financial sphere. So far as concerns individual member countries, they do undoubtedly have important international political interests. However, it would be quite difficult for any member country to utilize the Bank for the purpose of furthering its political interests. Each member country is represented on the Board by one member, and no country can cast more than 25 percent of the aggregate votes (V-1). Furthermore, the Board is expected to consult with the Advisory Council on matters of general policy. The Council is to consist of men of outstanding ability, whose primary concern would be with economic and financial rather than with political matters. (V-5).

It remains true that the possibility always exists that pressure will be exerted to induce the Bank to extend foreign credits because they are politically necessary. So far as possible, the draft proposal is designed to minimize such influences in international lending. We recognize, however, that no set of rules will of itself completely eliminate political considerations and that proper limitation of the Bank's activities depends ultimately on the character of the men responsible for its operations.

This does not imply that international loans for political purposes have no justification. Obviously, there will be instances when loans may properly be made to aid a friendly government. But such loans should not be made with the aid or encouragement of the Bank which is exclusively concerned with international investment

for productive purposes, nor should such loans be made with funds provided by private investors. Where loans must be made for political purposes, the funds should be provided by the interested government or governments, without requiring either the Bank or private investors to assume the risks inherent in such loans."⁷⁰

A similar reply was given by the U.S. Secretary of the Treasury, when asked during the Senate Hearings by Senator Taft whether he thought that "when a Board is set up, composed of the great nations and the small nations of the world, they are not going to be affected by politics about the making of a loan to a nation?"⁷¹ When addressing the practicality of this matter Secretary Morgenthau emphasized again that "the institutions will carry out their work as far as it is humanly possible to do it and - it depends on the people running it - on a strictly business basis."⁷²

It is noteworthy that while questions were raised regarding the practicality of insulating the Bank from political interventions by members and their representatives, the importance of preserving the international and apolitical character of the duties of the President and staff has never been called into question. Such an international character can hardly be maintained, however, if members do not honor their duty, also stipulated in the Articles,

⁷⁰Id. at 75-77. Emphasis added. The provisions of the earlier draft referred to in this answer which mentioned the expert committee and the Advisory Council have survived in the Bank's Articles (Article III, Section 4(iii) and Article V, Section 7 on the loan committees, and Article V, Section 6 on the Advisory Council), unlike the provision regarding the maximum votes a country could cast. The purpose of the latter provision has been served, however, through the allocation of shares and the provision on "preemptive rights".

⁷¹See Senate Hearings on H.R. 3314 (B) June 1945, at 15.

⁷²Id. Emphasis added.

to refrain from attempts to influence the President and staff in the performance of their work.

The practice of the Bank may have seen instances where the ideals of the Articles have not always been fully met and where political considerations may have influenced Bank decisions in varying degrees of subtlety. Executive Directors may have also voted at times on politically motivated instructions. The Bank's General Counsel, past and present, have stated that there was no legal remedy available to the Board to challenge a vote on the basis of unexpressed political motivations.⁷³ None of this, however, changes what is stated in the Bank's Articles. Nor does it provide a legally acceptable basis for its violation.

3. Political Considerations of Possible Relevance Due to their Direct Economic Effect or to Binding International Obligations

The Bank and its officers are thus required not to interfere in the political affairs of members and to take only economic considerations into account. Yet, internal or external political events may have significant direct economic effects which, due to their economic nature, may properly be taken into consideration in the Bank's decisions. Situations may also develop where political events lead to the creation of obligations for the Bank or its members which cannot be ignored in the Bank's decisions. Both areas require clarification in order to establish their consistency with the Articles' provisions.

⁷³ See the legal memorandum referred to supra note 43, at 6.

i) The degree of political instability of the government of a member requesting a loan and of the security of its territories could be such as to affect the development prospects of the country including its prospective creditworthiness. Political changes may also affect the borrower's ability to keep its commitments under a loan agreement or the ability of the Bank to supervise project implementation or to evaluate the project after its completion. As a result, partial or full foreign occupation of the country's territories or civil strife in such territories cannot be deemed irrelevant to the Bank's work simply because they are of a political nature. Bank lending in such circumstances may run counter to the financial prudence required by the Bank's Articles (Article III, Section 4(v)). It may also threaten the standing of the Bank in financial markets or otherwise adversely affect its reputation as a financial institution. Indeed, the Bank has long recognized that it "cannot ignore conditions of obvious internal political instability or uncertainty which may directly affect the economic prospects of a borrower."⁷⁴ This position has been consistently upheld by the Bank's Legal Department, most recently in the Legal Memorandum of December 23, 1987.⁷⁵ It is important to recall, however, that in such situations the Bank would still be taking into account relevant economic considerations; political events would represent only the historical origins or the causes which gave rise to such considerations.

ii) In addition to the above practical possibilities, other situations may arise where the Bank becomes legally bound to pay due regard to factors which

⁷⁴The World Bank, IDA and IFC - Policies and Operations 43 (April, 1968).

⁷⁵Referred to supra note 43, at 4 and 6.

are basically political in nature. Members of the Bank which are also members of the U.N. are required by the U.N. Charter (Article 48) to carry out Security Council decisions "directly and through their action in the appropriate international agencies of which they are members." Members' obligations under the U.N. Charter prevail over their other treaty obligations, including their obligations under the Bank's Articles of Agreement, by force of an explicit provision in the U.N. Charter (Article 103). The Bank itself is bound, by virtue of its Relationship Agreement with the U.N., to take note of the above-mentioned Charter obligations assumed by its members and to "have due regard for decisions of the Security Council under Articles 41 and 42 of the U.N. Charter"⁷⁶ (which cover the binding measures that the Security Council may take to maintain international peace and security). The resultant inability of the Bank to lend to a member country which is subject to embargo measures imposed by the Security Council falls into this type of situation. The Bank's Board of Governors, by a resolution dated September 13, 1951,⁷⁷ unilaterally undertook to have the same due regard for the U.N. General Assembly resolutions made pursuant to its "Uniting for Peace" resolution of that year⁷⁸ (presumably on the basis that such resolutions were equivalent to Security Council decisions taken

⁷⁶Article VI(1) of the Agreement Between the United Nations and the International Bank for Reconstruction and Development, Nov. 15, 1947, 16 U.N.T.S. 346 (see also 394 U.N.T.S. 222 for the similar agreement with IDA).

⁷⁷Resolution No. 64 adopted by the Board of Governors at Sixth Annual Meeting, World Bank, Sixth Annual Meeting of the Board of Governors, Summary Proceedings 26 (1951).

⁷⁸"Uniting for Peace" Res. 377 (V), 5 U.N. GAOR, Supp. 20 (A/1775) 10-12, Resolution adopted on the Report of the First Committee (1950).

under Articles 41 and 42 of the U.N. Charter).⁷⁹

It should be noted in this respect that the Bank refused, when the occasion arose in the 1960s,⁸⁰ to extend the same treatment to other resolutions of the U.N. General Assembly, which are normally deemed to be recommendations,⁸¹ invoking in this respect its Articles' provisions prohibiting political activities as well as the provisions of the Bank's Relationship Agreement with the U.N.⁸² Under this latter Agreement each organization is prevented from presenting formal recommendations to the other without reasonable prior consultation. Furthermore, the U.N. "recognizes that the action to be taken by the Bank on any loan is a matter to be determined by the independent exercise of the Bank's own judgement in accordance with the Bank's Articles of

⁷⁹The controversial "Uniting for Peace" Resolution was adopted to enable the General Assembly to act as organ for the maintenance of international peace and security when the Security Council fails to fulfil this task due to the exercise of the veto power by one of the five permanent members.

⁸⁰For a detailed account of this episode, prompted by the adoption of the U.N. General Assembly of resolutions in 1966 requiring the Bank not to give financial assistance to South Africa and Portugal, see, Shihata, The World Bank and Human Rights - An Analysis of the Legal Issues and The Record of Achievement 17 Denv. J. Int'l L. Pol. 43 et seq. (1988); Kneller, Human Rights, Politics and the Multilateral Development Banks, 6 Yale Studies in World Public Order 362 (1980); Marmorstein, World Bank Power to Consider Human Rights Factors in Loan Decisions, 13 J. Int'l. L. & Ec. 113 (1978); Whiteman, 14 Digest of International Law 1004 et seq. (1970); Bleicher, U.N. v IBRD: A Dilemma of Functionalism, 24 Int'l Organization 31 (1970).

⁸¹For a recent treatment of the legal nature of U.N. General Assembly resolutions, a controversial subject in certain respects, see, 62/2 Annuaire de l'Institut de Droit International, Premiere question: The elaboration of general multilateral conventions and of non-contractual instruments having a normative function or objective - Resolutions of the General Assembly of the United Nations, M.K. Skubiszewski, Rapporteur, 65-126 and Resolution adopted, 274 et seq. (1987).

⁸² See supra note 76.

Agreement." The Agreement explicitly provides that "[t]he United Nations recognizes, therefore, that it would be sound policy to refrain from making recommendations to the Bank with respect to particular loans or with respect to terms or conditions of financing by the Bank." The Bank has recognized only that the U.N. and its organs "may appropriately make recommendations with respect to the technical aspects of reconstruction or development plans, programmes or projects."⁸³ These latter provisions are also consistent with Article 1 of the same Agreement which states that "[b]y reason of the nature of its international responsibilities and the terms of its Articles of Agreement, the Bank is, and is required to function as, an independent international organization." Indeed, under its own Articles of Agreement (Article V, Section 8) the Bank is required to cooperate with any general international organization, such as the U.N., provided that "[a]ny arrangements for such cooperation which would involve a modification of any provision of this Agreement may be effected only after amendment to this Agreement under Article VIII".

While the Bank's position on this matter has prevailed in the context of the controversy which arose in the 1960s over lending to South Africa and Portugal, it may be interesting to note that the U.N. Legal Counsel at the time contended that the prohibition of political activities under the IBRD Article IV, Section 10, did not relate to criteria involving the international conduct of a state affecting its fundamental obligations under the U.N. Charter and that what was prohibited was interference in the internal political affairs of the

⁸³Article IV (3) of the Relationship Agreement, supra note 76. Emphasis added.

Bank members and discrimination against a member because of the political character of its government.⁸⁴ However, there was no disagreement during that episode that internal political affairs which have no serious international dimensions were outside the scope of the Bank's work.

