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NURICK

L. Nurick

INTERNATIONAL AGENCIES AIDING OR
AFFECTING FOREIGN INVESTMENTS

(Southwestern Legal Center: June 23, 1959)



One of the phenomena of the post-war world has been the formation and growth of public international organizations to assist in economic development. They have assumed great importance and I think will continue to have an increasingly significant role.

I refer particularly to organizations such as the World Bank, the International Monetary Fund, the International Finance Corporation, the European Investment Bank, and others now in various stages of organization, such as the Inter-American Development Bank, the Arab Development Bank, the International Development Association, and others. The United States lawyer who had to learn the lexicon of New Deal agencies must now begin again with the international alphabet, the IBRD, the IMF, the IFC, the IAB, the IDA. This is not to mention the purely national development organizations, such as the ICA, the DLF, the CDC, the CDFC, etc. etc. Nor is it to mention the supra-national organizations, such as Euratom and the European Coal and Steel Community; nor the funds, the United Nations Special Fund and the European Social Fund. And I dare say there are still permutations and combinations of letters available for others still to come.

In discussing these international organizations, one should start with the World Bank for many reasons--all quite obvious. The World Bank was established first and has served as a guide to the others, not only in the form in which they have been set up, but also in their method of operations. Considering them only from the mundane aspect of the money involved, the World Bank is by far the biggest of all. Finally, the

World Bank has become the fulcrum for a widespread complex of money, ideas and institutional development, all for promoting economic growth.

I therefore want to talk today about first the World Bank and its operations, then the International Finance Corporation and its operations, then briefly the European Investment Bank, the Inter-American Development Bank, the Arab Development Bank and the International Development Association, and finally a word about their legal problems.

Let us glance back, for a moment, to the closing years of World War II. It was then apparent that one of the big problems in the post-war world was going to be the need for investment capital; capital for the reconstruction of war-torn economies and capital for the economic development of under-developed areas. Neither of these needs could be met from domestic resources. Both required the movement of capital across national boundaries, that is to say, foreign investment. And it was quite clear that the amounts needed were far larger than private investors would be willing to invest in loans to foreign countries.

This was the basic reason why the Bretton Woods Conference was called in 1944. The problem at Bretton Woods was the necessity of combining in one cooperative workable group those countries which had exportable capital and those countries which needed it. This remains the basic problem in the organization of other international development organizations, although there are now more countries in position to export capital. As the late Lord Keynes put it at the Bretton Woods Conference, the problem was

"that only a few of the member countries will be in possession of an investable surplus available for overseas loans on a large scale, especially in the years immediately following the war.

It is in the nature of the case that the bulk of the lending can only come from a small group of member countries, and mainly from the United States. How then can the other member countries play their proper part and make their appropriate contribution to the common purpose?"^{1/}

Keynes, you may recall, was Chairman of the Commission which formulated the Articles of Agreement of the Bank.

The solution to this problem lies in the ingenious capital structure of the Bank. It was provided that the Bank would be set up in corporate form and that each member would subscribe to capital stock, with subscriptions being fixed in amounts substantially proportionate to the economic strength of the member countries. Each member would contribute a modest amount in gold or dollars, 2% of its subscription, and a more substantial amount, 18% of its subscription, in its own currency. The 2% in dollars was to be freely available for loans, but the 18% payable in local currencies was to be usable only if the member country concerned so agreed. It was expected that the 18% portion would be released for lending purposes by member countries as their own economic positions strengthened. The remaining 80% of each subscription was not to be paid in at all, but would be in the nature of a guarantee by each member callable if needed by the Bank to meet its debts and payable either in gold, dollars or the currency needed to meet its debts. This guarantee was to become the basis for the Bank's own credit in the market. Primary emphasis was, and still is, placed on the guarantee of the United States; but the guarantees of other countries should progressively assume

^{1/} Proceedings and Documents of the United Nations Monetary and Financial Conference. U.S. G.P.O., Washington, D.C. 1948, Vol. I, p. 86.

greater importance.

The total authorized capital was \$10 billion of which the United States subscription amounted to \$3,135,000,000; of this amount, as we have seen, 20% was paid in and the remainder, \$2.5 billion was left subject to call. As you probably know, the Bank's capital is now in the process of being doubled, from \$10 to \$20 billion, with an extra one billion dollars added for contingencies.^{2/} It is contemplated that none of this increase would be paid in, but would all be left subject to call to meet the Bank's debts.

The significance of this type of capital structure is clear. It has two principal effects; on the one hand it requires the Bank, although a public institution, to look to the private market for most of its loanable funds; on the other hand it requires the Bank, in its lending operations, to keep at least a weather eye on the market to see that its loans do not unduly disturb the market.

I may say here parenthetically that one common denominator of the World Bank, the Inter-American Development Bank, the European Investment Bank and the International Finance Corporation, regardless of the form in which they have been set up, is their dependence not only on their members but also on the private capital market for a continued source of funds for their operations.

Borrowing

After the Bank started operations it quickly found that much had to be done before it could borrow any substantial amount of money. At

^{2/} This increase in authorized capital is contingent upon an additional \$7 billion being subscribed by member countries by September 15, 1959. A statute has recently been enacted authorizing the United States to double its subscription to \$6,350,000,000 (Public Law 86-48; June 17, 1959).

first the Bank needed only dollars, but the character of the market in this country presented both financial and legal difficulties which first had to be overcome. In the first place the Bank was international—and anything international was suspect. Memories of the disasters of foreign lending in the 1920's and 1930's were still too fresh in memory. On the legal side, both federal and state law imposed severe restrictions on institutional investment in the Bank's bonds. These legal restrictions were gradually eased—after an extensive legislative program of the Bank—and state laws now permit institutional investment in the Bank's bonds on a wide scale. On the Federal level, special legislation was enacted exempting the Bank's bonds from the provisions of the Securities Acts and allowing national banks to deal in and underwrite them.^{3/} This, in effect, accorded the bonds the same general treatment under these Acts as United States government, state and municipal bonds, thus allowing the Bank to reach the wide part of the investing market interested in governmental securities.

In this highly technical but vital area, the groundbreaking work of the Bank will, I am sure, prove to be of benefit to other international organizations. Indeed, it already has; for following the example of the Bank, the bill authorizing United States acceptance of membership in the Inter-American Development Bank provides that its securities will be exempt from the Securities Acts.^{4/} Also I think it is fair to say that the good reception accorded by the New York market to the bonds of the European Coal and Steel Community was due in part to its prior acceptance of the bonds of the Bank.

^{3/} Act of June 29, 1949; 22 U.S.C. 286(k)

^{4/} H.R. 7072, 86th Congress; introduced May 11, 1959.

Although, as I have said, practically all of the Bank's early borrowing was in the New York market, as world conditions improved and as its need for other currencies grew, it started to borrow wherever it needed the currency and could get it at reasonable rates. Of the \$1.9 billion debt outstanding, about \$1.5 billion is in United States dollars, the rest is in Canadian dollars, pounds sterling, deutsche marks, Swiss francs, Dutch guilders and Belgian francs. And of the total, dollar and non-dollar, it is estimated that about one half is held outside the United States.

In addition to direct borrowing the Bank sells participations in its loans, usually to banks and other institutional investors in this country, and in the last several years, without its guarantee. The Bank has raised some 1/2 billion dollars in this manner. Finally it is participating more and more in so-called joint operations with the private market; that is where the Bank makes a loan simultaneously with a loan from the private market to the same borrower. The Bank's willingness to lend was frequently an important factor in the decision of underwriters to go ahead with an issue.

It is particularly important for the Bank, and will be for other similar bodies, to be able to raise funds in many different markets and by many different techniques. This not only reduces the dependence of the Bank on any one source of capital, but it also enables the Bank to tap a wider area of capital. Furthermore, as currencies become more convertible, it allows the Bank increasingly to take advantage of that capital market which may, at any particular time, be offering currencies useable by the Bank on the most attractive terms to borrowers. At a time when, as now, United States interest rates are high, this flexibility is of great value.

Lending

Now for the lending activities of the Bank. It may strike some of you that I am putting things in peculiar order by talking first about borrowing rather than about lending. But not much could be loaned if the Bank were unable to borrow. Nevertheless, lending, of course, is the prime business of the Bank. Keeping in mind the disastrous practices in international lending of the prior generation, the framers of the Articles of Agreement laid down specific principles to be followed by the Bank in lending. The basic principles are as follows:

1. The Bank can lend only for productive developmental purposes and usually only for a specific project; and usually only to finance the foreign exchange costs of the project.

2. It cannot lend to a borrower who is able to get financing on reasonable terms from private sources. In other words the Bank does not compete with the private market.

3. It must be as sure as it reasonably can be that it will get its money back.

4. It can lend only to governments; or to others, with a government guarantee.

Before the Bank makes any loan it satisfies itself that the particular project is a sound one and will be adequately carried out. As the Bank's borrowers will testify, this investigation is not a perfunctory one.

The Bank has loaned to date over \$4 $\frac{1}{2}$ billion. Breaking this amount into categories, it has loaned about \$1 $\frac{1}{4}$ billion for electric power, the same amount for transport and about \$600 billion for industry. The lending rate of the Bank has gradually increased, from an average of about \$250,000,000 a year up to 1954 to about \$700,000,000 in each of the last two years, and there is reason to think that the rate of Bank lending

will continue to grow.

One additional aspect of the Bank's operations I do not intend to discuss now is the role the Bank has been given and has assumed as mediator. It has mediated serious international disputes, such as that between India and Pakistan over the use of the Indus Basin waters, between the United Arab Republic (acting for Egypt) and the Compagnie Financiere de Suez and between the United Arab Republic and the United Kingdom over the nationalization of the Suez Canal. While these disputes affect investment, they also often involve far broader considerations as well. I mention this activity only in passing because, while extremely important, it is nevertheless sui generis and in a sense personal to the Bank.

IFC

This, then, is a very brief description of the Bank's main business. I should like now to discuss the International Finance Corporation. For the World Bank and IFC, between them, encompass a good part of the problems of economic development.

The IFC was established to help fill a need which was not met by the World Bank. The fact that the World Bank cannot make loans without government guarantee of repayment necessarily means that it will operate very largely in the public field. Furthermore, although it does make loans to private industry, they usually involve large projects with a substantial public interest, and often private industry, on the one hand, is reluctant to seek a government guarantee for fear of government interference, and the government on the other hand is reluctant to give a guarantee to a particular private borrower for fear of being charged with favoritism. IFC was set up, therefore, to assist in the financing of private enterprises by making investments without government guarantee.

IFC was organized in 1956 with an authorized capital of \$100,000,000, of which about \$95,000,000 has now been paid in. Subscriptions are about 1% of subscriptions to the World Bank. A country cannot join IFC unless it is a member of the World Bank. 57 countries are now members of IFC.

The World Bank and IFC are affiliated organizations; they have common governing boards. However, IFC has separate legal autonomy and its own funds.

