

**THE WORLD BANK GROUP ARCHIVES**

**PUBLIC DISCLOSURE AUTHORIZED**

Folder Title: McLain, Chester A. - Articles and Speeches (1947 - 1948)

Folder ID: 1652181

Fonds: Records of Office of External Affairs (WB IBRD/IDA EXT)

Digitized: February 12, 2014

To cite materials from this archival folder, please follow the following format:  
[Descriptive name of item], [Folder Title], Folder ID [Folder ID], World Bank Group Archives, Washington, D.C., United States.

The records in this folder were created or received by The World Bank in the course of its business.

The records that were created by the staff of The World Bank are subject to the Bank's copyright.

Please refer to <http://www.worldbank.org/terms-of-use-earchives> for full copyright terms of use and disclaimers.



THE WORLD BANK  
Washington, D.C.

© 2012 International Bank for Reconstruction and Development / International Development Association or  
The World Bank  
1818 H Street NW  
Washington DC 20433  
Telephone: 202-473-1000  
Internet: [www.worldbank.org](http://www.worldbank.org)

**PUBLIC DISCLOSURE AUTHORIZED**



McLain, Chester A - ARTICLES and Speeches (1947-1948)



The World Bank Group  
**Archives**  
A1992-007 Other #: 12 62181 212057B  
McLain, Chester A. - Articles and Speeches (1947 - 1948) # 12 212057B

**DECLASSIFIED**  
WBG Archives





IBRD / IDA  
304  
WBG  
89  
ARCHIVES

McLAIN



The immediate consideration is that the Bank can be of real assistance in the restoration and development of international trade. Whatever may be the attitude of the American investor toward his duty as a citizen of the world to contribute toward the restoration of a sound and healthful world economy, he owes it to himself to support the efforts of the Bank.

In 1946 the United States supplied goods and services to foreign countries in the amount of over 15 billion dollars. Private or commercial exports amounted to nearly eight billion dollars. Of the 15 billion dollars of goods and services supplied to foreign countries by the United States only 7.1 billion dollars were paid for by imports and services purchased from abroad by the United States. Of the remaining 8.2 billion dollars, 3.2 billion dollars consisted of government grants and private contributions. The remaining five billion dollars was financed by loans and credits of 3.5 billion dollars and by use of gold and dollar resources of the purchasing countries for the balance. For 1947 it is estimated that our total exports of goods and services will be approximately 15.2 billion dollars and our imports of goods and services approximately nine billion dollars, leaving an excess of about 7.2 billion dollars, of which about 5.4 billion dollars will have to be financed by loans and credits or foreign gold and dollar resources.

Unless this country is to face a serious decline in its export trade, a substantial part of the excess of its exports over its imports in the next few years must be financed by loans. Some may say that, rather than make loans abroad, we should forego a part of our export trade. Aside from its effect on other countries which need our goods in order to restore their own economies, that must mean a drastic curtailment in our own volume of production, especially of agricultural products, and in our national income, with a corresponding decline in our standard of living. Ultimately, of course, we must expect to receive payment of our loans abroad in imports of goods and services from abroad. But those imports can and should represent an increase in our standard of living.

The plain fact is that, unless the American investor is willing to invest some of his savings in foreign lending, he must expect to face a decline in the income on his domestic investments. That is the selfish motive which should impel the American investor to support the International Bank. It seems to me that the American investors should not be slow to appreciate that very simple fact.

*1,000 printed*

*Address by*

**CHESTER A. McLAIN**

General Counsel

International Bank for Reconstruction and Development

*at the*

Connecticut Trust Conference of the

Connecticut Bankers Association

at the New Haven Lawn Club



New Haven, Connecticut

May 13, 1947



## I. INTRODUCTORY

My subject this morning is the International Bank for Reconstruction and Development. I shall not in the time at my disposal attempt to discuss in detail the organization and operation of the Bank. I shall confine myself to a few salient points as to which there appears to be some lack of understanding or even misunderstanding among the banking community and the public generally.

## II. THE REASON FOR THE INTERNATIONAL BANK

The first question which is frequently asked by those who are not thoroughly familiar with the history of the Bank is "Why an International Bank?" That question goes to the very heart of the subject.

Today we find ourselves in a nation which has the greatest productive capacity in the world and which is producing in record breaking quantities everything from food to steel and automobiles. Across the oceans east and west are nations starving for those goods, but without the foreign exchange resources with which to purchase them. They find themselves in that condition because of the ravages of war. They are suffering not only from the destruction of their industrial plant by bombs and shells and enemy sabotage, but also by reason of the deterioration of their economies because of lack of proper up-keep and maintenance during the war years and the exhaustion of their working stocks resulting from the war.