The latter remark is of particular interest with regard to the issue of human rights violations and their effect on Bank lending. At least one member of the Bank has enacted legislation authorizing and instructing its Executive Director in the Bank (and in a number of other international financial institutions) to "oppose" any loan or other form of financial or technical assistance to any country with "a pattern of gross violations of internationally recognized human rights" or which "provide refuge to individuals committing acts of international terrorism by hijacking aircraft," unless, in all such cases, "such assistance is directed specifically to programs which serve the basic human needs of the citizens of such country."⁸⁵ However, the Bank's practice, which may have been recently subject to some interruption in the Bank's Board, has been to the effect that the degree of respect paid by a government to political

⁸⁴See 21 U.N. GAOR 4-20, U.N. Doc. A/C. 4 SR1653 (prov. ed. 1966). A similar position has been upheld by Bleicher, supra, note 80, at 31 and Marmorstein, supra note 80, at 127-31, but not by Kneller, supra note 80, at 418-21.

⁸⁵See Section 701 (a) and (f) of the International Financial Institutions Act, as amended, in U.S. Senate, U.S. House of Representatives, Legislation on Foreign Relations through 1988 at 153-56 (1989). For the legislative history of this provision, see Shihata, supra note 80 at 45 et seq. The history of PL95-118 makes clear that the U.S. Executive Director can "oppose" by abstaining, voting "present" or taking any action other than voting "yes". See Senate Conference Report No.95-363 at 101 (July 26, 1977).

and civil rights (as opposed to economic rights),⁸⁶ cannot be considered in itself a basis for the Bank's decision to make loans to that government. Violation of political rights may, however, reach such proportions as to become a Bank concern either due to significant direct economic effects or if it results in international obligations relevant to the Bank such as those mandated by binding decisions of the U.N. Security Council.

IV. THE BANK'S MANDATE IN RELATION TO ASPECTS OF GOVERNANCE IN ITS BORROWING MEMBER COUNTRIES

1. Defining the Issue

In its full sense, "governance" covers the manner in which a community is managed and directed, including the making and administration of policy in matters of political control as well as in such economic issues as may be relevant to the management of the community's resources;⁸⁷ it conveys the same meaning as "government" which is a "more modern word for governance".⁸⁸ There is thus some overlapping between the meanings given to the words "governance"

⁸⁶ See a clear distinction between the two categories of human rights in the two separate conventions prepared by the U.N. to ensure their protection: the International Covenant on Economic, Social and Cultural Rights, Dec. 16, 1966, 993 U.N.T.S. 3 and the International Covenant on Civil and Political Rights, Dec. 16, 1966, 999 U.N.T.S. 171. See also United Nations, Human Rights: a compilation of international instruments 3 et seq. (4th ed, 1983).

⁸⁷ See several definitions to this effect in the Oxford Dictionary, supra note 55, at 1181 and in Webster's New International Dictionary of the English Language 1083 (2nd Edition, 1948).

⁸⁸ The Concise Oxford Dictionary 530 (5th ed. 1964); more recent dictionaries simply refer to the definition of "government", see e.g. Webster's Ninth New Collegiate Dictionary, 529 (1990). The more comprehensive dictionary cited supra note 55, at 1181 states that "in the main [the word 'government'] may be considered to have superseded governance."

and "economy",⁸⁹ and more so between the meanings of "governance" and "politics".⁹⁰ Each of these three words no doubt evoke in their broad meanings questions which may readily fit under the other. Not only is "the political agenda full of economic issues",⁹¹ the economic agenda inevitably raises political questions and the governance agenda is full of both types of issues.

The possible broad meanings of "governance" and the different intentions of those who call on the Bank to take it into account indicate the importance, as well as the difficulty, of drawing a clear distinction between two sets of aspects of governance: (a) those which are related to the Bank's purpose as stated in its Articles and are not excluded by provisions in these Articles and (b) such other aspects which represent prohibited "political considerations." Notwithstanding the difficulty of making this distinction, it has to be made by the Bank, if it is to take certain governance issues in its borrowing members into account while avoiding the risk of violating its Articles. An appropriate distinction may also obviate the need for the amendment of the Articles from the viewpoint of those Bank members who attach at present particular importance to governance issues in borrowing countries.

The remaining part of this memorandum is meant to enable the Executive Directors to agree on ways in which the Bank may address certain aspects of governance without having to face either of the above-mentioned possibilities.

⁸⁹See, e.g., definitions in the Oxford Dictionary, supra note 55, at 831 and 1181.

⁹⁰Id. at 831 and 2228.

⁹¹Samuelson & Nordhaus, *Economics* 11 (1989).

It is perfectly clear that the Bank's purpose is not to substitute itself for the peoples and governments of its borrowing member countries in deciding how these countries are to be governed. This might be a task for a world government, not the World Bank. Nor do the Bank's purposes allow it and its staff to be involved in the political reform of its borrowing countries, no matter how badly needed such a reform may be. The issue at hand is simply to identify aspects of governance which are relevant to the Bank's work and may therefore defensibly fall within its mandate, and aspects which are clearly political considerations which cannot be taken into account without breaching the Bank's Articles. Such identification will make it possible for the Bank to determine the governance issues it may formally take up in its dialogue with borrowing countries and appropriately address in its operations, and the issues it should ignore in its work. High risks are involved in failing to make a correct distinction in this respect.

Before attempting to make such a distinction, it may be important to separate this matter from another issue with which it may be confused, that is the Bank's freedom to acquire relevant knowledge of the political situation in its borrowing members and to gain insight as to the underlying social and cultural factors behind such a situation. Acquiring this knowledge is not only legitimate; it is essential for the Bank's ability to provide useful advice on policy reform in the economic and social sectors. Without it, the Bank's assessment of the feasibility and effects of this type of reform may be grossly distorted. For instance, in areas such as the reform of the legal and regulatory framework for private sector activities, lack of such knowledge could easily lead to misguided advice with long term economic consequences. Knowledge

of the political situation may also be necessary in the assessment of the country's creditworthiness and of the ability of a certain government to carry out its obligations under a specific loan or of the Bank's ability to supervise the project to be financed by the Bank. Developing such knowledge should not however mean, in my view, permitting Bank staff to enter into a dialogue with the political parties in the country concerned without the concurrence of the government, as seems to have been recently suggested in a Bank document.⁹² The Bank should be careful, in building up its knowledge of the political situation, not to interfere, or give the impression of interfering in the political affairs of its members. Unchecked contacts with political parties, especially opposition parties, may easily give this impression, unlike the contacts with experts and professional associations.

2. Aspects of Governance Beyond the Bank's Mandate

The earlier discussion in this memorandum and the clarification of the six requirements provided for in the Bank's Articles in respect of political considerations⁹³ should make it clear that the following activities are legally prohibited by the Bank's Articles and thus may not be carried out under the guise of promoting "good governance":

⁹² See OED, Annual Review of Evaluation Results 6-26 (1990) where it states: "The Bank needs not only to be familiar with the programs of the competing parties or groups in a member country, but also to maintain a low-keyed contact with them all, to assure broader understanding of the Bank's views, appreciate the views and programs of the country's competitors for power, and help assure continuity in the lending program."

⁹³ See supra pp. 16-20.

i) The Bank should not be influenced by the "political character" of the member. It should therefore be of no relevance to the Bank if the country concerned is a member of a particular political bloc or professes a particular political ideology. It should be immaterial to the Bank if the country is a kingdom or a republic, follows a Western-style or another form of government or has a parliamentary or a presidential system. There is no evidence that economic growth would be achieved only under a political system which is more familiar to the Bank staff or is ideologically preferred by certain of its members. On the contrary, rapid economic growth has taken place "within a variety of political systems and with quite different ranges of public policies".⁹⁴ Regardless of how simplistic it may be to attempt to introduce political transformation through the conditionality of external lending, such conditionality would not in my view be consistent with the explicit provisions of the Bank's Articles of Agreement.

The general prohibition stated above is subject to the qualification mentioned earlier in this memorandum. Economic considerations are relevant to the Bank's decisions, even when they have political causes or origins. The linkage between such economic considerations and political factors cannot be presumed, however. It must be clearly established in each case where it is alleged to exist, as will soon be explained further.

⁹⁴Pye, Aspects of Political Development 34 (1966). The same conclusion has been recently confirmed by extensive research. See Sirowy & Inkeles, The Effects of Democracy on Economic Growth and Inequality: A Review, 25/1 Studies in Comparative International Development 126-157 (1990).

ii) The Bank should not interfere in the domestic or foreign partisan politics of any member. It should not favor one political party over another or one of competing political candidates in national or provincial elections. It should deal with the government in charge and act impartially with regard to the different political factions in the country, even if the Bank staff happens to believe that a certain faction is likely to be more understanding of Bank policies. And it should not attempt to influence the direction of the political foreign policy of the borrowing country.

iii) The Bank, as coordinator of foreign assistance for a given country, should not act on behalf of donor countries in influencing the recipient country's political orientation or behavior. It should concentrate on maximizing the effectiveness of aid efforts, avoiding duplication and inconsistencies and enhancing the volume and quality of assistance. Such beneficial role which is appreciated by both donors and recipients should not, in other words, result in giving the Bank staff a different, unauthorized role as political messengers for donor governments. Nor should it allow the political preferences or ideals of bilateral donors to color the Bank's own judgments and decisions. A clear line has therefore to be drawn between the Bank's coordinating role, which must be guided only by considerations of aid effectiveness and efficiency, and any conduct which makes the Bank a source of political influence or pressure.

iv) More generally, the Bank should not allow political factors or events (no matter how appealing they may seem to be) to influence its decisions unless, as explained earlier, it is established that they have direct and obvious economic effects relevant to its work. This judgment must be reached as a result of the

objective analysis of the Bank's staff, not in response to political pressure from a member or members or in application of unestablished development doctrines or theories. The staff have to establish the case for the direct economic effect in a clear and uncontroversial manner. For it to be taken into account, such economic effect has to be preponderant; a question which is traditionally considered as "political" cannot be turned into an economic issue just because of minor possible economic effects. It should be recalled that it is only the economic considerations which are relevant to the decisions of the Bank, as Article IV, Section 10 of the Bank's charter explicitly stipulates. To ensure consistency with this provision, when these considerations are associated with political actions or flow from political events, they have to be of such impact and relevance as to make them a Bank concern. Even then, the Article's provision requires the Bank to weigh such economic considerations impartially in order to achieve the Bank's purposes, not in order to satisfy political preferences or ideals.

v) Equally important, the staff should not build their assessment on the possible reaction of any Bank member to their analysis. Interference by Bank members in the staff analysis would form an undue attempt to influence the staff's discharge of their international duty and is explicitly prohibited under the Articles. In particular, the Bank should not take a position for or against lending to a particular member or for a particular project simply because such member or project is likely to be favored or opposed by other members. Each Executive Director is free to vote on loan proposals as he may deem fit; he is not to interfere, however, with the way the President, officers and staff prepare such proposals for submission to the Board. Consultation with Executive

Directors on proposed loans or policies should not be taken as an occasion to impose a position on the President or staff as to whether the proposal should be made or on the specific features of such a proposal. The President should be able to decide what position to take in light of the consultation, realizing that it is the Board as a whole which will finally decide on the matter. Attempts by a member or members to impose a certain position before a specific proposal was submitted to the Board in a formal meeting would not, in my view, be consistent with the Articles' requirement of non-intervention in the discharge of the duties of the President and staff.