Its principal policies are as follows:

- (a) It cannot compete with private capital;
- (b) It cannot accept government guarantee of repayment;
- (c) It can invest only in private enterprise, not in a government owned or operated enterprise;
- (d) It invests only in less developed countries;
- (e) Its investments can be in any form subject to the one very important restriction that it cannot invest in stock. I might point out here that a similar restriction has been imposed on the operations of the new Development Loan Fund--a United States agency. I will advert to this restriction later as it has an important bearing on IFC's operations.
- (f) Its loans have been predominately repayable in dollars.

Essentially IFC invests as would a private investor and it expects returns comparable to those which a private investor would expect. This desire for profit arises because one of the purposes of IFC is to try to demonstrate that foreign private investment, particularly portfolio investment, can be a profitable operation. Furthermore, IFC must obtain additional funds by selling portions of its loans to other investors; obviously it cannot do this unless it has rights in an enterprise which are attractive enough to suit a private investor. Indeed, the continuance

of its operations depends largely on its being able to sell its investments; for unlike the World Bank, the European Investment Bank and the Inter-American Development Bank, IFC has no guarantee obligation on which creditors can rely and it will therefore be far more difficult for it to sell its bonds.

To date IFC has entered into 16 commitments totalling about \$15 million. Unlike the World Bank, the financing terms of these investments do not follow a fairly uniform pattern but are tailored to the requirements of the particular deal. Fixed interest charges range from 5% to 7%. In addition IFC has received shares of profits, also varying in rate from deal to deal, and in most cases options to buy shares at a specified price. The largest number of investments made by IFC in any one country have been made in Brazil, where five investment have been concluded. There have been three in Mexico, two in India, two in Pakistan, two in Australia, one in Chile and one in Guatemala.

One of the most useful types of investment IFC has made, and one which promises much for the future, is that in which IFC acts somewhat as the leader of an investing syndicate, thus channelling available private funds to the enterprise. For example, it has invested \$2,200,000 in a copper mining venture in Chile, together with \$4,200,000 from three United States banking institutions. It has also invested \$2,450,000 in the Willys-Overland automobile company in Brazil, together with \$1,050,000 from two United States banking institutions. The fact that IFC was willing to make an investment might well have influenced the other lenders to participate in the deal. As IFC continues to gain experience in investigating projects in the less developed countries, operations of this kind should increase considerably.

I want to call specific attention to one particular aspect of IFC's operations, namely, the restriction in its Articles of Agreement against investing in capital stock. This restriction was imposed on IFC in its Articles of Agreement apparently because it was felt that a public body, such as IFC, should not directly own equity securities. Since IFC invests risk capital, however, it is required, as has been seen, to take options on shares by means of convertible debentures, stock warrants or some other similar option device. While these types of securities are commonplace in the United States and other countries with highly developed capital markets, they are either unknown or are legally suspect in many other countries. The fixed capital concept in civil law countries causes some of the difficulties; pre-emptive rights sometimes cause other difficulties; mere unfamiliarity with or suspicion of complicated financing techniques causes still others.

Without passing on the merits of this restriction from the point of view of public policy, it is clear that from my point of view as a lawyer this restriction has required IFC to adopt artificial and complicated substitutes for equity investments and has had a decidedly limiting effect on IFC's operations. I fail to see why both the public policy aspects of this restriction and the lawyer's desire for clarity and simplicity cannot be reconciled by merely allowing IFC to invest in stock but to provide that the stock would be non-voting in IFC's hands.^{5/}

It is too early to tell whether IFC's investments will prove

^{5/} It is interesting to note that a strong recommendation to this effect in regard to the Development Loan Fund was made in the recent Strauss report prepared for the Secretary of State. See, Report; Expanding Private Investment for Free World Economic Growth, Washington, D.C., April 1959, at 23.

profitable. If they do, IFC will presumably be able to realize capital gains and to increase its resources by selling the investments to private investors. If they do not, IFC's activities will necessarily become more restricted, unless it can get additional funds from other sources. But these are the risks intended to be assumed by IFC; and in this respect IFC is subject to much the same risks as the private financial investor.

For awhile it was thought that the Bank and IFC together left little uncovered in the international developmental field. But not so. Serious consideration is now being given by the United States Government and other governments to the establishment of still another organization, the International Development Association (IDA) which would, it is suggested, also be affiliated with the Bank.^{6/} The principal purpose of IDA would be to make loans on easier terms than the Bank, that is, to provide for repayment, at least in part, in the currency of the borrowing country.

Whether IDA is established and if so, what form it will take, will probably be decided this year. But if it is established along the general lines now being discussed, what was started at Bretton Woods will have taken still another turn in development.

So much for the World Bank family. I should now like to discuss, very briefly, the European Investment Bank, the Inter-American Development Bank and the Arab Development Bank, all regional banks set up primarily to aid in the development of particular areas.

^{6/} See S. Res. 264, 85th Cong., 2nd Sess. (1958); Sen. Rep. No. 1832, 85th Cong. 2nd Sess. (1958); Letter from Sec. of the Treasury Anderson, dated August 18, 1958 to President Eisenhower and reply, dated August 26, 1958; National Advisory Council on International Monetary and Financial Problems, Sixth Special Report to the President and the Congress, April 1956-March 1958 at 25-28.

I think it might be appropriate, however, before discussing the European Investment Bank to put it in the context of the European Economic Community as a whole. As you know, since 1946 tremendous strides have been taken toward the development of an economically integrated Europe --a United States of Europe, as Winston Churchill put it. A whole series of institutions have been established, in many different areas and with many different functions.

First and most general was the Organization for European Economic Cooperation, created in 1948, to help restore prosperity to Europe. To assist in reforming currency relations there was first established the European Payments Union (the EPU), which was succeeded in 1958 by the European Monetary Agreement (the EMA). There are also the institutions designed to encourage the development and free flow of certain industries in the six member nations of the European Common Market: France, Germany, Italy, Holland, Belgium and Luxembourg; these are the European Coal and Steel Community and the European Atomic Energy Community (EURATOM). Both these institutions can borrow and make loans; and in fact the Coal and Steel community has had two successful issues in this country. These two institutions are particularly interesting to lawyers, because they are supra-national bodies, with power to tax and with special courts whose judgments cannot be appealed to any local court. Then there is the European Economic Community, organized in 1957, pursuant to the Common Market Treaty, to help create a common market in its six member countries for their products, by gradually removing duties in the area and applying a single tariff system for trade outside the area. The Common Market Treaty also laid the basis for the European Investment Bank.

It is thus apparent that to an increasing extent much of Europe can

be regarded by the American investor, at least for economic purposes, as a single unit. The consequences of this will, no doubt, be far-reaching; how far-reaching remains to be seen.

With this background it might have been expected that the European Investment Bank would have been given some of the supra-national characteristics of the Coal and Steel Community and EURATOM and a greater capacity to commandeer capital resources. But it was decided to model it instead on an old-fashioned international institution--the World Bank.^{7/}

Its capital is one billion EPU units (1 billion) divided into three parts, in substantially the same way as that of the World Bank, and it may call on its members to lend it another \$400 million, but all in national currencies.

Loans

Except in special cases, loans can be granted for projects only to be carried out in European territories of its members, and if made to a non-member, either with or without the member's guarantee. On the whole its basic loan policies are the same as those of the World Bank. Each member undertakes to make available to the debtors of EIB the foreign currency required to repay the loan in its territories.

Although the EIB has been set up largely like the World Bank, many interesting differences will arise in practice, probably because of the differences in membership, the World Bank being an institution with membership consisting of almost all the countries in the free world and the EIB membership being limited to the fairly homogeneous six countries

^{7/} Statuts de la Banque Européenne d'Investissement et extraits des dispositions du traité instituant la communauté économique européenne et des protocoles annexes relatifs à la banque. Bruxelles, Imp. Laconti, 1958. The text of the protocole sur les statuts de la Banque Européenne d'Investissement is also in the U.N. Treaty Series, Vol. 294 (1958), p. 183.

in the European Common Market. These differences manifest themselves to some extent in the EIB's first loan, one to the Cassa per il Mezzogiorno, an Italian Government agency, with the Italian Government's guarantee. For example, in the Cassa guarantee agreement between the Italian Government and the European Investment Bank, there is no negative pledge given by the Italian Government, whereas World Bank agreements, following the general practice of loan agreements between private lenders and foreign government borrowers, contain negative pledges from borrowing or guaranteeing governments.

One question which will be of interest to United States suppliers is whether borrowers from the EIB will be free to buy goods in the United States. Although the charter is permissive on the point, the Cassa Loan Agreement provides that the beneficiaries of the loan will treat suppliers in the six member countries on an equal footing. It is silent on the position of the United States; presumably the borrower is free to decide whether or not it wants to buy in the United States; but in no case can the six members be discriminated against.

THE INTER-AMERICAN DEVELOPMENT BANK (IADB)

After a long and sometimes turbulent history, an agreement for the establishment of the IADB was signed on April 18, 1959. This agreement was the culmination of discussions extending for several years between the United States on the one hand and the Latin American countries on the other. The United States had originally taken the position that no new and special Latin American international development bank was necessary; the Latin American countries said it was. Finally in 1958 the United States agreed to consider the establishment of the

bank and after a three-months conference of representatives of the countries concerned, the agreement resulted. The agreement is now being submitted to governments for acceptance. It will come into effect when countries with 85% of the contemplated subscriptions accept membership.^{8/}

As in the case of the EIB, the IADB was, in certain basic areas, modelled after the World Bank, but with many differences obviously resulting because of the interests of the different groups involved.

There are, in effect, two different departments, a hard loan department and another department called a "Fund for Special Operations." The hard loan department will have a capital of \$850 million, of which the United States is to subscribe \$350 million, \$150 million payable in cash over a three year period and \$200 million left subject to call. The Latin American countries are to subscribe \$500 million, payable 1/4 in dollars and 1/4 in local currencies, and the 1/2 left subject to call. Local currency contributions can be freely used for purchases in the country concerned.

Loans from this capital are to be repayable in the currency loaned. A government guarantee is optional but in other respects provisions regarding loan operations are similar to those of the World Bank. The agreement also contemplates that an additional \$500 million of callable capital will be subscribed after September 1962.

The charter also creates the Fund for Special Operations which will receive \$100 million from the United States and \$50 million from the Latin American members, payable 1/2 in dollars and half in local currency. The Fund will be permitted to make loans payable in the

^{8/} Special Report to the President and to the Congress on the Proposed Inter-American Development Bank, National Advisory Council on International Monetary and Financial Problems, May 1959.

currency of the borrowing country.

One of the interesting questions in the operation of the IADB will be its relations with private sources of finance and other public financing bodies, principally the World Bank and whether the Bank will constitute a source of additional finance or merely a substitute for aid from other public sources. Unlike the World Bank, it is not enjoined from competing with the private market; its charter (Art. III, Sec. 7(ii)) merely requires the IADB to take into account the ability of the borrower to obtain the loan from private sources of financing "on reasonable terms."