Peace is more than the mere aftermath of war. The restoration of peace, if it means anything, must mean the restoration of free international intercourse, the free exchange of goods and services between those who need them and those who can satisfy the need. In order to restore that free intercourse it is first necessary to create in the countries which need such goods and services the purchasing power with which to buy them, so that they may restore the normal functioning of their own economies and thus create their own purchasing power through the production of exportable surpluses of goods which they can produce.

At the moment the needs of the respective countries are so great and political and economic conditions are so uncertain that private investors hesitate to take the risks involved. In order to bridge that gap, the representatives of 44 nations who met at



Bretton Woods, New Hampshire, in July, 1944, conceived the idea of establishing two great international cooperative institutions which were intended between them to promote freedom and stability in international exchanges and to restore the flow of international capital investment. Those two institutions are the International Monetary Fund and the International Bank for Reconstruction and Development.

### III. THE INTERNATIONAL MONETARY FUND

We are not here concerned with the operations of the International Monetary Fund. I shall, therefore, merely mention that it is designed to promote international monetary cooperation through consultation and collaboration among its members on international monetary problems and also to provide an international fund to assist its members in meeting conditions of temporary disequilibrium in their balance of international payments.

The Fund is thus intended to assist its members in meeting temporary deficits in their balance of international payments. The Bank, on the other hand, is intended to render long term financial assistance to its members for the purpose of reconstructing or developing their productive facilities and resources.

### IV. MEMBERSHIP IN THE INTERNATIONAL BANK

The Bank now has 44 members, not including Australia whose application for membership is now pending. Of those 44 members, 39 were represented at the Bretton Woods conference, one — Denmark — was admitted to membership at the inaugural meeting of the Board of Governors of the Bank at Savannah, Georgia, in March, 1946, and four — Italy, Turkey, Lebanon and Syria — were admitted to membership pursuant to action by the Board of Governors of the Bank at its first annual meeting in Washington last September. Of the 44 nations which were represented at the Bretton Woods conference only five are not now members of the Bank. They are Australia, New Zealand, Russia, Haiti and Liberia. As I have said, Australia's application for membership is now pending before the Board of Governors.

### V. THE CAPITAL OF THE BANK

The authorized capital stock of the Bank is 10 billion dollars divided into 100,000 shares of the par value of \$100,000 each. The total amount of the capital stock which has been subscribed is \$8,024,500,000. The amounts of the subscriptions of the original members were fixed at Bretton Woods and are set forth in Schedule A to the Articles of Agreement of the Bank. The subscription of Denmark was fixed by the Board of Governors at its meeting at Savannah, Georgia, in March, 1946. The subscriptions of new members are fixed in agreement with such members at the time when their admission to membership is approved.

For purposes of analysis the capital stock of the Bank may be divided into three parts:

(1) 2% of the subscriptions to the capital stock of the Bank is payable in gold or United States dollars. Original members of the Bank were required to pay that 2% on or before August 24, 1946. Members admitted after that date are required to pay such 2% when they become members by signing the Articles of Agreement. An original member whose territories were invaded during the war is entitled under the Articles of Agreement to postpone for 5 years payment of  $\frac{1}{2}$  of 1% out of such 2%. Six members have availed themselves of that privilege and the total amount payment of which has been thus postponed is \$4,915,000.\* The total amount of the 2% which has been paid in gold or United States dollars is thus \$155,575,000. That amount is freely available for use in the Bank's operations.

(2) 18% of the subscriptions to the capital stock of the Bank was subject to call for use in the Bank's operations and is payable in the currencies of the respective members. All of that 18% has now been called, the last call of 5% being payable on or before May 26, 1947. That 18% amounts in the aggregate to the equivalent of \$1,444,410,000. That part of the Bank's capital can only be loaned with the consent of the particular member whose currency is used. Since most of the members of the Bank are not in position to permit the export of capital, it can be expected that few, if any, members other than the United States, and perhaps Canada, would now consent to the lending of the 18% of their capital subscriptions which has been paid in their currencies. Accordingly, for the time being at least, the only part of such

\* China, Czechoslovakia, Denmark, Greece, Poland and Yugoslavia.



18% which will be available to the Bank for use in its lending operations is the \$571,500,000 which will have been paid in by the United States.