3. Aspects of Governance Consistent with the Bank's Mandate

One key to determining the aspects of "governance" which are relevant to the Bank's work and consistent with its mandate is to be found in a definition given to this term in contemporary English which sums up what is mostly intended by those who use it in the Bank. This is the meaning of "good order",⁹⁵ not in the sense of maintaining the status quo by the force of the state (law and order) but in the sense of having a system, based on abstract rules which are actually applied and on functioning institutions which ensure the appropriate application of such rules. This system of rules and institutions is reflected in the concept of "the rule of law", generally known in different legal systems and often expressed in the familiar phrase of a "government of laws and not of

⁹⁵ See Oxford Dictionary, supra note 55, at 831. According to Webster's Dictionary, supra, note 87, at 1083, the word means also "good conduct"; "self-control".

men".⁹⁶

Concern for rules and institutions is particularly relevant to a financial institution which at present does not only finance projects but is also deeply involved in the process of economic reform carried out by many of its members. Reform policies cannot be effective in the absence of a system which translates them into workable rules and makes sure they are complied with. Such a system assumes that: a) there is a set of rules which are known in advance, b) such rules are actually in force, c) mechanisms exist to ensure the proper application of the rules and to allow for departure from them as needed according to established procedures, d) conflicts in the application of the rules can be resolved through binding decisions of an independent judicial or arbitral body and e) there are known procedures for amending the rules when they no longer serve their purpose.

The existence of such a system is a basic requirement for a stable business environment; indeed for a modern state. In its absence, the elements of stability and predictability, so basic to the success of investment, will be lacking and the fate of enterprise, like that of individuals, will be left to the whims of the ruling individual, family or elite. Such absence will also

⁹⁶This phrase seems to be derived from the Massachusetts Constitution (Part the First, Article XXX) of 1780 which spelled out the principle of separation of powers "to the end [the government] may be a government of laws, and not of men." It has since been quoted in many decisions of the U.S. Supreme Court, beginning with its decision in Marbury v. Madison, 5 U.S. 137; 2 L Ed. 609, February 1803. The concept is known in other legal systems as well under appellations such as the "supremacy of law", although not always tied in other systems to the separation of powers principle. It has played a particularly important role in the evolution of the natural law doctrine and in the Islamic legal system, among others.

reflect a general lack of social discipline which could render meaningless any process of economic reform.⁹⁷

A system which has the basic elements explained above addresses the processes of the formulation and application of rules, rather than their substance. Such processes are meant to serve several objectives, among which the economic objective figures prominently. The substance of rules will of course reflect the policies of each government and should be based on its choices and convictions. The Bank may assist, if requested, in the design of policies related to its fields of competence and its mandate. It is also free to condition the disbursement of its loans on the adoption of agreed economic policies. This is different, however, from the above-mentioned institutional process for the formulation and application of rules as a prerequisite of economic reform and stability.

The emphasis placed on rules and institutions should not be seen as a call for excessive regulation or for rigid procedures. On the contrary, experience shows that such excesses lead to abuses of power and invite corruption and evasion, with negative effects on the development process. Rather, an appropriate system of a rule of law only ensures that both the application of

⁹⁷This point is well summarized in G. Myrdal, The "Soft State" in Underdeveloped Countries, 15 UCLA L. Rev. 1118 (1968) where he defines "soft development" as "a general lack of social discipline.., signified by many weaknesses: deficiencies in.. legislation and, in particular, in law observance and enforcement; lack of obedience to rules and directives handed down to public officials on various levels; frequent collusion of these officials with powerful persons or groups of persons whose conduct they should regulate; and, at bottom, a general inclination of people in all strata to resist public controls and their implementation." Id. at 1120.

and departure from existing rules should follow processes that are not only known in advance but also provide safeguards against arbitrariness and subjectivity.

Nor should this approach to governance issues be seen as unduly legalistic. The requirements of a system of rules and institutions and in particular the issue of compliance with the rules,⁹⁸ are complex matters which require multi-disciplinary studies which the Bank will do well to undertake, if it is to give the issue of governance adequate attention. They represent such important prerequisites of sustainable development, especially in market economies,⁹⁹ as to warrant further elaboration here through examples.

⁹⁸ Published writings on compliance include contributions by lawyers, sociologists, economists, anthropologists and others. They identify, inter alia, issues of knowledge of the rules, opportunity and capacity to obey them, likelihood of apprehension, perceived severity of sanctions, example given by officials and elite, perceptions of non-compliance by others, feelings of guilt, moral acceptability, fairness of the rules, economic interest, reciprocity, inducement, social habits, degree of popular participation in rule-making, etc. See generally, Securing Compliance: Seven Case Studies (M.L. Friedland ed. 1990); M. Posner, Economic Analysis of Law (1986); R.B. Seidman, The State, Law and Development (1978); O.R. Young, Compliance and Public Authority (1979); Compliance and the law (Krislov, Boyum, Clark, Shaefer & White eds. 1972).

⁹⁹ This is best illustrated in the writings of Max Weber where he stressed the relationship between "rational law" and economic development especially in the industrialization of Western countries. See M. Weber, Economy and Society (1968) (English translation of Wirtschaft und Gesellschaft, first published in 1921). See also Friedmann, Legal Rules and the Process of Social Change, 19 Stanford Law Review 791 (1967): "A market economy and a free society both impose upon the legal system a high demand for operational certainty in parts of the law which regulate important aspects of the conduct of everyday life and everyday business." Id. at 792.

Examples of Relevant Issues of Governance

Both in its investment lending and in its lending in support of economic policy reform, and especially in the context of the latter, the Bank may thus address issues of governance, other than those excluded above, to the extent it deems relevant to the success of the project or program involved. The following main aspects of relevant governance issues will illustrate how this subject may appropriately be addressed in the Bank's policy dialogue and in its loan conditionality. It should be made clear that while these aspects are consistent with the general framework elaborated above, they stand short of the broader coverage of governance which has appeared in some Bank staff papers and which, in my judgment, exceeds the Bank's mandate. All the following aspects relate to the degree and quality of the state's intervention in running the economy and are deemed to have a direct effect on investment prospects. They cover governance as a question of "good order" in the management of a country's resources through rules and institutions, rather than the exercise of political power to manage its affairs generally.

i) Civil Service Reform. The Bank has long been involved in institution building and human resource development and is increasingly called upon to enhance its activities in these areas. Concern for an efficient and honest civil service represents another aspect of this involvement. It is axiomatic that the effective management of a country's economy depends not only on the policies it follows but also on the institutions which translate these policies into action. Support of civil service reform may in certain cases take the form of assisting a country in reorganizing its administrative structures or studying its decision-making processes. It may even go into the restructuring of its

entire civil service with a view to introducing efficiency or eliminating or reducing corruption in a situation where the deterioration of civil administration has reached unusual dimensions. The direct relevance of a sound and efficient civil service to the success of state enterprises as well as private sector development is well established.¹⁰⁰ Civil service reform may thus be assisted by Bank loans both in the form of project or non-project lending. If such assistance is deemed by the Bank to be required for the implementation of economic reform and the promotion of investment and is provided at the request of the country, it obviously cannot represent an unauthorized interference in the country's political affairs.

ii) Legal Reform. The Legal Department paper on the Role of Law in Private Sector Development, circulated to the Executive Directors last year,¹⁰¹ has shown the importance of having an appropriate legal system, properly administered and enforced, for creating an environment conducive to business development. The transformation of economies from command to market systems cannot in particular be successfully achieved in the absence of workable, comprehensive legal infrastructures.¹⁰² In an earlier treatment of this subject

¹⁰⁰World Bank, World Development Report 1983 at 101 et seq. and B. Nunberg & J. Nellis, Civil Service Reform and the World Bank, PRE Working Paper Series 422 (May 1990).

¹⁰¹The Role of Law in Private Sector Development; Implications for the Bank's PSD Action Program, Discussion Paper, Legal Department (November 1989).

¹⁰²This point is clearly made in the Bank's papers on reform in socialist economies. See, e.g., From Socialism to Private Market Economy: Issues and Preliminary Lessons of Experience (August, 1990). A book on the Principles of Soviet Law published in the 1920s quoted Stalin as stating that "As the market declines, legal regulation and law itself lose their importance". Quoted in Izdebski, Legal Aspects of Economic Reform in Socialist Countries, 37 Am. J.

I had the occasion to point out that:

"The legal system may be generally unresponsive to the needs of important parts of the community, including the business community. Laws and regulations may be complex, deficient, unwritten or non-existent. Rule-making, whether in the form of legislation, regulations or minor decrees and directives may not be based on comprehensive data and analysis and are often influenced by vested interests and inter-personal considerations. The civil service in charge of administering the laws and regulations may be poorly trained and motivated. Delays, red tape, uncertainty and corruption can result. The court system and judiciary may follow protracted procedures resulting in unreasonable delays and may be unable to enforce judgements. No system of commercial arbitration may exist. Even minor commercial disputes may remain unresolved for years. The local legal and accounting professions may be underdeveloped or, given the excesses of the regulatory framework, may perceive their role as agents of avoidance or evasion of binding rules. This situation makes investment decisions more difficult and costly for domestic and foreign investors alike."¹⁰³

Legal reform requires profound knowledge of the economic and social situation in the country involved and can only be useful if it is done by the country itself in response to its own felt needs. The Bank may favorably respond to a country's request for assistance in this field, if it finds it relevant to the country's economic development and to the success of its lending strategy for the country.¹⁰⁴

Comp. L. 703, 705 (1989).