ARAB DEVELOPMENT BANK

Now for another part of the world--the Middle East. Although it has not received much attention in the press here, an Arab Development Bank is also now being formed. As these banks go, its capital is to be small--only twenty million Egyptian pounds, or about \$55 million. Its establishment was agreed to in principle when members subscribing 75% of its stock agreed to join. A revision of the shares of such members is now under way and the participation of other Arab countries, especially Iraq and Sudan, is dependent upon such a revision. Of course, the Arab countries--if they wished to contribute a substantial part of their oil revenues--could finance a big bank. Although the matter has been extensively discussed, up to now they have not been prepared to do so. The bank is therefore still in its formative stage and little else can be said about it now.^{2/}

^{2/} M. Fathalla El-Khatib, Arab Financial Institution for Economic Development, Arab Information Center, New York City, Oct. 1958. See also "Founding of the Arab Development Bank," in Lands East, Jan.-Feb. 1959, publication of the Middle East Institute, Washington, D. C.

Legal Problems

So much for the structure and operations of these organizations. Now I should like to say a brief word about their legal problems.

As far as the lawyer is concerned, these organizations present novel, interesting and significant problems and I think that at the moment more legal literature and attention is being devoted to these problems than any other one aspect of international and comparative law. Speaking very generally about these organizations as a whole, they present problems for both the public international lawyer and the comparative lawyer. For example, what is the status of these organizations under international law; are they entitled as a matter of law to governmental privileges and immunities or are they subject to domestic law; are their agreements necessarily international agreements; what law governs their contracts; can they insulate themselves against the effect of local law; what is the foreign law in any particular case; does a concept of one law have the same meaning in another. Then there are the problems of a private nature and here the range of problems is limited only by the nature of the activities of the particular organization itself.

Posing the questions is one thing; answering them another. And for the lawyer practicing in a foreign or international field, answering problems is never simple. I am sure I do not have to remind this audience that in going from one law to another you take things for granted at your own peril. Even when dealing with comparisons between American and British law, things are not always what they seem. The same basic legal words may have an entirely different meaning in the other jurisdiction. For example, the word debenture in American law means an unsecured promise to pay. In British law it is a neutral word, and like the American word

"bond" can mean either a secured or unsecured promise to pay. The word "stock" means different things in American and British law. And there are basic differences in concepts of fraud in the sale of securities; what would be a fraud in one jurisdiction might be common legal practice in another. Much more serious differences arise, of course, between the common law and the civil law, differences arising from different concepts in many areas.

As far as the particular problems of the World Bank are concerned, there are, first, the problems arising from the fact that the Bank is dealing and making contracts with governments. This immediately raises questions concerning the government's capacity to act, which, in turn, may raise questions concerning the nature of the government itself, whether it is a constitutional government, whether it is a de facto or de jure government, what procedures must be followed to be sure the government is bound. As you know, being close to Latin America, these problems are not always academic.

In addition to basic governmental problems of that kind, problems also arise in connection with the project itself. If, for example, the World Bank is lending to a government agency or other public body for the construction of a power plant, the Bank wants reasonable assurances that the project is sound, that the rates will be adequate for the purposes of the project, and that the public body will be able to carry out its commitments.

Finally, the Bank encounters a range of problems of a private nature where it makes loans to private corporations, as it has to Brazilian Traction in Brazil, Mexican Light and Power and others. These problems, like those of the IFC which I will discuss in a moment, include those

which any ordinary foreign investor doing business may have plus some problems peculiar to the Bank.

IFC's problems, on the whole, are quite different from those of the World Bank; they are more like those of a private investor. How should an investor put his money in; how will he be able to take it out; what is the best corporate form to use in setting up an enterprise; are there special foreign investment incentives in the country; if so, should he try to obtain them; what governmental consents must be obtained; are there special restrictions on foreigners; can he sell his investment without restriction; what is the likelihood of nationalization; tax questions, and so forth.

In addition to these fairly general problems, there are more unusual ones which arise when it is sought to introduce into the less developed countries complicated methods of financing which are unfamiliar to them. It is always difficult to try to introduce new patterns of financing in foreign countries, particularly where they do not fit into the accepted order of things or are based on different legal systems. No doubt the foreign investors in the United States in the last century had difficulty in introducing concepts of corporate finance unfamiliar in this country. The same may be said of investments flowing now from the United States to the less developed countries.

IFC has had to meet these problems as best it could. It took the attitude that merely because a pattern of corporate financing was unknown was not sufficient reason to exclude it. In other words, IFC is willing to try something new--with appropriate safeguards of course and with advice of counsel.

Thus in Mexico IFC worked out, for the first time as far as I know, something comparable to a stock warrant. It got the approval of a Mexican court and now IFC hopes others will be inclined to follow in the same path. In Brazil, it adapted to new uses a security unique to Brazil, partes beneficiarias, PB's as they are called; and a most useful type of security it is. It is continuously encountering novel problems and solving them as best it can.

This then is a short sketch of some of the legal problems of IFC and other foreign investors.

CONCLUSION

It is apparent that I have merely scratched the surface in describing the operations and problems of these international development institutions. As I said in the beginning of my remarks, we are in the midst of a new and growing field, and it seems clear to me that the international development agencies are in the process of growth. The flow of capital either coming directly from these agencies or channeled by them is constantly growing. In fact, I think the day has come where, to some extent, a good borrower can hope to find competition among them for his business; and may also find similar competition among the national agencies in the same field.

The role played by the international organization is particularly significant since their activities can, to a large extent, be kept free of political considerations and their decisions can be motivated on economic grounds. These, in my opinion, are extremely worthwhile objectives and should continue to be of substantial benefit to us all.

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CERTAIN ASPECTS OF THE LAW AND PRACTICE OF THE
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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Decisions of International Organizations;
Effectiveness in Member States

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I. INTRODUCTION

1. This paper discusses certain aspects of the topics on the Agenda to be discussed at the Second Conference on Legal Advisers and International Organizations, August 1967, relating to the law and practice of the International Bank for Reconstruction and Development (IBRD).

2. It should be made clear at the outset that this paper deals primarily with the legal effect of actions and agreements of the IBRD, principally as they are reflected in the IBRD's lending agreements, but also in certain other respects as well. The paper is thus somewhat broader in scope than the Agenda. However, since the main area in which the acts of the IBRD affect or are affected by local law is in connection with the IBRD's lending agreements, it was thought useful to include a discussion of those agreements in this paper. The paper will also discuss the one proceeding which has arisen where an interpretation by the IBRD of its Articles of Agreement has been given effect in a member country by decision of an administrative body.

3. In order to understand the significance of the IBRD's lending practices and agreements for purposes of this paper, it is first necessary to describe briefly the nature of the IBRD and its operations.

*The views expressed in this paper are personal and do not necessarily represent those of the IBRD.

Nature of the IBRD and its Operations

4. The IBRD is an international intergovernmental institution whose primary purpose is to promote the economic development of its members. One hundred and six governments are now members of the IBRD. To achieve its objectives, the IBRD makes loans to its members or to borrowers other than members with the guarantee of the member concerned.

5. The IBRD is set up in corporate form and its members subscribe to shares of its capital stock. The total subscribed capital of the IBRD is approximately the equivalent of \$22.5 billion. However, only a relatively small part of this capital is actually paid to the IBRD in a form which can be used for lending. The great proportion of the capital (90%) is not paid at all, but is in the nature of a guarantee which can be called on by the IBRD if necessary to meet its obligations. One of the main consequences of this capital structure is that in order to operate the IBRD must borrow most of the funds it needs from private sources.^{1/} This in turn means that the IBRD must conduct its affairs in a business-like way so that private lenders will have enough confidence in the IBRD to lend to it the very large sums of money it needs.

6. To avoid the errors which had characterized much of the international lending of the past, and particularly of the inter-war period, the Articles of Agreement contain certain protective provisions. The Articles provide that loans must be for productive purposes, that, except in special circumstances, they must be for specific projects,

^{1/} In this and many other respects the IBRD differs from the Fund.

that the merits of all projects must be carefully studied and that arrangements must be made to assure that proceeds of each loan are used only for purposes for which the loan was granted. Aside from these rather general provisions, however, the Articles are silent as to the conditions on which the IBRD should make its loans, and, in fact, for the most part it is the policy of the IBRD, not the requirements of its Articles, which determines these conditions.

7. The IBRD wants to be assured that its loans are made for productive purposes of high priority, that its loans are used only for the purposes of the project and that the projects are carried out efficiently -- all to the one basic goal, the economic growth of the IBRD's member countries. In seeing to it that these objectives are realized, the IBRD has worked out fairly elaborate procedures which have evolved over the years as the IBRD has become increasingly familiar with the problems of development.

8. The first major consideration of the IBRD is the country itself. Aside from the merits of particular projects themselves, the IBRD realizes that projects should be planned with due regard for their place in the economy as a whole. Thus, before making a loan, a careful assessment is made by the IBRD to analyze the economic position of the member state and to consider the relationship of individual projects to the member's development needs. These recommendations consider not only the effect of increased amounts of capital on the country, but also the important question of the possibility of improvement in the use of its resources.

9. The IBRD has developed a practice of organizing missions of experts to visit individual countries and to draw up comprehensive recommendations that serve as a basis for working out a detailed development program. Increasingly, the IBRD is engaging in consultations about the fundamental economic policies of its members.

10. The second major consideration is the particular project being financed. It has become evident that in many developing countries if the IBRD were to finance any considerable number of projects it would have to offer advice about how to prepare them. The IBRD, therefore, not only closely examines proposals through studies of documents and visits to the field; as expert it has also developed the practice of suggesting modifications or further study whenever necessary. It thus plays an advisory role of considerable scope and variety, concerned with economics, engineering, administration and other factors bearing on project execution. The IBRD discusses with the borrower what kinds of technical services are needed, advises on how best to obtain these services and, if necessary, draws up terms of reference for consultants.

11. The IBRD has evolved a set of policies to guide itself in evaluating projects of different kinds. Each of the different kinds of projects the IBRD finances (e.g. power, transportation, industrial, agricultural, education) must satisfy standards prescribed by the experts in those fields on the IBRD staff in evaluating the soundness of the projects.

12. The culmination of these efforts is of course the making of a loan. But it must be recognized that this step, the signing of the legal

documents, is only the final step in a lengthy process of analysis and negotiation. Much of what is done during this lengthy process may ultimately be reflected in changes in local law and administration. But the causal relationship, that is, the relationship between an IBRD position taken on a matter and the effect of this on the local law, may not be apparent since basically the process is one of consultation, advice and negotiation, not of fiat. Nevertheless, there still remains a wide area where the making of a loan specifically involves certain consequences in local law and these are examined below in Section III.