(3) The remaining 80% of the subscription of each member is subject to call only when required to meet the obligations of the Bank. It is in the nature of a guaranty fund, which is not available for use in the lending operations of the Bank, but can only be called and used to meet the Bank's obligations.

The Bank is frequently spoken of as an \$8,000,000,000 institution. This is true only in a very broad sense. As is apparent from what I have already said, the capital of the Bank which will be available for lending after May 26, 1947, will be as follows:

(1) 2% of its capital paid in in gold or United States dollars which is free for use in its operations (after deducting an operating deficit as of March 31, 1947, of \$805,355)	\$ 154,769,665
(2) 18% of the United States subscription paid in United States dollars	571,500,000
Together	\$ 726,269,665
(3) 18% paid in other currencies not presently available for lending	872,910,000
Total	\$1,599,179,665

## VI. THE ORGANIZATION OF THE BANK

The organization of the Bank consists of

(1) A Board of Governors composed of one governor appointed by each member and an alternate for each governor.

(2) A Board of Executive Directors composed of 12 members of which five are appointed by the five largest stockholders (the United States, the United Kingdom, France, China and India) and seven directors who are elected by the remaining members. Each Executive Director also has an alternate.

(3) The President, who is elected by the Executive Directors, and the staff appointed by the President under the general direction of the Executive Directors.

Under its Articles of Agreement all the powers of the Bank are vested in the Board of Governors, which may delegate and has delegated such powers (with certain exceptions) to the Executive Directors. The exceptions include the admission of new members, the increase or decrease of the capital stock of the Bank, the suspension of a member, decisions on appeals from interpretations made by the Executive Directors, approval of agreements with other international organizations and decisions with regard to the distribution of the net income of the Bank and the liquidation of the Bank.

In the Board of Governors each member nation has 250 votes plus one vote for each share of stock subscribed by it. In the Executive Directors each appointed director has the same number of votes as the government which appointed him and each elected director has the same aggregate number of votes as the nations which elected him.

The Board of Governors meets annually but may be called for special meetings when required. A vote of the Board of Governors may also be taken without a meeting by cable, wireless or letter.

The Executive Directors meet regularly once a week and are continuously available at the headquarters of the Bank for special meetings at other times. The function of the Executive Directors corresponds generally to that of a board of directors of a private corporation.

The President is *ex officio* chairman of the Executive Directors without vote except in case of a tie. He is the chief of the operating staff of the Bank and is responsible under the general direction of the Executive Directors for the conduct of the Bank's operations.

In practice there is close and constant cooperation between the President and his staff and the Executive Directors. At the regular meetings of the Executive Directors the heads of the operating departments are present and through informal discussions at such meetings the Executive Directors are kept constantly informed of the progress of the Bank's affairs and exchange views informally with the President and his operating chiefs on matters pending before the Bank. In that way the Executive Directors are placed in position to act promptly on all recommendations presented to them by the President.



## VII. THE LENDING OPERATIONS OF THE BANK

Briefly the purpose of the Bank is to assist in the reconstruction and development of the productive facilities and resources of its members by making direct loans, participating in loans made by others or guaranteeing loans made by others. It may make loans, participate in loans or guarantee loans to any member or any political subdivision of a member or to any business, industrial or agricultural enterprise in the territories of any member.

If the member government in whose territories the loan is made is not itself the borrower, and, therefore, the principal obligor on the loan, then the loan must be guaranteed by that member or by its central bank or other agency acceptable to the International Bank.

In carrying out its purposes the Bank seeks to promote private international investment. It cannot make or guarantee a loan unless it is satisfied that the borrower would be unable otherwise to obtain the loan under conditions which, in the opinion of the Bank, are reasonable for the borrower.

It is thus contemplated that the Bank shall make or guarantee loans only where private investors are unwilling to make such loans on reasonable terms. On the other hand, the Bank must weigh the purposes for which the loan is to be used and satisfy itself that the loan is within the scope of the purposes of the Bank, that is, that the proceeds of the loan will be used for the reconstruction or development of the productive facilities and resources of the country in which the loan is to be made; that the project to which the proceeds of the loan are to be applied is technically and economically sound; and that the amount, terms and conditions of the loan are such that there is a reasonable prospect that the loan will be repaid. The Bank is specifically enjoined by its Articles of Agreement to act prudently in the interests both of the particular member in whose territories the loan is to be made and of the members as a whole.