¹⁰³ Shihata, Law and the Development Process, 9 *The Bank's World* 12 (March, 1990).

¹⁰⁴ See recent examples in credits: Cr. No. 2162 (Central African Rep.) SAL III, July 2, 1990; Cr. No. 2090 (Senegal) SAL IV, February 9, 1990; Cr. No. 2023 (Benin) SAL, May 26, 1989; Cr. No. 2005 (Ghana) SAL II, May 1, 1989. The Bank is financing a comprehensive package of legal assistance in Guinea under Cr. 1963GUI, Nov. 29, 1988, and is administering a UNDP project in Laos which includes a component for the development of its legal framework for business activity.

The importance of legal reform to economic development is not limited to the stability it confers on contractual transactions and the predictability it gives to the treatment of property rights and management-labor relations; it extends to the essential requirement in any orderly economic activity of having workable rules and making sure they are objectively complied with.

iii) Accountability for Public Funds. When governments work in the absence of an adequate system of public procurement, accounting and auditing, substantive policies and rules can easily miss their social targets and become instead means for the exploitation of the public to the benefit of bureaucrats. The laws on the books will bear little relation to the norms actually followed and the officials responsible for their application will become part of a self-serving circle of beneficiaries. Attempted reforms will prove to be counter-productive and may only provide further opportunities for abuses and corruption. The phenomenon is only too familiar in many countries and the Bank's experience leaves no doubt as to the importance of public accountability for its reversal.

The Bank is therefore justified, indeed required, to make sure that proper accounting and disclosure procedures are followed and that adequate auditing, internal and external, is available for every endeavor in which it is involved. If it is addressing adjustment of the macroeconomic framework as a whole through a lending operation, it should be concerned, for the success of such operation, with the procedures needed to ensure "economy and efficiency", especially in the procurement of goods and services and in the auditing of public funds. These are not only matters that are mentioned in the Articles as requirements in the use of the Bank's loan proceeds, they are cited as counterpart to the political

considerations which are not to be taken into account.¹⁰⁵

iv). Budget Discipline. Proper budgeting processes are necessary to rationalize and control public expenditures. Through budgetary planning and execution governments translate their policies into action. Budgets do therefore raise important questions of economic policy. They also reflect at times major political choices. The Bank may take up the issue of budget discipline as a technical matter in its dialogue with a country with a view to improving that country's public finance management, rather than choosing for it how to spend its public funds. The Bank may also introduce conditionality in its adjustment loans to ensure that the processes of budget adoption and implementation will minimize waste and enhance growth. These are economic objectives which fit well under the Bank's mandate, even though they are closely related to the political arena. In fact, the Bank's concern for budget discipline may cause it to provide advice or, where appropriate, to introduce loan conditions related to strengthening budgetary planning and implementation, providing adequate information on revenues and expenditures and ensuring that public expenditures will be put to effective use. Considerations of cost-effectiveness and economic efficiency should guide this exercise. However, the Bank cannot, in my view, substitute for the constitutionally responsible government in setting the budgetary priorities. These are to be determined by the political bodies which are in charge of this function and constitutionally accountable for it. To state otherwise, would, in my view, deny governments the essence of appropriate governance and deprive them of a powerful tool in shaping the future of their

¹⁰⁵ See Article III, Section 5(b), quoted supra at p. 17.

societies. For its part, the Bank can of course provide advice on how this process may best enable the country to achieve its development objectives. Such advice has recently led in several instances to agreement between the Bank and certain borrowing governments, in the context of adjustment loans, on such matters as tax collection, government expenditures on certain fields, wage levels, the role of the central bank, etc. The Bank may also take into account, in determining its country lending strategies, the manner in which governments establish their budget priorities.

Borderline Cases

The above examples illustrate types of governance issues which may present themselves as "economic considerations" to be taken into account in the Bank's operations. Other issues of a similar character may exist and should be considered on their merits. The Bank is best advised to consider each issue with the greatest caution, lest it should find itself involved in areas prohibited under its Articles of Agreement. As several issues have both economic and political aspects, the judgment may depend on the degree of importance of each of these aspects in the case at hand. A matter which involves partisan politics or is traditionally considered political in nature should not, in my view, be of concern to the Bank, simply on account of some minor or doubtful economic effects.

One difficult subject, in this respect, is that related to popular participation as a general requirement. The Bank seems to have realized the advantages of ensuring adequate participation of the people affected by or benefitting from certain projects in the design and implementation of such

projects. It now requires consultation with local non-governmental organizations (NGOs) with respect to environment projects and plans and often provides for popular participation in social projects and rural development programs.

The Bank is also increasingly called upon, mainly by NGOs in developed countries,¹⁰⁶ to condition its lending on having a system of popular participation in rule-making generally or on the "democratization" of borrowing countries. While popular participation and democratization are indeed important goals which developing countries are generally trying to achieve, it is not clear how these goals may, in the abstract, become an operational concern for the Bank. There may be some cases where the Bank staff reach the firm conclusion that compliance with relevant rules in a given community is not possible without a measure of popular participation in the making of such rules. In such cases the Bank's concern with the issue of compliance may substantiate its pursuit in the policy dialogue with a given country of a form of popular participation in the making of such relevant rules taking into account the country's cultural values and its stage of development. However, to insist, as a general proposition that each borrowing country should have a Western-style democratic form of government cannot in my view be reconciled with the Articles' requirement that neither the Bank nor its officers should be influenced by the political character of its members or interfere in their political affairs.

¹⁰⁶This has most recently been evidenced by the discussions of the Bank/NGO Committee during its meeting in Washington, D.C. on October 31-November 1, 1990.

V. CONCLUSION

This memorandum makes it clear that not all issues related to "governance" of its borrowing members fall within the Bank's mandate and that such governance becomes an issue of concern to the Bank only in its strict sense of the good order required for a positive investment climate and for the efficient use of resources.

The Bank is not authorized to interfere in the partisan politics of its members or to be influenced by a member's political ideology or character or form of government. Indeed, the Bank is prohibited from taking political factors into account in its decisions. However, when such political factors lead to direct and obvious economic results relevant to the Bank's work, the Bank may properly take such results into account as economic considerations which only happened to have political causes or origins. In such situations, the effect on the Bank will be more in terms of whether or how to make its new lending commitments or to disburse under existing loans, rather than in terms of allowing the Bank to interfere in, let alone to "govern", the country's political affairs.

The main purpose of this memorandum is to distinguish between different issues of governance and to orient the treatment of this subject in the Bank towards the governments' process of establishing well functioning rules and institutions for the efficient management of the countries' resources -- a process which should go hand in hand with the investment of capital for productive purposes. Such a process would ensure that the economy is run according to a set of objective rules which are known in advance and are

actually in force, that there are procedures in place for amending the rules and for allowing departures from them when required and that there are efficient institutions for the application of these rules and for resolving disputes which may arise in this process. The memorandum clearly explains that the Bank may as a result address issues like legal reform in a borrowing country, the reform of its civil service and other institutions as well as the need for accountability and discipline in the use of public funds and, more generally, objectivity and efficiency in the rules and procedures related to the management of resources.

Activities with possible economic and political aspects may raise difficult questions. These should be considered with great caution with a view to limiting the Bank's attention to the economic aspects including such processes as may be clearly required for the efficient allocation and utilization of resources under objective criteria. It is not only that the Bank staff may not have adequate knowledge in the political arena and are not accountable to the people of the country for their advice and actions regarding the political affairs of Bank members; the Bank's Articles simply prohibit their interference in such matters. The distinction made in this memorandum, the concept of functioning rules and institutions introduced above and the Legal Department's clearance under the Bank's normal procedures should be helpful in providing guidance as to the appropriate framework for Bank action.

The Bank's role as coordinator of the assistance provided by the donor community to a particular country, a role which is practiced with respect to aid dependent Sub-Saharan African countries in particular, may place the Bank in a

situation where it has to advise the country about the current thinking of its donors. It should be careful, however, not to act in this respect as the conveyer of political messages and not to allow the political orientations of bilateral donors to influence its own decision-making processes.

The Bank, it should be recalled, is a financial institution which borrows and lends; it should be concerned with its financial strength and its standing in the market. This requires it, on the one hand, to avoid the vagaries of partisan politics and, on the other hand, to be careful that its funds are lent only for sound and efficient uses. Technical considerations of economy and efficiency, rather than ideological and political preferences should guide the Bank's work at all times. This was the intention of the drafters of the Articles and is the explicit message of the Articles' provisions.

There may, of course, be views favoring the involvement of the Bank in a broader set of issues including such attractive matters as political reform and democratization. These views cannot in my judgement be satisfied without an amendment of the Articles of Agreement which would broaden the Bank's purpose and dispose of the provisions prohibiting political activities. The Bank, it has been said, cannot be all things to all people. It is indeed an international organization, the legal capacity and the mandate of which are limited by the purposes stated in its Articles and by the provisions excluding political considerations. It cannot venture to act beyond its purposes and statutory prohibitions without the risk of acting ultra vires (beyond its legal powers). While the Executive Directors have the power to interpret the Articles of Agreement subject only to a possible review by the Board of Governors if a

member so requests,¹⁰⁷ they cannot, in my view, correctly interpret the Articles which explicitly prohibit political activities as authorizing such activities.

Amendment of the Articles is an intentionally onerous process which requires, in addition to the approval of the Board of Governors, further approval by member states acting by a high majority of their number and an even higher majority of their votes.¹⁰⁸ Unless such approvals are obtained and the Articles are amended for the purpose of engaging the Bank in the political reform of its members, a highly controversial proposition, the Bank may not, in my view, exceed the framework outlined in this memorandum for addressing governance issues.

¹⁰⁷ See Article IX of the IBRD Articles of Agreement and Article X of IDA's.

¹⁰⁸ See Article VIII of the IBRD Articles of Agreement and Article IX of IDA's. In the IBRD, following the Board of Governors' approval, proposed amendments must be approved by 60% of the members having 85% of the total votes. In IDA, the same requirement applies except for the latter percentage, which is 80%.