13. It should be noted that the activities of the IBRD are supplemented by another international institution which is affiliated with it, the International Development Association (IDA), which makes loans for essentially the same purposes as the IBRD, but on much softer terms of repayment.^{2/} The IBRD makes loans to private and public entities but only with the guarantee of a member. IDA, on the other hand, makes loans only to members; if the project is for the benefit of a private or public entity, the member will usually relend the proceeds of the IDA loan to such entity under agreements satisfactory to IDA. As far as the nature of the understandings reached with the recipient of the loan is concerned to carry out and implement the project, the IBRD and IDA follow essentially the same policies and consequently the effect of these undertakings on local law is essentially the same. In this paper, references to the IBRD can be taken to include IDA, unless the context otherwise requires.

^{2/} There is still another international institution affiliated with the IBRD, the International Finance Corporation (IFC), which deals only with the private sector. This paper does not discuss the IFC.

II. THE CHOICE OF TECHNIQUES TO CARRY OUT AN
AGREED COURSE OF ACTION

14. As has been seen, a substantial part of what may be called the "course of action" agreed between the IBRD and a borrower arises as a result of the evaluation and negotiation process described above. The agreement may be merely the decision of a member (reached in agreement with the IBRD) to construct one type of project rather than another or not to proceed with a particular project at all. These "decisions" or agreements are not usually to be found in a formal document as such, but are reflected as a position taken by the IBRD and an action taken by the member followed by a loan from the IBRD. This type of process is probably one of the most far-reaching of all those in which the IBRD is involved.^{3/}

15. During the next stage in the process, more formal and more obvious techniques are used, including informal understandings, letters of representation and formal agreements.

(1) Informal understandings

16. As mentioned above, before the IBRD decides to extend a loan in a member country, an evaluation will be made by the IBRD of the economic policies and performance of the member. It may be that this evaluation will lead the IBRD and the member to decide that certain economic policies which affect development should be changed before a loan would be

^{3/} Another related example, and an important one, is a decision taken by the IBRD not to lend to a member country which has failed to honor certain kinds of international financial obligations (e.g., certain cases of expropriation of foreign property or of default in payment of an external debt). In these cases the "agreement" may be reflected by a decision of the government to pay the debt followed by a decision of the IBRD to lend to that country. The government's decision may require implementing local legislation.

fruitful. The IBRD and the member may then, in consultation, reach an informal understanding as to the nature of the action to be taken. These understandings involve the general economic policies of a government (e.g., the desirability of raising taxes in a case where public savings are too low to justify an IBRD investment; the composition of a development plan, taking into account the availability of resources; the desirability of affording agriculture a higher priority in the allocation of resources; the desirability of encouraging certain kinds of imports and exports; the desirability of liquidating unnecessary and wasteful statutory corporations). This type of understanding, while it may result in substantial changes in a member's law, is not reflected in a legal document and must be distinguished from the cases referred to below where legal commitments are entered into.

(2) Letters of Representation

17. Occasionally a borrowing member may furnish to the IBRD a letter of representations in connection with a particular loan that it "intends" to take certain legislative or administrative action which is regarded as desirable for purposes of the loan. This technique of the member's describing an intention rather than furnishing a clear contractual commitment may be used where the member may not be able to give such a commitment or where the IBRD may feel it is not necessary for its purposes to obtain one. Nevertheless, this type of representation may well involve the enactment of legislation.

(3) Formal Agreements

18. The main formal agreements used by the IBRD in its lending operations are as follows:

- (a) Loan Agreement (between the IBRD and the borrower under which the IBRD agrees to make the loan);
- (b) Guarantee Agreement (between the IBRD and the member state, in case the borrower is not a member state, under which the member agrees to guarantee the loan);
- (c) Project Agreement (between the IBRD and the entity carrying out the project if such entity is not the borrower);
- (d) Supplementary letters (exchanged between the parties amplifying, when necessary, the above agreements);
- (e) Additional contractual arrangements, when necessary, evidencing specially agreed matters (e.g. security arrangements such as trust deeds, mortgages, take-or-pay contracts);
- (f) In addition, in certain cases, there may be a complex of agreements between a government and a private party (e.g., a concession) which the IBRD, although not a party to the agreements, will rely on in making a loan.

19. These documents embody, in legal form, the agreements reached between the Bank and other interested parties to a loan. The content of these agreements is the legal reflection of the IBRD's policies and decisions for a particular type of loan operation. These agreements are the cornerstone of the IBRD's legal relationships with its borrowers, as far as lending is concerned, and they are examined in some detail in Section III below.

20. It is evident that as far as its formal documentation is concerned, the IBRD follows practices which are similar to those of private financial lenders. This is not to say that the contents of the IBRD

agreements are the same as those of the private institutions; they are not, since IBRD agreements, among other things, contain covenants regarding the execution of projects and standards of performance which are not generally found in private agreements. But the IBRD does rely to a large extent in the carrying on of its business on formal contractual arrangements, unlike the Fund which does not.

(4) Conditions to be fulfilled for effectiveness of agreements;
legal opinions

21. The IBRD's loan and guarantee agreements provide that they shall not become effective until evidence satisfactory to the IBRD shall have been furnished that the execution and delivery of the agreements on behalf of the borrow and guarantor, if any, have been duly authorized or ratified by all necessary governmental action. They also provide that such evidence shall include a legal opinion satisfactory to the IBRD showing that this condition has been satisfied and that the agreements constitute valid and binding obligations of the borrower or guarantor in accordance with their terms. In addition to these standard clauses, the IBRD's agreements also often contain additional conditions precedent to effectiveness. While these conditions vary greatly they concern those elements of a project which are considered important to the achievement of the purposes of the agreement. Accordingly, for example, the IBRD may wish to be satisfied that under local law funds are available to complete the project, the entity carrying out the project shall have been given adequate powers, and the like.^{4/} In effect,

^{4/} There may also be conditions regarding other types of action which have to be taken to permit the project to go forward; e.g., the purchase of necessary land, the conclusion of specified contractual arrangements.

these provisions mean that before the IBRD declares itself bound under the agreements it wants to be satisfied, among other things, that they can be carried out under the relevant municipal law.

22. This may require a borrowing country to enact new legislation or amend existing legislation permitting the project to be carried out in accordance with the terms of the agreement. One example of this arises occasionally in cases where under local law a member state can only borrow up to specified amounts authorized by law; in such cases it may be necessary to enact special legislation increasing the amount so authorized in order to cover the amount of the loan from the IBRD. Another example is where existing local law may not authorize a member state to guarantee loans to private corporations; in such a case such legislation would have to be enacted before the IBRD agreements were made effective.

III. THE LOAN DOCUMENTS

23. In addition to examining the general economic policies of a government, the IBRD examines the economic justification and consequences of the particular project it is interested in financing. In order to be assured that the project will be efficiently carried out and will yield the returns which will make it an economically justified project, the IBRD requires various governmental assurances designed to achieve those ends. These assurances, unlike those referred to above, are contained in formal agreements reached in connection with a loan. From a legal viewpoint, these assurances may call for the taking of legislative or administrative action as a condition for the loan. This

is what may be called the positive aspect of the IBRD's course of action. In many cases, however, the IBRD's course of action takes the form of negative covenants restricting the administrative or legislative freedom of the country involved or its agencies in order to make certain that the conditions considered as essential to the success of the loan will not be subsequently put in question by governmental action contrary to both the borrower's and the IBRD's interests. The particular assurances which the IBRD may seek in a loan depend on the nature of the loan and the circumstances of the particular case. Accordingly, these assurances take a wide variety of forms and deal not only with relatively minor technical aspects of a given project but also with more basic problems arising from the relationship between the economy of a country and the project. Although the assurances are very varied in form and scope, nevertheless in a particular type of loan they tend to follow a similar pattern. Examples of some of these assurances, broken down into categories, are as follows:

(1) Economic Considerations Relating to Projects

a. Rate Adjustment

24. It is the policy of the IBRD to obtain assurances that a public revenue-producing entity (e.g., electric utility, port authority, railroad corporation) will be allowed to earn a reasonable return on invested capital. An assurance of this kind may have a particularly significant effect on local law since it may require legislative changes to permit the entity to raise its rates; and the making of this change may be required as a condition of the loan. In any event, the IBRD takes care to try to see to it that the rate covenant in the loan agreement is consistent with local law. Sometimes this consistency is achieved by a

member state's making changes in its law or by the enactment of new legislation. In addition, there may be a requirement in the agreement that the relevant law will not be changed. For example, in the loan for the construction of the Volta Dam in Ghana, the loan agreement provides (Loan No. 310 GH) that the Volta River Authority, a governmental utility authority, will charge rates in accordance with the requirements of the Volta River Act, 1961. This Act specifically provides for the fixing of power rates according to certain prescribed standards and was worked out in consultation with the IBRD. In the Guarantee Agreement for the loan, the member state has agreed to guarantee the performance by the borrower of all of its obligations under the loan agreement; this in effect means that that member government has agreed to take no action which would interfere with the borrower's being able to act in accordance with the Volta River Act.

b. Elimination of Rate Subsidy

25. In some cases, the rate structure of a utility has been such as to give preferential rates to certain groups (e.g., the military, government employees, students). The IBRD may regard this as unsound financial administration and provide, in the loan agreement, that such subsidized rates be eliminated.

c. Limitation on New Expansion Program

26. In some cases the IBRD believes that execution of the project imposes such demands on the borrower's financial and manpower resources that the successful completion of the project might be endangered by the borrower's dividing its energies. Accordingly,

a limitation may be imposed on any new expansion program in that particular field until a project being financed by the IBRD is completed.

27. Occasionally the IBRD considers that once the project which it helps to finance is completed, the goods or services produced may for some considerable time to come meet the demand of the area in which the project is located or of the member state as a whole and that it would be imprudent further to expand production in that field without a careful review.

28. In the guarantee agreement for the Volta Dam Project (Loan No. 310 GH), the member state (Ghana) has agreed not to finance an additional major power project in the country unless the project would not materially interfere with the Volta Dam Project and "there is adequate economic justification for such project, taking into account not only the said project standing by itself but also the effect of such project on the obligations assumed by the Borrower and the Guarantor in connection with the Project."