In respect of each loan a special committee consisting of one or more members of the staff of the Bank and an expert selected by the governor of the member in whose territories the loan is to be made makes a study of the project for which the proceeds of the loan are to be used and submits a written report of its recommendations on the merits of such project.

In practice each loan application and the data submitted in support of it are analyzed and studied by a working group of members of the staffs of the Loan Department and the Research Department assisted by members of the Treasurer's staff and the legal staff of the Bank. This group is in constant consultation with representatives of the prospective borrower in order to obtain necessary explanations and additional information whenever required. The results of the studies of the working group are from time to time presented to the President and the Vice-President and the heads of the operating departments and form the basis of the ultimate recommendations of the President to the Executive Directors. In the meantime the Executive Directors are kept apprised of the progress of the studies through informal reports at their meetings and through memoranda summarizing the factual data presented to the Bank. The procedure is not specifically formalized and necessarily varies as among different loan applications depending on the character and scope of the project for which the loan is desired. On technical engineering and economic matters the Bank avails itself of the services of outside experts on a consultative basis. When necessary the Bank sends members of its staff or experts specially retained by it to the borrowing country in order to study the project on the ground.

The Bank is required by its Articles of Agreement to make arrangements to ensure that the proceeds of the loan are used only for the purposes for which the loan was granted. When the Bank makes a contract to grant a loan it sets up on its books an account in the name of the borrower to which the amount of the loan is credited. The borrower is permitted to draw on that account upon submitting proof satisfactory to the Bank that the amount to be withdrawn will be applied only to the purposes for which the loan was granted.

Furthermore, having regard for the general purposes of the Bank and its international cooperative character, it intends to include in its loan contracts provisions whereby, during the life of the loan, it will be furnished currently with information concerning the application of the proceeds of the loan, the progress of the project for which the loan was granted and general economic and financial conditions in the country where the project is located. Provision will also be made whereby the Bank will be in position at all times to consult with the borrower concerning



all such matters. It is believed that such provisions will be of increasing importance in enabling the Bank to keep informed with regard to economic and financial conditions and trends throughout the world and to direct its efforts and resources most effectively toward the promotion of the long-range balanced growth of international trade and the maintenance of equilibrium in international balances of payments.

### VIII. BORROWING BY THE BANK

The Bank is empowered to borrow funds for use in its operations provided that it obtains the approval of the member in whose markets the funds are to be borrowed. It is obvious that in present conditions the Bank must rely for some time to come on its ability to borrow in the investment markets of the United States, if it is to come anywhere near to satisfying the applications for loans which have been or will be made to it.

The form and terms of the securities which the Bank will issue for that purpose and the methods by which it will distribute those securities are still being studied by the management of the Bank. To a large extent the determinations of those matters will depend on market conditions when the offering is made. Considering the amounts which the Bank will need to borrow, it seems clear that it will have to look chiefly to large institutional investors, such as insurance companies and savings banks, and others who customarily invest in prime securities. At the same time, from a long range point of view, the Bank should seek to have as wide a distribution as possible of its securities.

The officers of the Bank realize that there is not now adequate understanding by the investment public and the banking community of the purposes and operations of the Bank. For that reason they welcome any opportunity such as this to explain the functioning of the Bank. More than that, you will find them in a receptive mood toward any questions, comments or suggestions which those who may be interested shall have to offer.

Everyone is, of course, interested in the security behind any obligations which the Bank shall issue. From time to time various people have prepared hypothetical tabulations on the subject. All such tabulations have the inherent weaknesses of *pro forma* balance sheets. They present a static picture and do not reflect a course of operations over a period of time.

The Articles of Agreement of the Bank provide that the total amount of loans made or guaranteed by the Bank cannot exceed its unimpaired subscribed capital, reserves and surplus. That would mean that at the present time its total loans and guarantees would be limited to \$8,000,000,000 in round figures.

Frequently calculations are based on the hypothesis that the loans made by the Bank have reached that limit. Those calculations disregard the fact that it would be some time before the loans made by the Bank could reach that amount. During that time some of the currencies other than dollars may become available for lending, thus reducing the total amount which the Bank would have to borrow. Furthermore the Bank may avail itself of its power to guarantee loans which would also reduce the total amount which the Bank would have to borrow directly.

Moreover, during the first ten years of its operations the Bank is required to charge on all loans guaranteed by it and on all loans made by it out of borrowed funds a commission of not less than 1% and not more than 1½% per annum on the amount of the loan outstanding. That commission is required to be kept in liquid form in a special reserve to meet the Bank's obligations. The present policy of the Bank is to charge a commission of 1% per annum on all loans, whether made out of capital or out of borrowed funds. That commission will be accumulating in the special reserve during the period in which the Bank is making its loans.