NOTE ON WORK IN PROGRESS ON GOVERNANCE

Purpose

1. This note summarizes PRE-led work in progress on governance, and is intended to inform PC members of issues being addressed and proposed outputs. The paper from LEG delimits broad areas for Bank action on governance. Within this framework, the cross-complex work program described in this note will define major operational issues of governance and explore possible Bank responses. An issues paper is being produced for early senior management consideration, followed by a fuller paper for PC and Board review within this fiscal year. A schedule is set out at the end of this note.

Key Areas of Work

2. The Bank is increasingly encountering "governance" problems in its everyday operations -- most obviously in Africa, where the Region has pioneered work on governance, but in fact across all regions. The Bank has tried for a long time to address some aspects of governance through public sector reform and institutional development efforts, and by encouraging greater local and NGO participation in development processes. But there are some important areas, discussed in the LEG paper, where we have not so far done very much. This gray area involves the economic impact of the exercise of governmental power and authority. How should we come to grips with this operationally, beyond what we are already doing in public sector management and economic policy reform?

3. In determining the potential role of the Bank in each of these areas, the overriding criteria should be that Bank action should not involve overt political choices (e.g. in favor of multi-party democracy, etc.), and that the problems addressed -- e.g. state enterprise accountability, participation in poverty programs, reduction of government corruption -- should be both operationally important and tractable to some form of Bank intervention. The emphasis will be on identification of good practice appropriate to specific situations, rather than on breaking new ground. Three lines of work are being explored:

- Increasing information and openness in the conduct of public business. Traditional Bank concerns include publication of accounts, auditing, and greater budgetary transparency. More broadly, the Bank has been trying to encourage governments to "go public" with their reform programs -- and associated undertakings to the international community -- to build ownership of reforms and increase their staying power. Even in established activities such as the scrutiny of public expenditure, more systematic concern for openness may ultimately involve the Bank more directly in hitherto closed issues, for example military expenditure.
- Strengthening institutional accountability and pluralism. What role should the Bank play in dealing with accountability more broadly, than the traditional concern with public accounting and auditing, hard budget constraints for state enterprises, etc? Striking the right balance between accountability and autonomy of state

enterprises is an example on the borderline between such public sector management concerns and governance. At a broader level LAC, for example, is helping parliaments in Argentina and Chile to strengthen oversight of economic policy and management. Better accountability is also a critical way to get at the problem of corruption -- which for many people is the crux of bad governance. Rooting out corruption additionally requires reducing pervasive and arbitrary controls which enhance government power, provide opportunities for rent-seeking, and inhibit the development of plural and independent social and economic institutions.

- Providing a predictable framework for economic activity, as the LEG paper indicates, is a key requirement of good governance. There could be more explicit Bank support for development of secure and openly enforceable legal frameworks and administration of justice (especially relating to property rights and contracts). Within that overall system of law and due process, it is also important to improve the quality and predictability of government behavior -- to reduce capricious policy changes, and to eliminate arbitrariness and harassment in government conduct, particularly towards the private sector.

4. Another major area is participation. Here the Bank has done a lot in recent years, especially with respect to community and NGO participation in projects. But there are wider issues. One is inclusion of potentially excluded communities and groups (women, poor people, etc.) in decision-making. Another is strengthening participation, capacity and accountability at lower levels of government (e.g. working with local NGOs and improving local government), especially given the key role they play in poverty programs, safety nets and the management of infrastructure investments. This is an area the Bank is only beginning to deal with on any scale -- the new urban policy paper, for example, moves strongly in this direction.

Organization of the Work Program

5. PRE has primary responsibility for producing the proposed Board discussion paper. The paper will be prepared in close collaboration with Operations and Legal, which are represented on the task force responsible for organizing the work and consulting Bankwide. The task force will be guided by a steering group of Directors.

Schedule

Note on work in progress	to PC	December 17
Issues paper	to PC	February 26
Discussion paper	to PC	April 15
Board seminar		to be decided

.

DRAFT

December , 1990

To All Staff:

Follow-up to the Attitude Survey

In early October, in my first comments on the Attitude Survey, I said that I would react in more detail by the end of the year, especially in the areas of communications and career development, on which staff concern is strong. This note announces a number of steps which we are taking now in response to the Survey. Other actions will follow in the next few months, following further consideration of Institutional issues and the completion of Survey follow-up at the work group level.

Like most people working in the Bank Group, I am very proud of this institution, and I had no doubt after reading the Survey results that our strengths are much more important than our weaknesses. However, in meetings since then with the President's Council (twice), with Directors and Vice Presidents, with the Chief Personnel Officers and with the Executive Committee of the Staff Association, I have stressed that we cannot sit back on our "positives" and hope that the "negatives" will go away. We need to work hard to correct important weaknesses in the organization, and it will take time -- more than a matter of weeks and months -- to do that. There are no "magic" or "instant" solutions to some of these problems, but at the same time they are too important to be considered intractable.

The Survey provides us with a wealth of information, which we have only begun to digest and which will guide Management about staff views for a long while yet. So far, however, the most significant outcome of our further analysis is that there are only minor differences among staff -- whether grouped by grade, gender, occupation, or nationality -- with respect to most Institution-wide issues. This not only confirms the depth and breadth of the aggregate results but also suggests that follow-up actions can be general, too, rather than aimed at particular groups of staff.

Communications. In expressing dissatisfaction with upward and downward communications, you are obviously not asking for more written circulars. Instead, you want us to "tell it as it is", even if this means simply discussing the constraints on the Institution, internally and externally. Furthermore, you want to see management behavior which backs up the written and spoken word. If we stress the importance of "people management", you want to see Vice Presidents and Directors as approachable and considerate of the human element in the office as you expect your

Division Chiefs to be. If we seek staff views on important subjects, you want some detailed sense of how they were taken into account and you want to see us change our minds now and then in response to strong and sensible reactions to specific proposals. To reflect the diversity of our efforts, you want to see line managers -- as someone told me at a recent staff lunch -- celebrating a particularly successful mission, or the completion of an economic or sector study, rather than just the approval of a complex loan by the Board.

Ultimately, these small but critical aspects of management behavior are more important than formal or written communications, and all managers need to keep reminding themselves of this. However, we also need to share insights and experience more regularly across the Institution. With this in mind, I have decided on the following practical steps:

- I will convey my thoughts directly to you more often, either through notes like this or videotapes of meetings which I think will be of interest to you, especially regarding recent developments in the world and how I see them affecting the Bank Group's objectives and priorities.
- I will circulate a daily log of my meetings and activities to the Executive Vice Presidents, Senior Vice Presidents and Vice Presidents (and I am asking them to do the same within their own units), as a means of achieving a broader understanding of issues under consideration.
- Decisions of the President's Council, Operations Committee, Finance Committee and PRE Committee on important issues will be shared promptly with Division Chiefs via the All-in-1.
- I have also asked the Senior Vice Presidents and Vice Presidents to meet regularly and informally with managers in their own units and in other Vice Presidencies or Complexes, as well as with task managers, team leaders and administrative secretaries, to exchange views and experience.

None of these initiatives on its own will be sufficient to achieve the necessary results, but taken together -- and in combination with spontaneous efforts elsewhere in the Institution to "open up" our management processes and share critical information -- I believe that we can achieve a much broader understanding of our goals and our constraints in pursuing them as completely and as quickly as we sometimes would like.

Career Development. This is not only a critical issue for the organization: it is almost a raw nerve. Almost everyone regards promotion as the most important form of professional recognition; but most staff

also are pessimistic about their prospects for promotion in the light of slow growth in the organization, low turnover and, more disturbingly, inadequate evidence of equity and objectivity in promotions actually made. The first two factors are difficult to change, but the third is something which is well within our control.

I am pleased to report that Personnel staff and the Staff Association have recently collaborated on a joint task force on career development. They have produced an initial set of recommendations, which are specific and concrete, and they intend to make further suggestions in the next several months. They want it made clear that responsibility for career development is shared by managers and staff, that it benefits the Institution as well as the individual, and that it must involve processes which are open and understandable. They have suggested that we promote reassignments across major organizational units more actively; make the Vacancy Information Service (VIS) more effective and credible; facilitate developmental assignments inside and outside the Bank Group; strengthen procedures for internal and external training; enhance the work of the Career Advisory Program; make information on career paths and promotion criteria more comprehensive and widely available; review the operation of Bank-wide panels; and experiment with new forms of staff recognition -- not as a substitute, but rather as a supplement, for promotions and rotations. The report of the Group is available from the Personnel Teams, the Staff Association and your managers. Mr. Alisbah has invited comments on the report but indicated that he intends to accept the Group's recommendations, unless he hears strong views to the contrary.

I also want to commend Mr. Eccles and the Support Staff Action Steering Group for their very careful preparation of proposals to facilitate career progress and job satisfaction for the large number of our colleagues at Levels 11-17. Their recommendations will be considered and, I hope, widely discussed during the next month.

These steps should deal with many of your concerns, but they do not address directly the two factors which staff said in the Survey most inhibit their advancement: aspects of the job grading system and the way managers make their selection decisions. On these matters, I want to take two further steps:

- I am asking the Personnel-Staff Association task force which is looking at career development issues to examine a recent review of the job grading system prepared by Personnel staff and let us have their own assessment of the strengths and weaknesses of the system. I am also asking them to consult as widely as possible on the subject, especially among Division Chiefs and within the Staff Association. I expect to hear from them by the end of March 1991.

- I would also ask all managers to pay careful attention to the manner in which they reach their selection decisions, and to seek advice from the Personnel Teams on appropriate "best practices". A great deal of staff frustration would be avoided if simple courtesy and consideration (such as advising candidates whether they have been shortlisted or not, and if not, why not) were a matter of course rather than an exceptional practice. In a large organization, a small amount of thoughtfulness can go a very long way.

Stress. In October, I mentioned my concern about the large number of you who are experiencing undue tension in your jobs, with negative effects on your health and outside life. As this is a complex subject and it has been a recurrent feature of Surveys within the Bank Group, even within otherwise "satisfied" and healthy work groups, I did not intend to say much more about it until follow-up discussions in the work groups were complete. However, many of you have raised the matter with me or Bilsel Alisbah during the last three months, and I want to share a few thoughts with you on the subject.