29. Sometimes the agreement is simply to consult, rather than to obtain the Bank's approval, before embarking on the program. For example, in an education credit made to Pakistan (Credit No. 87 PAK), the Province of East Pakistan undertakes to furnish to IDA "its general programs for the construction of new, and the expansion of existing, education institutions," and to "afford the Association an opportunity to exchange views with respect thereto."

d. Reduction of Number of Employees

30. The IBRD sometimes finds that a government corporation desiring to borrow from the IBRD is overstaffed, resulting in inefficient and wasteful operations. In such a case the IBRD and the borrower may agree that the borrower should reduce the number of its personnel.

e. Distribution of Costs

31. In order to maximize the production expected under a project, the IBRD may seek to allocate among the interested parties the costs of maintenance of the project in such a way as to benefit one group in particular. For example, in a loan to Malaysia (Loan No. 500 MA), the member state has agreed, in the loan agreement, to:

"make suitable arrangement for the recovery, by means of charges for the use of irrigation water and by means of increased taxes on land in the Project Area, of all operating and maintenance costs and of as much as practicable of the moneys invested in the Project together with reasonable interest thereon. The Borrower shall cause such water charges and taxes on land in the Project Area to be assessed and shared between landlords and tenants on such a basis that tenant-cultivators will have an incentive to maximize production."

f. Price and Export Controls

32. In certain agricultural projects the IBRD may want to be assured that the government will not take measures which would adversely affect the economic benefits expected to result from the project, such as, price and export controls on commodities related to the project. In that event it may be agreed that a government will remove existing controls on such commodities or that it will not impose any additional such controls.

(2) Organization and Management of the IBRD's Borrower or the Beneficiary of the Proceeds of the Loan

a. Establishment of a New Entity

33. The IBRD considers that the soundness of the entity which is to carry out the project (whether it be the borrower or the beneficiary of the loan) is important to the success of a project. In many cases, the IBRD has required that a new entity be established to carry out the project. This is particularly true with respect to multi-purpose projects where existing forms of organization may not be readily adapted to the complications of a project of that kind. It is the practice of the IBRD not to make the loan until the legislation or other instrument under which the entity is created has been enacted and the entity is properly organized.

b. Setting up a Special Section within a Ministry or Department to Carry Out the Project

34. If a loan is made to the member state and the project is to be carried out by a ministry or department of the government, the IBRD will, when appropriate, want a special section or unit in the ministry or department to be established to discharge special functions or to carry out the project. Such an undertaking by the government usually would not require legislative action. Nevertheless, budgetary allocations have to be made, and more often than not, administrative responsibility has to be reallocated in the ministry or department concerned.

35. In most of the education projects, the agreements have provided that a special project unit be set up to carry out the project. A typical example is the education project in Pakistan (Credit No. 87 PAK) where the Province of East Pakistan has undertaken to appoint

a project director who would be in charge of a project office to carry out the project.

36. In agricultural credit loans, a growing activity of the IBRD, elaborate governmental machinery has often been set up for the handling of both the financial and agricultural aspects of the project. These cases may involve extensive changes in both law and administration.

c. Maintenance of the Existence of the Entity

37. In lending to a governmental entity, the IBRD is concerned to see that the entity maintains its existence and proper organization. Usually the IBRD agreement provides that the charter, the articles of association or the act under which the entity is created shall not be amended without the prior consent of the IBRD.

38. Or, alternatively, the loan agreement may provide that any material change in the instrument under which the entity is created shall be an event of default.

d. Management

39. The IBRD considers that competent and experienced management is essential to the success of a project and before making a loan will want to be assured that such management is or will be available.

40. Accordingly, the IBRD's agreements often contain provisions regarding the appointment of the personnel who will carry out the project. For example, in some cases it is provided that the borrower will appoint a project manager only if acceptable to the IBRD or in consultation with it.

41. This may mean in the cases of loans to public corporations that special requirements of the IBRD in this regard will have to be reconciled with civil service and personnel laws of a generally

applicable nature.

(3) Financial and Technical Considerations

a. Provision of Funds to Complete the Project

42. In loans made either to a member state or to a non-member borrower, it is usually provided that the borrower and sometimes also the guarantor will provide funds to complete the project.

43. In loan agreements, sometimes the provision simply states that the borrower shall carry out the project, which necessarily includes the obligation of providing sufficient funds to complete the project. In other cases, explicit provision is made stating that the borrower shall provide "promptly as needed, the funds, facilities, services and other resources" required for the purpose of carrying out the project. In guarantee agreements it is often provided that:

"The Guarantor specifically undertakes, whenever there is reasonable cause to believe that the funds available to the Borrower will be inadequate to meet the estimated expenditures required for carrying out the Project, to make arrangements, satisfactory to the Bank, promptly to provide the Borrower or cause the Borrower to be provided with such funds as are needed to meet such expenditures."

Provisions of this kind may require special budgetary and appropriation legislation.

b. Debt Limitation

44. In most loans to autonomous revenue-producing public entities, a debt limitation covenant is provided in the loan agreement restricting the right of the borrower to incur additional debt. There are various formulas to set such limit, the purpose of which is to maintain the financial soundness of the entity which is to carry out the project. While this kind of restriction would not usually be incon-

sistent with local law, it may serve to impose an additional restriction on the right of a public corporation to borrow beyond that found in local law.

c. Exemption from Taxes on Payments under Loans

45. There are standard provisions in loan and guarantee agreements for tax exemptions with respect to the payment of principal, interest, and other charges on the loan, and on the execution, issue, delivery or registration of the loan and guarantee agreements and the bonds called for thereunder. These provisions may require reconciliation with the general tax laws of the member countries. If the Bank's requirements in this respect conflict with local law and it would be impractical to insist on a change in local law, the Bank is willing to adapt its requirements if it can get substantial protection of its own interests in a way which would not conflict with local law. For example, where payments on the bonds received by the Bank from its borrowers would not be exempt from local taxes under local tax law, the Bank may accept, instead of a clause providing for such exemption, an agreement on the part of the Bank's borrower to pay the taxes if such taxes are imposed.

d. Taxes Affecting Project

46. In a few cases, the IBRD takes an interest in the incidence of local taxes on the construction of a project or its subsequent implementation; where appropriate in special cases the IBRD's agreements may provide that the tax regime in a particular country as it affects a particular project will not be changed or that certain taxes will not be imposed.

47. For example, in a credit made to Kenya for a tea development project (Credit No. 64 KE), Kenya has agreed in effect that tea

processed under the program financed by the IDA credit shall be free from local taxes except taxes in effect at the time of the signing of the agreement.^{5/}

48. Such undertakings may require changes in the tax law and regulations of the member state.

49. When there is a concession or establishment convention between the borrower and the guarantor government providing for tax or customs duty protection, the Bank may provide in the loan documents that the concession or convention shall not be amended without the IBRD's consent or to make such an amendment an event of default. This is a situation which has obtained in several loans for projects in African countries (e.g., Mauritania, Gabon and Congo Brazzaville).

e. Auditing Requirements

50. In loans to a revenue-producing public entity, the loan agreement normally provides that the accounts of the entity must be audited by an independent auditor or by an independent accounting firm satisfactory to the IBRD. Existing law is not always consistent with such a provision; in such a case, special action may have to be taken to give effect to the provision in local law.

f. Procurement Method and Procedures

51. One of the important areas where IBRD agreements may have considerable impact on local law and administrative regulations is the

^{5/} In connection with a loan made to the Republic of the Philippines for the benefit of the College of Agriculture of the University of the Philippines (Loan No. 393 PH), special legislation (R.A. No. 3854) was enacted providing that the University shall be exempt from all taxes, duties, fees, imposts and other charges of the Republic of the Philippines on items imported for the use of the University in the development program for the College of Agriculture.

field of procurement. It is IBRD policy to insist on international competitive bidding for procurement under most of its loans. This means that if, say, a government corporation is a borrower from the IBRD it must issue tenders on an international basis and must be prepared to award the contract to the lowest evaluated bidder. In many cases government corporations are bound to adhere to special rules regarding procurement under local law which may be in conflict with the principles of international competition. If so, local laws and procedures must be changed so as to permit the borrower to conform to the IBRD competitive bidding requirement.

52. One of the problems that sometimes arises is the effect to be given to local laws which provide for certain preferences to local manufacturers. Here again, the member government concerned must see to it that these preferences do not conflict with the award of a contract to the lowest evaluated bidder.^{6/} This area of procurement is of particular importance since it involves very large sums of money and it is one in which the member governments of the IBRD, both on the capital exporting and the capital importing side, have expressed great interest. In order to standardize the procedure as much as possible, the IBRD has published a document entitled "Guidelines relating to Procurement under World Bank Loans and IDA Credits" which borrowers agree to follow in the preparation of tender documents and the award of contracts.

^{6/} In recognition of the legitimate interests of borrowing countries in promoting the growth of sound industries, the IBRD will, in appropriate cases, allow a margin of preference to domestic over foreign suppliers in the comparison of bids to supply material and equipment being procured for purposes of an IBRD financed project.

53. The IBRD normally reviews contracts which are being financed under its loans to see, among other things, whether they comply with the principles prescribed in the Procurement Guidelines and are satisfactory to the IBRD in other respects as well.

54. While the Guidelines do not provide that the contract documents must contain provisions for settlement of disputes between a government and a contractor, nevertheless in cases where the absence of a satisfactory provision for settlement of disputes has led to difficulties between a contractor and a government in the past, the IBRD may require any future loan to be conditioned upon a government's providing for a satisfactory method for settling disputes with foreign contractors. This is not because the IBRD is committed to any particular method of settling disputes but because it may conclude that without such a satisfactory procedure foreign contractors will not want to bid on a contract or that they will put in bids which are unduly high. A requirement of this kind by the IBRD may involve the enactment of legislation in a member state allowing disputes between the government and a foreign contractor to be settled on a basis satisfactory to the IBRD.

g. Standards and Specifications

55. The IBRD takes an interest in the standards and specifications of the goods or construction being financed by its loan and the agreements may provide that such standards and specifications shall be subject to the approval of the IBRD. In some cases the IBRD will examine and approve the standards and specifications before the loan is made. In any event existing government regulations, if inconsistent with the agreed standards,

would have to be reconciled with them.

h. Non-interference by the Government

56. The IBRD believes that when an autonomous public entity or a private corporation agrees with the IBRD to carry out a project the member state (which is the guarantor of the loan) should agree not to interfere with the carrying out of the project. For example, guarantee agreements will generally provide that the member state

"will not take, cause or permit to be taken, any action which would prevent or materially interfere with the carrying on by the Borrower of its operations and affairs in accordance with sound financial and investment standards and practices, or with the performance by the Borrower of its obligations under the Loan Agreement."

57. This is an important provision and one which might well help insure satisfactory completion of a project. Questions have arisen as to whether or not this so-called non-interference clause would prevent a government from enacting legislation of a general nature which, incidentally and as a by-product, might interfere with the IBRD-financed project and conflict with this clause. The IBRD prefers to treat this question in the context of a particular case, rather than to deal with it as a general problem. But one example may be of interest.

58. In a loan made to a government corporation, the loan agreement provided that any suspension, repeal or amendment of the Act under which the borrower was set up which would affect adversely the ability of the borrower to carry out its obligations under the loan agreement would be an event of default. The Act had been reviewed with the IBRD in detail before it was enacted and it provided, in effect, that the government would not interfere with the corporation's general financial

and business policies. In 1966, another act was enacted which provided that:

"notwithstanding any provision of any enactment, the Minister of Finance may give to such Corporation, such directions with regard to (a) the Corporation's general financial policy; (b) any specified items of the Corporation's estimate of revenue or expenditure as he may think fit and the Corporation shall give effect to such direction."