Generally speaking the security behind the Bank's obligations will be

First, its portfolio of loans;

Second, its liquid assets in cash and in the special reserve; and

Third, the 80% of its subscribed capital which is subject to call only to meet its obligations.

The loan applications now pending in the Bank aggregate about 2 - 3 billion dollars. Those applications cover requirements of the applicants which will be spread over from one to three years. Any calculations based on the assumption that the Bank will have made loans up to its limit of eight billion dollars within the next two years are entirely hypothetical. As a matter of fact, by the time the loans made by the Bank pass the amount of the United States subscription to the Bank's capital, investors will have had an adequate opportunity to judge of the soundness and prospective success of the Bank's lending operations.



9/16/48 - 100 copies ordered

Speech Series #50

INTERNATIONAL BANK FOR  
RECONSTRUCTION AND DEVELOPMENT



Address by Chester A. McLain, General Counsel,  
International Bank for Reconstruction and  
Development, before the Semi-Annual Meeting of  
the United Nations League of Lawyers,  
Washington, D.C., 7:30 p.m., Thursday,  
September 16, 1948

I am very glad to be with you this evening and to become better acquainted with your organization. I think that it is highly significant that there is such an organization. It is significant because it shows that the lawyer has a real part to play in the grave international problems which confront the world today. It is important because of the opportunity it affords for lawyers who are actively engaged in work on those problems and lawyers who are interested in them to become better acquainted with each other and the activities in which they are respectively engaged.

In my two years at the International Bank I have had a great satisfaction in the opportunity which the Bank affords for earnest men of many nationalities to rub elbows and match wits in the tackling of the many problems with which such an institution is called upon to deal. I have found that the day to day contacts among these men are doing much to promote better mutual understanding, tolerance and good will among them and the nations from which they come. Material progress in solving international problems both in the political and the economic field may be difficult and slow, but the constant willingness of earnest men to sit down and coordinate their efforts toward the solution of those problems is bound to be of great importance to the future of world peace and order.

In that connection it is appropriate on this occasion to pay a brief tribute to a great American lawyer and a great international figure who has done his full share in promoting international order and peace. I refer to Charles Evans Hughes who devoted a great part of his active life to international problems. He was an earnest man of good will who brought to the cause of international peace a great legal mind and a spirit of mutual cooperation and tolerance.

I have thought that it would perhaps be of most interest to you as lawyers if I should speak to you briefly this evening about the functions of the lawyer in an institution such as the International Bank and the kind of problems with which a lawyer is called upon to deal in the Bank.

Organization of the Bank

So that you may have the background in which the Bank's legal staff works, I shall first sketch very briefly the organization of the Bank.

The Bank was created under Articles of Agreement which were drawn up at the United Nations Monetary and Financial Conference at Bretton Woods, New Hampshire, in July, 1944, by representatives of 44 nations. The Articles entered into force on December 27, 1945, and the Bank formally commenced operations in June, 1946. The Bank now has 47 members.



The corporate organization of the Bank consists of a Board of Governors, a board of Executive Directors and the administrative staff. The Board of Governors is composed of one governor and an alternate appointed by each member. It functions like the stockholders of a corporation. It has regular annual meetings and in the intervals between meetings votes may be taken by mail or cable.

The board of Executive Directors has 14 members of whom 5 are appointed by the 5 largest stockholders (the United States, the United Kingdom, France, China and India) and 9 are elected by the remaining members of the Bank. The Executive Directors function like the board of directors of a corporation. They hold regular weekly meetings and are available for special meetings when required.

The administrative staff is headed by the President, who is appointed by the Executive Directors and is the chief executive officer of the Bank. He is ex officio chairman of the Executive Directors without vote except in case of a tie. Subject to the general direction of the Executive Directors on questions of policy, he is responsible for the conduct of the business of the Bank and for the organization, appointment and dismissal of its officers and staff. He is assisted by a Vice-President, who is the general manager of the Bank.