First, most staff take pride in being hardworking and expect deadlines to be tighter, now and then, than they would prefer. What causes stress to build up to uncomfortable levels is when work is always rushed or special effort is taken for granted. There is no aggregate Institutional solution to this problem. It can only be corrected at the work group level, through thoughtful management of individual work programs and intelligent responses to the unforeseen. Managers need to draw the line, with themselves and with their own managers, when work requirements become so consistently large as to affect individuals or the work group adversely.

Second, staff need to be encouraged -- not just allowed -- to take regular leave, and preferably for extended periods. The build-up in leave credits in parts of the Bank Group suggests that the necessary balance between work program needs and the health and good humor of our staff is not being struck successfully, and senior managers -- not just work group managers -- need to be concerned about this. The situation is so serious that we are considering changing the maximum carryover of leave from 60 to 75 days and increasing incentives to use it more regularly.

Third, budget procedures are quite clearly a source of concern and are seen to entail a disproportionate effort in a large number of work groups. We need to look again at ways of simplifying the budget process, and I have asked Mr. Picciotto to canvass views on how this could be done. On this subject, too, I expect to receive suggestions by the end of March.

I know that many of you are interested in follow-up on other Institutional subjects. Mr. Alisbah will be coordinating further work in interpreting the Survey data and, where necessary, proposing remedial

action. This additional work, together with the results of follow-up at the work group level, will be considered by the President's Council in the Spring, and we would expect to issue a full progress report to you in May/June 1991.

In the meantime, please convey your views to us, directly or through your managers and Personnel teams, on matters of Institutional concern, and we will take them into account in considering other steps in response to the Survey results. We have a large agenda to work on, but just as important as our service to our member countries are efforts within the organization to release latent talent and energy and recognize the considerable commitment which we are making as individuals, not just as an institution, to promoting the well-being of people in developing countries.

Allow me to wish all of you and your families a very peaceful holiday and a promising start to 1991.

ROUTING SLIP		DATE: December 12, 1990	
FROM THE OFFICE OF THE VICE PRESIDENT AND GENERAL COUNSEL			
NAME		ROOM NO.	
Mr. Isenman		S-13-145	
Mr. Serageldin		J-3073	
SL		done 12/14	
CB			
Sarwar (a/1005)			
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APPROVAL		NOTE AND SEND ON	
COMMENT		PER OUR CONVERSATION	
FOR ACTION		PER YOUR REQUEST	
INFORMATION		PREPARE REPLY	
INITIAL		RECOMMENDATION	
NOTE AND FILE		SIGNATURE	
REMARKS: You may find the attached articles on "Governance" of some interest.			
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FROM: I.F.I. Shihata		ROOM NO.: E7071	EXTENSION: 81601

REFORM

To prod sub-Saharan nations to democratize, should donor countries and institutions tie their aid to political as well as economic reforms? While improvements in governance are crucial to achieving sustained economic growth, the role of donors needs to be carefully thought out so as not to hinder Africa's budding efforts toward political pluralism.

By CAROL LANCASTER

Should rich countries and international institutions providing concessional assistance and debt relief to sub-Saharan Africa link their aid to political, as well as to economic, reforms? This is the question of the day, raised and debated in the media, in policy discussions within the U.S. government, in public documents by international economic institutions, by African intellectuals, and by development experts.

This question emerges from two rather separate trends in world poli-

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Betty Press

tics: efforts at structural adjustment in Africa, begun in the 1980s as a result of the deepening economic crisis, the desperate need of African governments for foreign financing, and the increasing tendency of governments, the IMF, and World Bank to condition their assistance on economic stabilization and structural

adjustment. Over 30 African countries now have stabilization and/or structural adjustment programs with the IMF and World Bank.

But structural adjustment has yet to produce a clear-cut success in sub-Saharan Africa. Sustained economic reform programs in Ghana and elsewhere have contributed to healthy

OR ELSE?

growth rates (of 5 percent or above in Ghana) over several years. However, an examination of the components of this growth suggests that it is based on an expansion in capacity utilization in agriculture and industry, large aid inflows, some investments in mining—likely to produce quick and profitable gains—and in the informal sector. Significant new investment in manufacturing and agriculture have not yet materialized. Indeed, in Ghana, domestic savings and investment remain among the lowest in the world and disinvestment in industry continues as inefficient firms collapse in the face of import competition. An increase in private, productive investment is a critical element in the success of structural adjustment; without it, there will be no sustained economic growth. The question is why the investment has not occurred and what can be done to encourage it. This is where the problem of governance arises.

Investors, African or foreign, put their resources at risk to make profits. In many lines of investment, particularly in manufacturing, investors will gain profits only over a period of years and so will invest where they have reasonable confidence that business conditions will not alter dramatically. In many of these aspects, Africa remains uncompetitive with other parts of the world. The logistics of doing business in Africa are still difficult, with transport and communications facilities poor and unreliable in many countries. Physical infrastructure is still inferior to that in other parts of the world. African labor is becoming cheaper, but in many places is still uncompetitive with the disciplined, literate, and often skilled labor in much of Asia or, more recently, Eastern Europe.

But above all, investors lack confidence in African governments which say they want private investment, but then act, at times unintentionally, to discourage it or which are riddled with corruption. Perhaps the most important obstacle to private investment and growth in Africa is that everything is open to negotiation.

Rules and regulations are frequently implemented by government officials in an arbitrary and capricious fashion. Above all, investors require predictability on the part of their host governments. This is not present for them in much of Africa and so they go elsewhere.

Without an improvement in governance, sustained growth will not

Is the pluralism so often thought to be necessary for a successfully functioning democracy sufficiently developed in Africa to support democracy?

occur, for behind problems of economic mismanagement and corruption are problems of leadership, interest group pressures, patronage politics, a lack of transparency and probity in government decision-making, and an absence of public accountability. The Economic Commission for Africa acknowledged the problem of governance in its recent report, *An African Alternative Framework to Structural Adjustment Programmes*, as did the World Bank in its recent long-term study, *Sub-Saharan Africa: From Crisis to Sustainable Growth*. Thus, the problems with structural adjustment and renewed economic growth in Africa raise the question: Should aid be linked to political reform?

The question is also raised as a result of the recent changes in Eastern Europe and the West's response to them. Eastern Europeans have combined their dramatic moves toward economic and political liberalization with appeals to the West for economic help (less concessional assistance than commercial loans, debt restructuring, technical assistance, and private investment). The Western Europeans and the U.S. have responded with some money and some promises, and the condi-

tioning of their help on continuing political liberalization. The fact that democracy could break out in Eastern Europe, where it was least expected, suggests that it could happen elsewhere. Why not encourage it in Africa by conditioning aid on political liberalization there?

In answering this question, there are several important issues to consider. First of all, what is the *objective* of tying aid to political reform? Is it to promote more open, democratic societies as an end, for the good inherent in them? Or is it to promote economic development?

A corollary to this question is which reforms are necessary for meaningful political liberalization? What, in the words of Robert Dahl, would it take to ensure that African governments are "responsive to the preferences of their citizens"? To ensure citizens basic political rights, the following conditions are usually regarded as necessary: freedom of expression (implying media, universities, and public fora free to raise and debate political issues and to criticize government) and freedom of assembly; an independent judiciary enforcing the rule of law; and an opportunity on the part of the public to change the political leadership through periodic, free and fair elections. Much of the experience of independent Africa suggests that it may be difficult to fulfill these conditions within the framework of a one-party state. A multi-party state may be unavoidable.

As attractive as the idea of political liberalization is for Africa, there are some potential problems. First, open political competition may center on ethnic, regional, or religious cleavages dangerous to national unity. At independence, the fear of ethnically based politics (far from groundless) was the justification for the one-party state. Is there reason to believe that the dangers of ethnic politics have by now declined in importance or that ethnic politics would be less disruptive of national unity today than at independence? Does the answer to this question differ from country to country? If so, why? The tensions

resurfacing in Eastern Europe and the USSR suggest that even when they have been suppressed for decades, ethnic politics do not disappear as potent and often destructive political forces.

Second, is the pluralism so often thought to be necessary for a successfully functioning democracy sufficiently developed in Africa to support democracy? Third, are powerful political groups prepared to abide by democratic rules rather than resort to the use of force to gain or retain political power? Where societies lack powerful, organized groups with diverse and sometimes competing interests, a dominant group or coalition can function as an autocracy, even in democratic camouflage, promoting the interests of its own supporters and depriving others of economic opportunities as well as political rights.

Are Zaire, Liberia, Sudan, or Somalia sufficiently pluralist societies in which powerful groups are willing to play by democratic rules? The answer is clear in these cases. It is less so regarding Kenya, Nigeria, Senegal, or Côte d'Ivoire—although in each of these cases, ethnic or religious-based politics remain a possibility and a threat.

Fourth, it is possible that democratization in African societies can harm rather than hurt the success of structural adjustment programs, generally regarded as critical for restoring economic growth in the region. Open political debate would inevitably include the major issue with which so much of the continent is now struggling—structural adjustment. Structural adjustment programs are controversial (not the least because of the foreign involvement in them), painful (particularly for vocal and influential groups), and often emotive and ill-understood by the general public. The largest group benefitting from them—rural farmers—are typically the least articulate, the least well-organized, and among the least politically influential group nationally. Would they organize, articulate, and vote their economic interests in an election where

structural adjustment is an issue?

It is very possible that where structural adjustment programs become the subject of open political debate or a major issue in political campaigns, where articulate, powerful groups and individuals are predominant (whose interests are threatened by structural adjustment), these programs will be discarded along with those politicians supporting them. President Babangida of Nigeria has acknowledged this threat by attempting to exclude it from the upcoming national election campaign. It very nearly defeated President Diouf of Senegal. There may well be a trade-off between political liberalization and economic liberalization in sub-Saharan Africa.

A second major issue is how aid should be linked to political liberalization. Conditioning foreign aid on political liberalization would add an additional degree of coercion to relationships between African governments and foreign powers, which is already there in conditioning aid on economic reforms. Perhaps, a degree of coercion on economic reform in exchange for additional resources is warranted, but there are limits beyond which such conditioning becomes counter-productive, both in terms of short-run relationships between aid donors and recipients, and in terms of the long-run interests of Africans who, in the last analysis, must be responsible for making their own decisions affecting their destinies.