59. The IBRD considered that the provision of the second act had, in effect, amended the first and that such amendment would adversely affect the ability of the borrower to carry out its obligations under the loan agreement, which requires the borrower to carry out the project with due diligence and efficiency and in conformity with sound financial practices. After discussions with the government concerned, a decree was made to exempt the corporation from the application of the second act.

IV. COMPLIANCE

(1) Default Provisions of Loan and Guarantee Agreements

60. The loan and guarantee agreements of the IBRD give it the right, if the borrower or guarantor defaults under those agreements, (i) to suspend future disbursements under the loan or cancel the remaining balance of the loan or (ii) in certain cases to premature payment of the loan, that is to call on the borrower to make payment in full of the entire amount of the loan outstanding.^{7/} Provisions of this kind are normally found in both private and public loan agreements.

^{7/} No doubt under general principles of law the IBRD would also have other rights in certain circumstances; e.g. it could rescind an agreement or sue for damages if there had been a material misrepresentation made to the IBRD in connection with the obtaining of a loan.

61. The events which permit the IBRD to suspend disbursements or premature a loan are two kinds (a) failure by the borrower or guarantor to comply with any obligations under the agreement, or (b) events which make it impossible or improbable that the purposes of the loan will be achieved. Attached hereto as Appendix A is an excerpt from the form of loan agreement normally used by the IBRD listing the events which permit the IBRD to take such action. In addition to these events, others may be added, depending on the circumstances of the case.

62. In this connection a technique used by the IBRD calls for comment. As noted above, often the IBRD wishes to be assured that a member state will not enact legislation which will adversely affect the project or will change the basis on which a loan is made. In most of these cases, a covenant to this effect would not be feasible. It is, however, feasible to provide in the agreement that any such legislative enactment constitutes an event of default, and this is sometimes done.

63. There have been cases where, because of a default by the borrower, the IBRD has suspended disbursements on a loan or cancelled the remaining balance of a loan. This, however, has happened infrequently and, as discussed below, is a remedy which the IBRD hopes not to have to exercise.

64. The IBRD in fact has never prematured a loan and the question may be raised whether a provision entitling the IBRD to premature a loan is useful. There are several reasons why the IBRD has decided to include these provisions in its loans. In the first place, in the case of a private borrower the right to premature gives the IBRD a better position in a bankruptcy or reorganization than it otherwise would have. Secondly,

since the IBRD wants to sell participations in its loans and since this kind of provision is common in loan agreements generally, it probably makes it easier for the IBRD to sell participations under an agreement set up in a form to which participants are accustomed. Finally, as far as governmental borrowers are concerned, including both a government entity and the government itself, while it is unrealistic to think of a bankruptcy or reorganization in a normal commercial sense, nevertheless, in case of default, the right to premature would permit the IBRD to make a claim for the full amount of its outstanding loan in any debt rescheduling if other lenders were to make such a claim.

(2) Arbitration

65. The loan and guarantee agreements provide (Section 7.03 of the Loan Regulations) that any controversy between the parties to the agreement or any claim by either party against the other arising under the loan or guarantee not determined by mutual agreement is to be submitted to arbitration.^{8/} It is also provided that arbitration is to be in lieu of any other procedure for determining such controversies and claims. Detailed provisions are included as to the appointment of arbitrators, the procedure of the arbitral tribunal and the rendering of the award, which can be by default. Each party agrees to abide by and comply with any award rendered by the arbitral tribunal.

66. The agreements provide no special means for enforcing an award against a borrowing country unwilling to comply with it. In fact it is specifically provided that "the Bank shall not be entitled to enter

^{8/} A brief statement regarding the law applicable to IBRD's loan and guarantee agreements is set forth in Appendix B.

judgment against the borrower upon the award, to enforce the award against the Borrower by execution or to pursue any other remedy against the Borrower for the enforcement of the award, except as such procedure may be available against the Borrower otherwise than by reason of the provisions of this Section." On the other hand, it is specifically provided that if the IBRD does not comply with the award the borrower may take any such action for the enforcement of the award against the IBRD.

67. No arbitration has ever been had under a loan or guarantee agreement of the IBRD.

(3) Informal Action To Obtain Enforcement of Obligations

68. The ultimate purpose of action by the IBRD to enforce its agreements is to see that the project is carried out properly and that the loan is repaid. The IBRD does not seek to enforce provisions of its loan agreements solely because there has been a default; it first looks to see what the nature of the default is and to determine how the difficulties which have arisen can be best resolved.

69. Almost all the projects financed by the IBRD have given rise to problems of one kind or another, some serious and some not. It seems to be almost axiomatic that in development lending problems will arise, the only question being what they will be. For that matter, the same would probably be true if in more conventional financing agreements between private investment bankers and borrowers it was tried to cover so many details of the execution of the project and the conduct of the borrower's affairs. The problems cover a wide spectrum. The main problems of this kind have been: (i) engineering and technical problems arising in the course of construction, (ii) inadequacy of management, including difficulties arising from the exodus of expatriates, (iii) inability of the borrowers to obtain

local financing (iv) inability to cope with the consequences of inflation, (v) inability of the borrower to obtain proper rates, and (vi) chronic failure by the borrower to comply with its obligations. Sometimes, they may be ascribed to circumstances within the control of the IBRD itself, including cases in which covenants in loan agreements have proved to be unworkable and unrealistic and amortization schedules have proved to be unrealistic.

70. These types of problems and many others have become familiar to the IBRD and the IBRD has a special procedure set up to obtain current information about the functioning of a project, including field trips to the site to try to anticipate these problems before they become serious and to try to solve the problems as they arise. This kind of supervision of projects represents a very substantial part of the IBRD's activities. In other words, once the IBRD decides to make a loan and enters into a loan agreement, this is only the first step in a lengthy process by which the IBRD assures itself that the purposes of the loan are being achieved.

71. It should be emphasized that this process has over the years developed into a standardized activity which has become well known to the IBRD's borrowers. The legal basis for this process rests in provisions of the loan agreements under which a borrower furnishes information to the IBRD about the functioning of the project and the IBRD is entitled to send missions to the site of the project to see how it is functioning and, if necessary, to make recommendations as to changes in the project. This kind of consultation is one in which the major results are achieved by understandings reached between the borrower and the IBRD which may or may not be reflected in a change in the loan agreement or in local law.

72. The IBRD does not normally insist on strict compliance with its agreement to the point of using the legal remedies available to it until it is first satisfied that there is no practical alternative. The rationale is that the principal objective of the IBRD is to get a healthy project functioning and the IBRD has therefore preferred to try other ways of obtaining compliance, the particular method depending on the circumstances. Generally speaking the IBRD usually first tries to use its persuasive powers before it attempts stronger methods. This is not to suggest that the IBRD does not expect its agreements to be carried out. It does; and when violations do occur the IBRD requests and receives an explanation. But the IBRD would generally rather try to get a project functioning well than to use its sanctions. Probably the most effective remedy the IBRD has is to refuse to make further loans to a borrower who deliberately defaults to the IBRD. This is a powerful lever, especially where a member and the IBRD expect to maintain a pipeline of loans. For the IBRD to stop lending in such a case means that the member will have to look elsewhere to meet its development needs and this may not be easy to do.

73. The drastic legal sanction available to the IBRD to premature a loan would most likely be used only in case of flagrant misbehavior or possibly to protect the IBRD's legal position, and these cases are likely to be rare. Essentially the IBRD expects and does obtain compliance because it is in the interest of borrowers, as well as the IBRD, to comply and because the IBRD and the borrowers expect to maintain a continuous cooperative relationship.

(4) Articles of Agreement

74. In addition to these rights under loan and guarantee agreements, the Articles of Agreement of the IBRD provide that if a member country

fails to fulfil any of its obligations to the IBRD the IBRD may suspend its membership and the member so suspended shall automatically cease to be a member one year from the date of its suspension unless restored to good standing (Article VI, Section 2). This provision means that if a member defaults on its obligations to the IBRD under a loan or guarantee agreement the IBRD could suspend its membership. In fact the IBRD has never taken action under this section against such a member.

V. SPECIAL PROBLEMS OF FEDERATED STATES

74. The IBRD has sometimes been faced with the problem of seeing to it that an obligation under a loan is binding upon the constituent units of a federal state. Some of the cases in which this problem has arisen and the method by which the IBRD has dealt with it are as follows:

75. The IBRD has made loans in a federal state for a purpose which is primarily within the competence of a region or political subdivision of that state. The problem may be complicated by the fact that some aspects of a particular project may be within the competence of the federal government whereas the balance will be within the competence of the region or political subdivision. An example of this arose in connection with a \$20 million credit by IDA to the Federal Republic of Nigeria to finance the construction and equipping of a number of schools in the Northern, Eastern, Western and Mid-Western Regions of Nigeria and in the Federal Territory. Education in the regions was largely within the constitutional competence

of the regional governments. On the other hand, foreign borrowing was a federal subject; for this reason and in order to coordinate various aspects of this project it was thought desirable to make the loan directly to the Federal Republic which, in turn, would relend the proceeds to the various regions. In order to obligate both the Federal Republic and the regions to carry out the project the following complex of agreements was entered into:

a. IDA and the Federal Republic entered into a credit agreement under which the Federal Republic agreed to "exercise every right and recourse available to it to cause" the regions to carry out the projects applicable to each of them. If Nigeria had not been a federation and had full authority to control education throughout the country, the quoted words would have been omitted from the agreement; in the normal IBRD loan agreement the borrower agrees to cause the project to be carried out, and the quoted words will not be included. The addition of the quoted words makes clear that the Federal Government must exercise only such rights and recourses as are constitutionally available to it to cause each region to carry out its project. It does not purport to bind the Federal Republic to take action which would be unconstitutional.

b. IDA entered into so-called "project agreements" with each of the regions under which each region agreed to "carry out or cause to be carried out," the project applicable to it. Thus each region is bound by agreement to IDA to carry out the project.

c. The Federal Republic entered into so-called "subsidiary loan agreements" with each region which provided for the relending of the proceeds of the IDA credit to each region and for the undertaking

by the region to carry out its obligations under the project agreement.