The administrative organization of the Bank is divided into 8 departments:

1. The Secretary's Office - which is the custodian of the archives and the corporate seal of the Bank and functions generally like the secretary's office of a corporation.
2. The Loan Department in charge of the Loan Director - which is responsible for the examination of loan applications and the negotiation of loans.
3. The Economic Department in charge of the Economic Director - which handles economic research both in connection with loan applications and generally.
4. The Treasurer's Office - which handles the funds and financial transactions of the Bank and is also responsible for seeing that the proceeds of loans are expended for the purposes for which the loans are granted.
5. The Marketing Department in charge of the Director of Marketing - which handles all matters in connection with the sale of securities by the Bank.
6. The Public Relations Department in charge of the Director of Public Relations - which handles press relations and all other public relations matters.
7. The Administration Department in charge of the Director of Administration - which is the service department of the Bank and handles all personnel, transportation, supply and other service matters.
8. The Legal Department in charge of the General Counsel - which advises the Bank on all legal matters.



There is also an assistant to the Vice-President who supervises liaison matters with the United Nations and other international agencies.

The Legal Department now consists of the General Counsel, two Assistant General Counsels and eight lawyers, with their secretaries, a librarian and file clerk.

#### Functions of the Legal Department

The Legal Department advises with regard to all legal questions arising in the internal operations of the Bank. It prepares or reviews minutes of meetings of the Board of Governors and the Executive Directors, and resolutions and reports of action at such meetings. It advises with regard to legal questions arising in connection with the internal housekeeping of the Bank, that is, in connection with personnel matters, property, travel and liability insurance, the Bank's pension plan, regulations governing the reimbursement of income taxes on salaries of Bank employees and the like. These are for the most part routine matters, which while they take up a substantial amount of time of the legal staff, are of only incidental interest here.

The Legal Department is also called upon to review publicity material of all kinds such as press releases, informational pamphlets, speeches and the like. The purpose of the review is to check the material for accuracy of statements concerning such matters as the organization and powers of the Bank, the provisions of its loan agreements and other matters with which the Legal Department is generally concerned. This again is a routine function which none the less takes a considerable amount of time.

The Legal Department advises the Loan Department on all legal questions arising in connection with the handling of loan applications. This involves examinations of the relevant laws of the country to or in which the loan is to be made and the charters and other relevant documents relating to the organization and powers of the borrower, when the borrower is not a member government. The Legal Department prepares the agreements and other instruments under which the loan is made and also reviews reports to the Executive Directors on the proposed loan. In practice two lawyers are assigned to each loan application and they follow it through from the beginning under the general supervision of the General Counsel or an Assistant General Counsel.

In connection with the Bank's borrowing operations, the Legal Department prepares all the relevant documents, such as the registration statement and prospectus, if the particular issue must be registered under the United States Securities Act, the forms of the securities, the resolutions to authorize their issue and sale, and similar documents. Among other tasks in connection with the issue of bonds by the Bank, the Legal Department examines the laws of each state of the United States in order to determine whether or not the bonds are legal for investment by banks, insurance companies and other fiduciaries in the respective states. It also advises with regard to proposed legislation in various states to make the bonds legal for investment in those states. We are now engaged in revising and bringing down to date a memorandum on that subject which was issued when the Bank sold its first issue of bonds in July, 1947.

I think that at this point I should call attention to one important difference between the Bank and most of the other international agencies which are



in the field today. The Bank is distinctly a financial institution. It deals entirely with financial obligations. Moreover, for the most part it is dependent for its loanable resources on funds which it can borrow in the investment markets of the world. In its lending operations it deals with funds of others, funds supplied by its stockholders or by its bondholders. It must deal with those funds as any fiduciary institution should, with due regard for the interests of those whose funds they are.

That means that its approach to the problems which it meets in the course of its operations is different from the approach of other organizations which deal entirely with political or economic problems. The Bank's action in practically all cases must be decisive and unambiguous. It must decide definitely whether or not to make a loan or whether or not to borrow money, and the terms of the loan and the terms of the borrowing must be clear and unambiguous. In such financial transactions there is little or no room for temporizing or compromising action or for ambiguous language.

In calling attention to this difference I do not mean to minimize the legal problems or to be critical of the operations of other international agencies. I merely intend to call attention to a factual difference which is not always appreciated, but which cannot be ignored.

#### Some Particular Problems

It may be of interest if I take a few minutes to discuss briefly some of the particular problems with which the Legal Department has had to deal in the first two years of the Bank's operations. One of the interesting features of the operations of the Bank relates to the interpretation of its Articles of Agreement.