More important, conditioning aid on political reform puts the initiative of deciding which reforms are appropriate and workable in the hands of foreigners, particularly government officials and international civil servants. There are few who are well enough informed to make such decisions about what will work politically in Africa's complex and changing societies.

An alternative to conditioning foreign aid on political liberalization would be for aid donors to deploy a portion of their aid in support of the many changes useful to promote democracy in Africa: training for

judges, legislators, journalists, trade unionists; support for non-governmental groups which would be important in a pluralist political system, for example, professional, youth, and women's groups; support for independent public policy research institutions which could develop the alternatives to government policies necessary for open and informed debate.

These would not be new activities for the U.S. government, which has funded similar programs for four decades in Asia and the Far East through the Asia Foundation. It has not financed these sorts of activities in Africa (except in a small way in South Africa). This alternative would not be coercive and would leave decision-making in the hands of the Africans, but it would probably not bring about major political reforms quickly.

A further alternative for supporting democracy in Africa would be for aid donors to provide African govern-

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ments with additional aid after moves toward democratization had been implemented. This approach would contain a degree of coercion, but would leave decision-making and initiative in the hands of the Africans.

If the objective of linking aid to political reform is to promote the success of structural adjustment, more limited reforms may be sufficient and appropriate. These reforms could be targeted at economic governance and would include: transparent government budgeting (no more hidden accounts for the discretionary use of a Mobutu, Doe, or Abidjo); well-planned investments appropriate to national economic needs and priorities (no white elephants dedicated to the everlasting memory of a particular leader or foreign aid donor); open and competitive bidding for large public investment projects (no more Turkwell dams in Kenya, Inga-Shabas in Zaire or Ivorian sugar projects); and the consistent and fair implementation of regulations governing investment.

Extending the conditions of foreign aid to economic governance implies that foreigners would assume the role of ensuring public accountability by African governments on issues of economic governance through close coordination of their aid and export policies, through monitoring recipient government economic decision-making and policy implementation, and through reducing or raising their aid levels based on the performance of African governments in this area. In theory, this is what is happening now with IMF stabilization and World Bank structural adjustment programs. The conditions of these programs could be formally extended to include economic governance.

An approach linking additional foreign aid to economic governance is not without problems. The most difficult problem may be getting foreign governments to cooperate in their policies vis-à-vis the Africans. There is a considerable degree of informal cooperation now, but many of the failures of implementation of economic reform programs in Africa

Developed countries have their economic and political interests in Africa and are still often willing to put them ahead of their interests in economic reforms.

can be traced to the support of developed countries of their African clients' desires to avoid reforms. President Mobutu of Zaire has demonstrated the most skill in manipulating his three patrons to avoid serious reforms. But he is not alone. Presidents Houphouët-Boigny of Côte d'Ivoire and Traoré of Mali have sought (and obtained) French intervention to avoid painful policy reforms.

Developed countries have their economic and political interests in Africa and are still often willing to put them ahead of their interests in economic reforms. It remains to be seen whether the economic decline in the region and the decrease in East-West tensions will so erode foreign economic and political interests there that they will be willing to center their economic support for African governments largely on progress toward reforms.

Another problem with adding economic governance to the list of aid reforms required by foreign governments and international institutions is operationalizing the concept. What are the policies that should be reformed? How can we tell when they are changed? Should aid be conditioned on a sliding scale of reforms or on attaining an absolute level of reform? These are difficult, but not impossible questions to answer.

The final and most critical question is whether reforms in economic governance would be effective in promoting investment and growth in Africa. There are obstacles to increased investment in Africa, other than problems of economic gover-

nance. The question of whether extending structural adjustment lending to include economic governance would be effective in stimulating investment can only be answered in practice. Where other factors (infrastructure, labor costs and productivity, potential profitability of an investment) are favorable, improved economic governance could be helpful and perhaps decisive in encouraging investors. And it may only take one or two large and profitable investments in Africa to re-ignite investor confidence in the region.

In any case, improved economic governance is unlikely to worsen economic conditions in Africa or hurt broader prospects for investment and growth. At a very minimum, it would ensure a more efficient use of existing resources. And something needs urgently to be done to make structural adjustment successful—if initially only in one place. The alternative is further decline.

The linking of concessional resources to economic reforms has been with us for most of the decade of the 1980s. It now appears that governments are beginning to think about linking any additional aid resources to political reforms. This is an attractive notion to Western governments and to many Africans and one strongly suggested by the experience of Eastern Europe. There may be some useful and workable reforms to be achieved through this approach, particularly in the area of economic governance.

But linking economic support to broader political liberalization can be a dangerous and destructive approach to forcing desirable changes in African societies because, thus far, it is so poorly thought out on both sides; because foreign officials are not well-positioned to advise Africans on effective political changes; and because Africans, in their desperation to obtain additional concessional resources, may agree to changes which in reality they cannot or will not implement or which implemented, will prove unsustainable and generate further political and economic instability. ○

PARTNERSHIP

If "Afropessimism" is not to take hold, African nations still mired in autocracy, bureaucracy, and corruption must begin to democratize their political systems. Democracy alone, however, is not the answer—it must be accompanied by greater openness and accountability in the economic arena. Then, the continent will be in a stronger position to seek support from the West.

By RICHARD JOSEPH

The numerous challenges confronting African countries have now become cumulative, while the capacity of governments and societies to cope with them is increasingly strained. A widening fear that matters will become significantly worse rather than better in coming years has been given the label "Afropessimism." However, while realistically confronting the dilemmas of the continent, we must resist defeatist attitudes.

Using any set of available statistics—Africa's declining share of world trade, the comparatively small size of its economies, or the increasing proportion of debt to GDP—it is evident that the continent's economic contraction is likely to worsen during the coming decade unless current trends are reversed. Few statistics are more telling than the fact that Africa, which now holds an estimated 16 percent of the world's poor, can expect to see that proportion doubled by the end of the century. The warning by General Olusegun Obasanjo that Africa is becoming "the Third World's Third World" cannot be dismissed as merely alarmist. If there is an alarm, it should be one that arouses us to action.

Richard Joseph is a professor of political science at Emory University and fellow for African studies of the Carter Center.

The economic decline that sub-Saharan Africa experienced during the 1980s provoked a sometimes rancorous debate about what should be done. Most of the arguments advanced in that debate are now well-known and have been fully aired in publications of the World Bank and the Economic Commission for Africa. However, before real evidence of economic recovery could be identified in countries undergoing stabilization and adjustment reforms, the continent was swept by a wave of demands for more pluralistic political systems. Single-party rule in particular has come under sustained attack in the streets of many African cities and in the boardrooms of the major bilateral and multilateral donors.

Will democratization help, hinder, or confuse the process of economic transformation and development in Africa? It can be stated quite categorically that democracy, in and of itself, is not a panacea for Africa. There are, of course, African countries in which vigorous democratic systems are associated with dynamic economies, such as Botswana and Mauritius. Yet, there are also others in which democratic openings were accompanied by an acceleration of economic decline: Ghana (1979-81), Nigeria (1979-83), and Sudan (1985-89). A more nuanced analysis is therefore

needed if we are to arrive at a satisfactory understanding of the relevant issues and considerations.

As a general principle, drawing on world-wide experiences, it is clear that the absence of democracy does not mean that economic growth will be stymied. There are nations like South Korea and Taiwan that experienced decades of sustained economic expansion under highly authoritarian systems, and even Japan's "liberal democracy" still retains oligarchic features. Another country now regularly cited in this vein is Indonesia, which has enjoyed a prolonged economic upswing under an autocratic military regime.

However, this pattern of reasoning is not fully satisfactory. Some scholars, like Claude Aké, distinguish economic growth from development, the latter which he feels necessitates human-centered qualities that are suppressed in "developmental dictatorships." Equally important is the fact that this issue does not have to be considered abstractly since we now have a good understanding of the dynamics of post-colonial Africa on which any analysis and prognosis should be based.

Virtually all countries in Africa today are hurting economically, including those that adopted socialist strategies of an authoritarian nature, such as Benin, as well as those that used more conciliar approaches, such as Tanzania. They also include countries that have been capitalist in orientation, such as Cameroon, Côte d'Ivoire, and Kenya; those that are led by military as well as by single-party regimes; and even those that are quasi-democratic like Senegal. In brief, a global crisis afflicts most of sub-Saharan Africa and its elements include the weakening of commodity prices, pronounced difficulties in

NOT PATRONSHIP

achieving export diversification, the absence of adequate domestic markets and limited access to external ones, and recourse to increasing indebtedness followed by a failure to generate earnings sufficient to service that debt.

A general cycle of impoverishment has therefore taken shape into which the majority of African countries have been gradually drawn. With an average of nearly 50 percent of external earnings being consumed by debt-servicing, and with commercial investments drying up, African countries have been rendered increasingly dependent on concessional aid and loans. In the short term, one of the major effects of structural adjustment programs is to compel African governments to acknowledge their countries' impoverished status by making sharp reductions in social spending—public employment, education, health, transport, and welfare services.

To adequately address the question of democracy and development in Africa, it is necessary to consider an additional dimension, namely governance. Those countries on the Pacific Rim cited earlier may be undemocratic, or partially democratic, but they have also developed appropriate systems of governance, especially concerning the use of available resources in both the public and private sectors.

Carol Lancaster has advanced the term "economic governance" to refer to practices of decision-making and implementation in the economic realm (*Africa Report*, July-August 1990). Concerned as this perspective is with matters that directly affect public investments and expenditures, her categorization is meant to exclude issues of a more strictly political nature such as the number

of political parties, the nature of the electoral system, the structure of the government, and general constitutional provisions.

While there is some overlap between Lancaster's analysis and the one advanced here, one important difference is that I do not believe it is possible in contemporary Africa to achieve the separation she postulates between the economic and the more political dimensions of governance.

In the case of the newly industrialized countries, they succeeded for a few decades in making this separation until their people rejected the suppression of civil liberties and the artificial compression of incomes and living standards. One important reason for the success of these countries in expanding their economies under authoritarian political systems is because an investment climate was fostered characterized by predictability, stability, and productivity. This climate contrasts with the typical African one where, according to Lancaster, "everything is open to negotiation."