76. A somewhat similar problem arises in connection with the so-called negative pledge or pari passu clause in IBRD agreements. Under such a clause (which is a normal clause in loan agreements) the borrower agrees that if any lien is created on any governmental assets, including assets of a political subdivision, such lien shall equally and ratably secure payment of the loan. Constitutional limitations may make it difficult or impossible for a member state to undertake a negative pledge commitment on behalf of its political subdivisions. In such cases, various methods have been used to give the IBRD the substance of the protection it needs, while recognizing the constitutional limitations of a government. In some cases, regardless of direct constitutional powers, government control of foreign exchange or specific legislation respecting public external borrowing gives the member state sufficient power to give effect to the negative pledge clause insofar as political subdivisions are concerned. In these cases it is the IBRD's practice (i) to acknowledge in its agreements the existence of the constitutional issue by providing that the member will make the clause effective "within the limitations of its constitutional powers" with respect to liens on the assets of its political subdivisions and (ii) to rely for the implementation of the commitment upon the authority vested in the government to control foreign exchange available to the political subdivision. (See Loan Agreement between the Government of Australia and the IBRD, Loan No. 156 AU). In other cases, where governmental control of foreign exchange does not exist and the member government therefore would be unable to make the clause effective, the member state may nevertheless undertake to

give to the IBRD an "equivalent lien satisfactory to the IBRD" if a political subdivision creates a lien which would fall within the scope of the negative pledge clause.

77. The agreements make clear that, as far as the IBRD is concerned, while it recognizes the constitutional limitations on the federal government in a federated state, it may obtain the protection it needs either by obtaining separate agreements from the units of the federation or by obtaining special assurances from the federal government.

VI. AMENDMENT OF THE ARTICLES OF AGREEMENT OF THE IBRD

78. The Articles of Agreement of both the IBRD and IDA contain provisions for their amendment. While these provisions differ in certain respects, they both provide that, except as stated below, an amendment may be approved by a qualified majority. Under both charters, certain amendments can become effective only by affirmative vote of all members; these cases are the right to withdraw from the institution, the preemptive right to subscribe to additional shares or subscriptions and the limitation on liability of each member in connection with its subscription.

79. Article VIII of the Articles of Agreement of the IBRD provides as follows:

"(a) Any proposal to introduce modifications of this Agreement, whether emanating from a member, a governor or the Executive Directors, shall be communicated to the Chairman of the Board of Governors who shall bring the proposal before the Board. If the proposed amendment is approved by the Board the Bank shall, by circular letter or telegram, ask all members whether they accept the proposed amendment. When three-fifths of the members, having four-fifths of the total voting power, have accepted the proposed amendments, the Bank shall certify the fact by formal communication addressed to all members.

"(b) Notwithstanding (a) above, acceptance by all members is required in the case of any amendment modifying

- (i) the right to withdraw from the Bank provided in Article VI, Section 1;
- (ii) the right secured by Article II, Section 3(c);
- (iii) the limitation on liability provided in Article II, section 6.

"(c) Amendments shall enter into force for all members three months after the date of the formal communication unless a shorter period is specified in the circular letter or telegram."

80. It is thus provided that, except in the three cases mentioned, the Articles may be amended, after approval by the Board of Governors, by a vote of $3/5$ of the members having $4/5$ of the total voting power. The same qualified majority is required in a case of an amendment to the Articles of IDA.

81. The IBRD has amended its Articles only once. This amendment was designed to permit the IBRD to make loans to its affiliate, the IFC. (Article III, Section 6 added by amendment effective December 16, 1965). A corresponding amendment was made to the IFC Articles.

VII. EFFECT OF DECISIONS AND OTHER ACTIONS RELATED
TO IBRD'S PRIVILEGES AND IMMUNITIES

82. Under its Articles the IBRD, like many other international organizations, enjoys certain privileges and immunities. The question of obtaining proper recognition in local law of these privileges and immunities is largely a problem of interpretation of the Articles; in that sense the only "decision" of the IBRD involved is its "decision" that it is legally entitled to a given privilege or immunity and then to take whatever action may be required locally to try to get whatever it's entitled to. Except for the Federal Communications matter referred to later, this area of activity is not discussed in this paper, except for the following few comments which indicate the substantial nature of the problems encountered.

Borrowing by the IBRD in the Markets of a Country

83. A vital part of the IBRD's operations is its borrowings in the markets of some of its member countries. Except for the effect in local law of its special status and its privileges and immunities, and of any special local legislation which may be relevant to it, when the IBRD borrows in the private markets of a country it does so as a private person subject to local law.

84. When the IBRD first sold a public bond issue in the United States the question arose whether or not the Securities Acts were applicable to the IBRD and to that sale. The IBRD decided not to contend that under its Articles of Agreement it should be regarded as exempt from those Acts^{2/}

^{2/} The Articles provide (Article VII, Section 6) that the property and assets of the IBRD shall be free from restrictions, regulations, controls and moratoria of any nature to the extent necessary to carry out its operations.

and in its first two public issues registered its securities under the United States Securities Act of 1933. Thereafter special legislation was passed in the United States exempting bonds of the IBRD from the Securities Act of 1933 and the Securities Exchange Act of 1934 (22 U.S.C. 286). Similar legislation was also passed relating to the bonds of the Inter-American Development Bank.

85. Problems of this kind have arisen under the so-called "blue sky" and "legal investment" laws of the United States and of other countries and on many occasions special laws have been passed giving the IBRD and its bonds special status or privileges under that kind of legislation.

Tax Immunities

86. In the charters of most international organizations, the privileges and immunities to be accorded the organization are dealt with in general terms only, leaving the handling of the specific details to subsequent agreement.^{10/} The charter of the IBRD, however, spells out its privileges and immunities in detail. It is thus provided in the Articles of Agreement of the IBRD that the IBRD and its operations and transactions shall be immune from all taxation (Article VII, Section 9(a)). Implementation of this provision may have a substantial effect on local law.

87. The Articles provide that each member "shall take such action as is necessary in its own territories for the purpose of making effective in terms of its own law the principles set forth" in the Articles (Article VII, Section 10) and in accepting membership a member must deposit an instrument stating that it has accepted the Articles "in accordance

^{10/} Dettner, Lawmaking by International Organizations, p. 181 et seq. (1965); Broches, International Legal Aspects of the Operations of the World Bank, 98 Recueil de Cours, 1959, p. 311).

with its law and has taken all steps necessary to enable it to carry out all of its obligations" thereunder (Article XI, Section 2(a)).

88. The way in which this tax immunity (as well as other privileges and immunities) afforded the IBRD has been made effective under the local law of the member states has varied, depending on the way in which the particular member makes treaties effective under its own law. Thus in some cases the tax immunities have been given the force of law solely as a result of the legislative act ratifying acceptance of the Articles without further special enabling legislation. In other cases legislation has been enacted specifically incorporating the tax immunities into local law and, sometimes, specifically amending existing tax law which may be inconsistent with the tax immunities accorded the IBRD.

89. A few examples may be of interest. The United States accepted membership in the IBRD pursuant to the Bretton Woods Agreements Act which expressly incorporates into United States statutory law the provisions conferring privileges and immunities upon the IBRD^{11/} by simply providing that such provisions "shall have full force and effect in the United States..."^{12/} France accepted membership in the IBRD pursuant to

^{11/} 59 Stat. 516 (1945); U.S.C. §286(h) (1946)

^{12/} This procedure should be contrasted to that followed by the United States under the International Organizations Immunities Act (59 Stat. 669 (1945); 22 U.S.C. §288 (1946)). Under that Act public international organizations in which the United States participates (when designated as such by the President of the United States by Executive Order) are entitled to certain specified privileges and immunities. That Act specifically amends the tax laws of the United States (the Internal Revenue Code and other tax laws) in order to confer tax immunities upon international organizations coming within the scope of the Act. That Act was designed, among other things, to accord privileges and immunities to international organizations whose charters, unlike those of the Bank and Fund, do not contain detailed provisions spelling out their privileges and immunities; and, for such organizations, it was therefore not regarded as sufficient merely to incorporate their charters into United States law.

similar legislation.^{13/} In the United Kingdom, where a treaty is not regarded as self-executing without implementing legislation, the United Kingdom accepted membership in the IBRD pursuant to a statute^{14/} which provided (Section 3(1)) that "His Majesty may by Order in Council make such provision as He may consider reasonably necessary for carrying into effect any of the provisions of the...Bank Agreement relating to the status, immunities and privileges of the ... Bank." Pursuant to such provision the "Bretton Woods Agreements Order in Council 1946" was issued^{15/} which provided that the provisions of the Bank Agreement set out in the Schedule to such Order "shall have the force of law" and in such Schedule there was specifically set forth the tax immunities, among others, accorded to the IBRD under its Articles of Agreement. Ceylon and Ghana specifically following the example of the United Kingdom, accepted membership in the IBRD by statutes similar to that of the United Kingdom.^{16/} Most other countries on the other hand accepted membership in the IBRD pursuant to the legislative action ratifying acceptance of the Articles of Agreement without further specific enabling legislation. Germany, Guinea and The Netherlands are examples of this procedure.^{17/}

^{13/} Law No. 45-0138 of 26 December 1945; Journal Officiel de la République Française, December 27, 1945.

^{14/} Bretton Woods Agreements Act, 1945, 9 & 10 Geo. 6, Ch. 19; 20 December 1945.

^{15/} Statutory Rules and Orders, 1946 No. 36, 10 January 1946.

^{16/} Ceylon, Bretton Woods Agreements Act No. 20, of 1950, 22 August 1950. Ghana, International Bank, Fund and Finance Corporation Act, 1957, No. 17 of 1957.

^{17/} Germany, Law of July 28, 1952; Bundesgesetzblatt, Part II, No. 13 August 1, 1952.
Guinea, Law No. 77/AN/62 of November 23, 1962.
The Netherlands, F 318, Law dated December 20, 1945.

90. On many occasions questions have arisen as to the scope of the IBRD's tax immunities and its effect on local tax law. When questions of this kind have arisen they often have been handled simply by way of interpretation by the local tax authorities of their tax laws so as to afford recognition of the IBRD's tax immunities. This has been done either by regulations issued by the tax authorities or by an informal exchange of letters between the tax authorities and the IBRD. For example, a question has arisen whether the IBRD or other party to the transaction is subject to payment of stamp tax on the delivery of an indenture in connection with security arrangements under a loan. The IBRD has taken the position that a stamp tax, being a tax on a transaction, cannot be imposed even on a party to the transaction other than the IBRD.^{18/} This position has been recognized by the tax authorities in several countries where the question has arisen. The question has also been raised whether the United States Interest Equalization Tax Act applies to sales by the IBRD of portions of its loans out of portfolio to a private person. The IBRD took the position that the Interest Equalization Tax, being an excise tax and therefore being a tax on the transaction, could not be properly imposed on such a portfolio sale. This position was also recognized by the United States tax authorities.

91. In some cases a country may enact general tax laws which could be interpreted in such a way as to conflict with its obligations to the IBRD under the Articles. The general tax law may specifically recognize the immunity of the IBRD in order to avoid any possible question of conflict between a treaty obligation and a later statute. For example, under the United States Interest Equalization Tax Act which provides for

^{18/} Article VII, Section 9(a) of the IBRD's Articles provides that "The Bank, its assets, property, income and its operations and transactions authorized by this Agreement, shall be immune from all taxation and from all customs duties. The Bank shall also be immune from liability for the collection or payment of any tax or duty.

a tax on obligations issued by a foreign obligor to a United States person the Act provides, in effect, (Internal Revenue Code; Section 4920 (3)(A)(i)) that it shall not apply to bonds issued by an international organization of which the United States is a member (e.g. the IBRD, the Inter-American Development Bank).