Article IX of the Articles provides that any question of interpretation of the Articles arising between the Bank and any of its members or between members of the Bank shall be submitted to the Executive Directors for their decision. Decisions of the Executive Directors on questions of interpretation are subject to appeal by any member to the Board of Governors, whose decision is final. Pending any appeal the Bank may act on the decision of the Executive Directors.

That means, of course, that insofar as concerns the interpretation and application of its Articles of Agreement the Bank may so to speak make its own law. To the layman that might seem to make life simple for the Bank's lawyers. The lawyer will readily appreciate, however, that this is a power which must be exercised with the utmost discretion. All possible implications of any proposed interpretation and its effect upon the future operations of the Bank must be taken into account. Care must be taken to ensure that any proposed interpretation does not do violence to the letter or the spirit of the Bank's Articles.

This power has thus far been exercised on 8 occasions. None of the decisions of the Executive Directors on interpretations of the Articles have thus far been appealed to the Board of Governors. There is not time here to discuss all of those interpretations. As illustrating the usefulness of the power, however, I might refer to one set of interpretations which were made at the time of the Bank's first bond issue.

In the course of discussing the proposed bond issue with banks, insurance companies and other prospective investors questions were presented as to the



obligations of members of the Bank to respond to calls on their subscriptions to its capital in the event that one or more members failed to pay the amounts called. It was important to clarify those questions, because 80% of the subscription of each member of the Bank is subject to call only to meet obligations of the Bank on its borrowings or guarantees. Since the 80% of the United States subscription amounts to over  $2\frac{1}{2}$  billion dollars, it is obvious that, until the liabilities of the Bank on borrowings or guarantees shall exceed that amount, those liabilities are in effect guaranteed by the United States, provided, of course, that the United States is liable to respond to calls on its 80%, even if all other members of the Bank fail to respond to such calls.

The language of the Articles is not specific on the point, but under general principles of both the common law and the civil law it is reasonably clear that the obligations of the respective members on their subscriptions are independent of each other and that each is obligated to respond to calls up to the full amount of its subscription even if others fail to do so. In order to clarify the matter, however, the questions were submitted to the Executive Directors and they unanimously rendered a decision to that effect.

#### Corporate Status of the Bank

When I accepted my appointment as General Counsel of the Bank my lawyer friends promptly began to chide me by asking me the obvious question, "What is the legal nature of this institution for which you are proposing to act as General Counsel?"

That is an interesting question which I have not yet purported to answer definitively. In the prospectus for the Bank's first bond issue we described the Bank as "an international institution established and operating under Articles of Agreement" among its members. That description has been used in other formal documents and is I believe sufficient for the purpose. It will I assume suggest to those of you who are familiar with Roman Law a more definite answer to the question.

A more definite answer can also be abstracted from the Bank's Articles. Article VII on the Status, Immunities and Privileges of the Bank provides that the Bank "shall possess full juridical personality, and, in particular, the capacity: (i) to contract; (ii) to acquire and dispose of immovable and movable property; (iii) to institute legal proceedings." That Article also provides that actions may be brought against the Bank in a court of competent jurisdiction in the territories of a member in which the Bank has an office, has appointed an agent for the purpose of accepting service or notice of process, or has issued or guaranteed securities, but that actions may not be brought against the Bank by members or persons acting for or deriving claims from members, and that the property of the Bank shall be free from seizure except on execution after final judgment against it.

Those provisions of the Articles are given force of law in the territories of the members of the Bank. In the United States, for example, the Bretton Woods Agreements Act, under which the United States accepted membership in the Bank, expressly provides that such provisions shall have full force and effect in the United States, its territories and possessions, and the Act also contains provisions establishing the venue of suits against the Bank.

The Bank may thus be said to be a legal entity having substantially all of



the attributes of a corporation.

That does not answer all the questions, however. For the purposes of some statutes, for example, the Bank may not be deemed to be a corporation as the term "corporation" is used in the particular statute.

In August, 1947, the Attorney General of Ohio rendered an opinion in which he held that the Bank is not a corporation within the meaning of an Ohio statute permitting Ohio state banks to purchase certain obligations of corporations. He based his opinion on the ground that the term "corporation" as used in the statute should be given its commonly accepted meaning as a corporation formed and owing its existence to a sovereign power, and that it could not be assumed that the state legislature intended to include within the term an international bank the creation of which was not within the contemplation of the legislators at the time the act was passed. That may be a somewhat narrow interpretation of the statute; but I do not believe that any court would hold it to be an unreasonable interpretation.

On the other hand there are instances in which the Bank has been held to be a corporation for the purposes of other statutes.