The reason why an African economy such as Kenya's began losing its attractiveness to investors, according to human rights lawyer Gibson Kamau Kuria, is because everything became open to negotiation or, put more bluntly, to bribery and political influence: Debts were no longer speedily repaid, official decisions were not based on the relevant legislation and regulations, and judgments of the courts did not reflect a transparent application of the laws.

Consultations that have been conducted by the African Governance Program of the Carter Center of Emory University have identified the ways in which the increasingly undemocratic nature of African governments was part of a more general

failure to generate appropriate modes of governance. In this regard, the African crisis shares many similarities with that of the Soviet bloc.

Most African countries have become characterized by increasing centralization of government operations, by the entrenchment of political monopolies by single parties or military regimes, by the consolidation of what Thomas Callaghy in his writings on Zaire has called political aristocracies, by the relentless increase in presidential and military expenditures, by the bureaucratization and declining efficiency of the state sector, and by the closing-off of democratic routes to the procurement of state-controlled resources and the encouragement of nepotistic networks.



The pervasiveness of what we have termed prebendalism, as state offices are privatized and used to generate income for office-holders and their sectionally defined clients, has often culminated in extensive corruption at the summit of the political order and its replication in subordinate echelons. Students of Africa who many years ago decried Stanislaw Andreski's characterization of African urban societies as "kleptocratic" are now forced to acknowledge the contemporary popular adage that "to eat *magendo* you have to earn *magendo*" (*magendo* referring to illicitly obtained goods and income).

In short, the general crisis in governance and the increasingly undemocratic nature of most African political systems have become intertwined. It is no longer possible to tackle one without the other, whether in the USSR and Poland, as is now generally accepted, or in Gabon and Zaire.

Nevertheless, we must avoid the seductive notion that democracy or "multipartyism" will rescue Africa from its distress. Democracy, while a prerequisite for Africa's economic revival, will not by itself guarantee such an outcome. Nor is the authoritarian route to economic recovery a viable option any longer because there is a need in Africa not just for an economically enabling environment, as is frequently asserted, but a politically enabling one.

Most African countries no longer have the luxury of trying to restructure their economies in isolation from the unfavorable political dynamics outlined above. This observation applies as much to Benin and Zambia, whose economies have hit rock-bottom, as to Cameroon and Kenya, which still possess some resilience. It is no longer possible to separate, on the one hand, disregard for the rule of law, the weakening of institutional checks on governmental power, and the monopolization of power by ruling cliques and autocrats, from the stifling of economic initiatives, the difficulty of sustaining economic reforms, and the prevalence of dishonest practices in business operations on the other.

Efforts to pursue a series of circumscribed reforms in economic and financial management, as was attempted in Zaire under IMF auspices, and in Liberia under U.S. AID, must now be recognized as impractical. President Gorbachev has learned with difficulty that the Soviet economy and political system must be simultaneously transformed. The Chinese gerontocracy pulled back sharply at the point when its version of perestroika without glasnost was firmly challenged. African countries, with their fragile economies and plural composition, cannot afford either

a prolonged re-learning period for their leaders or violent, Ceausescu-like defenses of the decaying order.

It is evident that virtually all African countries must devise appropriate ways of facilitating greater openness, transparency, and accountability in their economic and political life. Attempts to create an economic marketplace without a corresponding political one are no longer credible. It must also be recognized, however, that Africa's predicament does not stop at its shoreline: Increased economic and political pluralism, even if appropriately combined, will not in themselves guarantee economic recovery. What is undertaken domestically will not automatically change the ways in which Africa is marginalized by the operations of the world economy.

In exploring new pathways to Africa's resumed development, the political dimension looms large wherever we look. Within African nation-states, unrepresentative and unaccountable governments must give way to ones that enjoy democratic legitimacy. At the regional level, long-frustrated attempts to promote integration and the gradual dissolution of national boundaries must be revived and accelerated in order to create larger markets and the freer flow of capital, labor, and entrepreneurial capacity.

Internationally, a peace dividend must be procured for Africa. A continent which has given so much to the world in the physical force of its enslaved and colonized peoples, in its cultural productivity, and in the material exports that largely served external needs, could rightly demand that new and determined efforts be matched by generous external assistance and special instruments to reconnect its economies to the growth points of the world economy.

The issue of externally imposed conditionalities is a secondary one. More important is the reverse consideration, namely, whether African countries will once again be in a position to demand supportive actions from the world community and espe-

cially from the richer nations and major development agencies. That was the premise of the 1986 Special Session of the UN General Assembly on the African crisis. Many promises made during that session by the industrialized nations have not been kept. However, it must also be acknowledged that much of Africa, in light of the internal shortcomings discussed earlier, may not have deserved the keeping of some of those promises.

A new Africa, with governments truly of, by, and for the people, could rightfully demand a "New Deal" for the continent. The promotion of progress in democracy and development in Africa requires the formulation in a coordinated manner of new domestic and external initiatives. It is only if these combined initiatives can be implemented in a spirit of partnership rather than patronship that hope will revive that Africa might elude the grim future being forecast by economists. ○

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CHALLENGING CONDITIONALITY

Western donors' attention on Eastern Europe's aid needs and their introduction of democratization as a condition for further support are troubling to Africa's leaders, who fear a disengagement from the continent just when nations are adopting politically risky policy reforms.

By SALIM LONE

It is getting harder and harder for Western donors to convince African leaders that the flow of international resources toward Eastern Europe will not be at the expense of assistance for the world's neediest and most crisis-ridden region. Doubts about this assurance were hardened further in July when the Western economic summit's aid deliberations focused not on Africa, but on the Soviet Union.

Since 1986, when the United Nations recognized the imperiled state of African economies, each of these summits had regularly adopted special measures to foster economic recovery on the continent. Before last year's summit in Paris, President Bush had announced the first-ever U.S. debt write-off for a group of sub-Saharan countries.

But in recent months, Africans have been startled by a sudden shift in this support. Senior aid officials as

well as the media have been regularly focusing on African policies and a lack of democratization as the exclusive causes of the continent's crisis, without acknowledging its severely disadvantaged position in the global economy. International policy-makers have therefore been meeting at the United Nations and at other specially convened international gatherings, most recently in London and in Maastricht, the Netherlands, to devise strategies to ensure that Africa does not become completely marginalized.

International marginalization is not the only challenge Eastern Europe is posing for African governments, who were already under severe pressure from restive populations bristling at years of unfulfilling austerity. The popular repudiation of single-party rule in the Eastern-bloc countries has also set off a wave of demands for similar pluralism across the continent, even in countries formerly thought stable. Adding to the

pressure in this area is the newly articulated demand by senior U.S. and Western officials that the level of democratization within Africa will soon condition the amount of assistance allocated to it.

Everywhere on the continent, there is intense concern about these developments, and widespread skepticism about the motivation behind the sudden introduction of the conditionality of democratization. Africans note that donors are not saying that political pluralism will lead to more aid, only that those not democratizing will receive less.

Most Africans also know that the continent cannot possibly compete with Eastern Europe as a magnet for Western investment—indeed, this had trickled to a virtual halt even in once-favored countries such as Nigeria, Côte d'Ivoire, and Kenya well before new opportunities opened up in Eastern Europe.

Africans also recognize that the broad public support that existed in-

ternationally for a continent in distress in the mid-1980s has been largely dissipated by the persistent nature of its crisis and its repeated appeals for increased international assistance.

So they suspect on the whole that the toughened donor attitudes herald a cutback on aid and a disengagement from a region whose problematic economies and poor future prospects seem less and less relevant to the growth of the richer countries.

Naturally, there is bitterness in many quarters about these new attitudes, as there is about the speed and volume of assistance being organized for developed Eastern European economies when compared to the slow pace of desperately needed debt relief and resource inflows for the world's most impoverished continent. There is particular bitterness over the fact that the seeming disengagement from the continent comes while the vast majority of African countries are pursuing politically risky economic policy reforms which had been urged on them by the

donors as prerequisites for increased assistance and investment.

Socialist Tanzania, for example, has adopted foreign exchange regulations which are infinitely more liberal than neighboring market-oriented Kenya's, and has just passed into law a state-of-the-art national investment code to attract foreign capital. Togo is rushing to establish an export processing zone which gives foreign investors a virtually free hand. But are these countries really going to see an influx of foreign capital when the economic and political returns are infinitely greater in Eastern Europe?

Donors have a right to play a role in determining how their aid is used, and to encourage greater political pluralism and respect for human rights where it is needed.

But crude conditionality—which bases assistance on how strictly a country follows policies chosen by the donors—is at best counter-productive. It might elicit compliance from resource-starved states, but it also breeds deep resentment. In any event, no reforms will work unless

they are, and are seen to be, nationally inspired. Nor can the diversity of African situations be addressed through the application of standard formulas that many donors advocate for *all* African countries.

Donors need to look carefully at how each country is proceeding in its own context. Most African countries have broken radically with their past orientations, and have initiated actions which call for enormous sacrifices from their people and which carry real risks for incumbent governments. Politically, many are moving to adjust to new domestic pressures for pluralism.

To succeed, such countries need less, not more, conditionality, and much more assistance. Their economic reforms will never succeed without such support, nor can the democratization donors are pushing for take place in a climate of extreme deprivation. The one bright spot in this long and uphill struggle is that Africa's needs for external assistance are minuscule when compared to the resources required for Eastern Europe. ○

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The World Bank/IFC/MIGA
OFFICE MEMORANDUM

DATE: 04-Dec-1990 12:18pm

TO: Paul Isenman

(PAUL ISENMAN)

FROM: Anthony A. Churchill, IENDR

(ANTHONY A. CHURCHILL)

EXT.: 33241

SUBJECT: Another Inquisition

I have asked Zia Kalim to send you his comments on Ian Johnson's draft for further work on the governance of our externally funded programs. I think it would be counterproductive to launch such an initiative at this point in time.

First, I do not agree with many of Ian's premises or hypotheses concerning existing programs. There is a difference between cofinancing of Bank programs and Bank cooperation with other agencies. The Bank has broader objectives than simply support for its own investment programs. His characterization of the financial and fiduciary responsibilities of program management is overplayed.

Second, the timing is bad. For both the water and energy programs, the last thing we need at this point in time is another time consuming and devisive investigation.

Third, at a minimum we should have a thorough discussion by all parties concerned before any wider circulation of the proposal. The credibility of these programs is endangered by the endless questioning within PRE of their purpose and goals.

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