Effect in Local Law of Interpretation of IBRD's Articles of Agreement; The Federal Communications Commission Case

92. The Articles of Agreement of the IBRD and Fund contain provisions setting up a procedure for the interpretation of the Articles by the Executive Directors of the respective institutions. Under these provisions any question of interpretation of the Articles arising between any member and the IBRD or the Fund or between any members of the IBRD or the Fund are to be submitted to the Executive Directors for their decision.^{19/} Once the Executive Directors have duly rendered a decision, that interpretation is binding on all the members of the IBRD and Fund subject to the right of appeal to the Board of Governors whose decision is final.

93. The IBRD has adopted a number of interpretations involving various provisions of its Articles. However, except for the interpretation discussed in this section, none of the interpretations involved the effect of the Articles on private persons under local law. The only proceeding in which the question has been raised as to the binding effect of an interpretation in a local forum arose in connection with an interpretation by the IBRD of the provisions of Article VII, Section 7 of its Articles. In this proceeding the IBRD and the Fund filed a complaint with the U.S. Federal Communications Commission claiming that they were

^{19/} IBRD Articles of Agreement, Article IX, Fund Articles of Agreement, Article XVIII.

entitled to the same "treatment" as governments for their cables, that the Executive Directors had interpreted the word "treatment" to encompass treatment with respect to rates and that therefore they were entitled to special governmental rates. The Federal Communications Commission ruled in favor of the IBRD and the Fund.^{20/} The case squarely holds that an interpretation by the IBRD and the Fund of their Charters is binding on their member governments and that the charter provisions so interpreted must be given effect in the territories of members even against private persons. The case is an extremely interesting and important one which surprisingly has been neglected by the commentators.

94. Briefly, the facts were as follows: In 1949 certain United States cable companies, which had hitherto been charging special governmental rates for cables sent by the IBRD and the Fund from the United States to other countries, filed revised tariffs under which the IBRD and Fund would be charged full commercial rates. The IBRD and the Fund filed a complaint with the Federal Communications Commission asserting that the revised tariffs were unlawful because the cable companies were required to charge only governmental rates because of various provisions of law. The IBRD's case was based primarily on the following argument:^{21/}

(a) Article VII, Section 7 of the IBRD's Articles provides as follows:

"Section 7. Privilege for communications

The official communications of the Bank shall be accorded by each member the same treatment that it accords to the official communications of other members."

^{20/} 17 FCC 450 (1953).

^{21/} The discussion of this case applies equally to the Fund.

(b) This provision was interpreted by the Executive Directors of the IBRD to mean in effect that member governments are required to see to it that the IBRD is charged rates for its cables no higher than those rates accorded cables of other member governments and that if a member exercises regulatory powers over rates, it is not relieved of its obligation by reason of the fact that the communications facilities are privately owned.

(c) Under the U. S. Bretton Woods Agreements Act (the act pursuant to which the United States accepted membership in the IBRD), these provisions have "full force and effect in the United States." The IBRD argued that consequently the United States was obligated to accord the IBRD governmental rates for its cables and that accordingly the United States, acting through the Federal Communications Commission, was obliged to insure that the cable companies filed tariffs according the IBRD such rates. It is interesting to note that during the proceedings before the Commission the United States State Department wrote two letters to the Commission stating that the United States Government was obliged to carry out the Articles of Agreement as interpreted in accordance with the provisions of the Articles and that since the IBRD had interpreted the Articles to relate to the treatment to be accorded to official communications, including governmental privileges with respect to rates, the State Department was of the opinion that the United States Government was committed to support that interpretation.

95. The cable companies argued that the interpretation was not binding on the Federal Communications Commission; that the Commission could not enforce the provision of the charter of the IBRD against a private

cable company, and that the cable companies were not parties to the interpretation and that therefore they could not be bound by it.

96. On the major issue, the Commission held that the interpretation was binding on the United States Government and therefore on the Commission. In this connection it stated as follows:

"We believe that the question as to the application of the term 'treatment' in the Bank and Fund Articles to rates has been conclusively determined by the Bank and Fund Executive Directors' interpretation, by unanimous vote, that the language in question applies to rates charged for official communications of the Bank and the Fund. Under the terms of the Bank and Fund Articles of Agreement, this interpretation, in effect, is final. This procedure for issuing interpretations binding member governments does indeed appear novel; but it also appears to point the way toward speedy, uniform and final interpretations. This procedure is not only an integral part of the Bank and Fund Articles, which have been accepted by the United States, but its use was specifically invoked with respect to questions of interpretation by sections 12 and 13 of the Bretton Woods Agreements Act; and the United States Congress, by directing that an amendment of the Articles be sought if the requested interpretations were not satisfactory, appears to have recognized in these two sections that the United States is bound by the results of the interpretations. The United States Government is therefore bound by the Executive Directors' interpretation of the term 'treatment' and is under an international obligation to act in conformity therewith."

97. It is also interesting to note that the cable companies argued that the interpretation was unreasonable and ultra vires. The Commission rejected this argument and stated as follows:

"...assuming for purposes of argument, that if the interpretations of the term 'same treatment' by the Executive Directors of the Bank and Fund were so unreasonable, arbitrary or capricious as to constitute in fact an amendment of the Articles of Agreement rather than interpretations thereof we should not have to give effect to them, we think it clear that the interpretations made in this case cannot be so categorized. The language of the Articles of Agreement appears to be sufficiently broad and general to include rates, and nowhere is there any exclusion of the matter of rates, either expressed or implied, or any words of limitation."

98. Finally it should be noted that the Commission specifically stated that it was bound to consider in determining whether a particular rate schedule was legal not only the Federal Communications Act but also the impact of special legislation on international agreements.^{22/}

99. The case was decided on the ground that the United States was bound to observe its obligations under an international agreement irrespective of any local law; and, as has been noted, the case squarely holds that the Articles of Agreement of the IBRD, as interpreted by the Executive Directors, must be given effect under local law, even as against private persons.

^{22/} An interesting aspect of the decision is that the Commission saw fit to interpret the interpretation of the Bank. One of the issues in the case was whether the United States was bound to insure that in all circumstances the cable companies should extend to the IBRD the same standard of rate treatment as prevailed for other member governments or whether the cable companies were required to do so only when their foreign correspondents observed certain conditions of reciprocity such as division of tolls or reduced rates. The Commission held that if the United States cable companies were required unilaterally to give reduced rates to the IBRD without reference to the reciprocity of their corresponding companies they would not be giving the IBRD the "same treatment under Article VII, Section 7," but better treatment. The Commission therefore held in effect that the obligation on the United States cable companies to extend governmental rates to the IBRD should prevail only where the foreign correspondent also accorded governmental rates for their part of the toll.

PROVISIONS IN LOAN AND GUARANTEE
AGREEMENTS RELATING TO SANCTIONS

A. In loans to borrowers which are guaranteed by a member government, the loan and guarantee agreements in their normal form entitle the IBRD to suspend the right of the borrower to make withdrawals from the loan if the events listed below occur. If the right to make such withdrawals is suspended for thirty days, the IBRD may then cancel the unwithdrawn part of the loan.

- (a) A default shall have occurred in the payment of principal or interest or any other payment required under the loan agreement or the bonds.
- (b) A default shall have occurred in the payment of principal or interest or any other payment required under any other loan agreement between the IBRD and the borrower or under any loan agreement or under any guarantee agreement between the guarantor and the IBRD or under any bond delivered pursuant to any such agreement.
- (c) A default shall have occurred in the performance of any other covenant or agreement on the part of the borrower or the guarantor under the loan agreement, the guarantee agreement or the bonds.
- (d) An extraordinary situation shall have arisen which shall make it improbable that the borrower or the guarantor will be able to perform its obligations under the loan agreement or the bonds.
- (e) The borrower shall have been unable to pay its debts as they mature or any action or proceeding shall have

Appendix A

been taken by the borrower or by others whereby any of the property of the borrower shall or may be distributed among its creditors.

- (f) The guarantor or any other authority having jurisdiction shall have taken any action for the dissolution or disestablishment of the borrower or for the suspension of its operations.
- (g) The guarantor shall have been suspended from membership in or ceased to be a member of the IBRD.
- (h) The guarantor shall have ceased to be a member of the International Monetary Fund or shall have become ineligible to use said resources under Section 5 of Article V, Section 1 of Article VI or Section 2(a) of Article XV of the Articles of Agreement of said Fund.
- (i) After the date of the loan agreement and prior to the effective date any event shall have occurred which would have entitled the Bank to suspend the borrower's right to make withdrawals from the loan account if the loan agreement and the guarantee agreement had been effective on the date such event occurred.

B. The events listed in (a), (b), (c), (e) and (f) also entitle the IBRD, after specified notice, to premature payment of the full outstanding amount of its loan.

NOTE REGARDING LAW APPLICABLE TO IBRD'S LOAN
AND GUARANTEE AGREEMENTS

It seems to be generally accepted as a matter of law that the loan and guarantee agreements between the IBRD and a member state are international agreements and governed by international law. This concept is given expression in the agreements between the Bank and its member states which provide that "the rights and obligations of the Bank and the Borrower under the loan [guarantee] agreement and bonds shall be valid and enforceable in accordance with their terms notwithstanding the law of any state, or political subdivision thereof, to the contrary." (Section 7.01 of the Loan Regulations which are incorporated in each loan and guarantee agreement.)*

The rule set out in Section 7.01 establishes the duty of the member state to give effect to the terms of the loan or guarantee agreements to which it is a party and this provision has the effect of insulating the loan or guarantee agreement from the member state's own law, either existing at the time of the signing of the agreements or later enacted.

In the case of a loan agreement entered into between the IBRD and a non-member borrower, the question has been raised as to whether the parties can validly insulate the loan agreement from the provisions of municipal law. In this connection the General Counsel of the IBRD has stated:

* The parties may provide that provisions of the agreements relating to security arrangements (e.g. mortgages) are made subject to a specific municipal law. See, Delaume, Legal Aspects of International Lending and Economic Development Finance, pp. 138-140.

** Broches, International Legal Aspects of the Operations of the World Bank, 98 Recueil de Cours 1959, p. 352.

Appendix B

"...while the borrower could not contract itself out of the applications of municipal law, the Bank and the guaranteeing member may do so in respect not only of their relationship but also (with the borrower's consent evidenced by the borrower's acceptance of Section 7.01) of that between the Bank and the borrower.

"The importance of the problem should not be overestimated since, even if the borrower's obligation could be impaired or affected by municipal law, the guarantor's obligations could not, and it would appear that the Bank could proceed against the guarantor, who is in a position of a joint co-debtor, independently of municipal law."