#### Enforcement of Obligations to the Bank

Another interesting set of questions arises from the fact that all of the members of the Bank are sovereign governments. Those governments may have obligations to the Bank in two respects. First, they are all stockholders and are liable to the Bank for the unpaid parts of their subscriptions to its capital stock, when and as the Bank shall call upon them for payment in accordance with its Articles. Secondly, some of the member governments are themselves borrowers from the Bank or are guarantors of loans made by the Bank and are liable for the payment of those loans. That raises the interesting question as to what means the Bank may have to enforce performance of the obligations of its members to the Bank.

That question was also presented in connection with the sale of the Bank's bonds last year. My recollection is that the Securities and Exchange Commission then expressed the view that some reference to the matter should be made in the prospectus for the bonds. Accordingly, we included in the prospectus the following, which I think fairly states the position:

Attention is called to the fact that, since all the members of the Bank are Governments, the obligations of the respective members of the Bank (including the United States of America) on their subscriptions to its capital stock and on any loans which shall be made to or guaranteed by them, like obligations of Governments generally, depend on the faith and credit of the respective Governments and are not enforceable against them by legal process without their consent. It is also true, however, that each member Government, by reason of its subscription to the capital stock of the Bank, has a direct interest in the performance by every other member Government of its obligations to the Bank.

A similar question arises in connection with loans made by the Bank. We recognized from the beginning that it would probably be futile to attempt to include in our loan agreements provisions which would permit of their enforcement by judicial procedure. We decided moreover that the most effective sanction for



the enforcement of the obligations of governments under such agreements would be world opinion and that the most effective means of mobilizing world opinion for that purpose would be an award of an arbitration tribunal in favor of the Bank. Accordingly, all of our loan agreements provide for the arbitration of disputes arising under them by an arbitration tribunal composed of one member appointed by the Bank, one member appointed by the borrower and an umpire selected by agreement between them or, if they fail to agree, by the President of the International Court of Justice.

The regulations to govern the arbitration of such disputes are set forth in Loan Regulations No. 1 which were promulgated by the Executive Directors on May 9, 1947, and are incorporated by reference in all loan agreements.

Conclusion

Needless to say there are many other legal questions with which we are currently dealing. I have had time to mention only a few which illustrate the kind of work which the Bank's legal staff is called upon to do.

The Bank is still a youthful organization. In such an institution it is important that such questions be determined in the light of experience and on the basis of concrete cases. We do not attempt and it would be unwise to attempt to decide all of the questions that can eventually arise in the course of its operations abstractly and without regard to concrete facts. We are quite content to deal with the questions as they arise and to refrain from anticipating questions which may never arise or may never have to be answered. We regard the pragmatic approach as the only practicable approach to the problems of an international experiment like the Bank.



Remarks of C.A. McLain at Annual Meeting  
of Machinery and Allied Products Institute  
Washington, D.C., June 10, 1948



1. Introductory

I do not pretend to any expert knowledge regarding the foreign trade of the United States. Nor do I have at my command statistics from which to analyze the trends in the export of capital goods from the United States to the Latin American republics or from which to predict what the future of those trends will be. It is true that I have recently accompanied the President of the International Bank on a five weeks' tour of South America. But that trip did not equip any of us with the crystal ball from which to discern the future of inter-American trade in capital goods. Generally speaking we learned nothing specific which was not previously known to us or available from data which the staff of the Bank had already collected. What we did get was a general feeling of the political and economic atmospheres in the various countries, which we hope will enable us better to understand and more keenly to appreciate the problems involved in financing the economic development of those countries.

Among those general impressions, I cannot emphasize too strongly one fact which was borne in upon us throughout our trip. That is the fact that conditions in the various countries differ so greatly and in so many respects that the several countries cannot be grouped together and treated as a single Latin America for the purposes of intelligent discussion. That is true not only of geographical and climatic conditions but also of political, social and economic conditions. On the other hand the various countries present certain general and important similarities which justify a certain amount of generalization provided always that in generalizing one is careful not to obscure the important differences between the various countries.

The figures which I have seen indicate that in 1947 capital goods constituted about 1/3 in dollar value of all exports from the United States to the 20 Latin American republics and that the proportion was about the same in 1938 and 1941. The figures also indicate that in 1947 total exports and capital goods exports to the Latin American republics were about 8 times in dollar value what they were in 1938 and about 190% of what they were in 1946. Of course, a large part of that increase can doubtless be attributed to increased prices, the great pent up demand for goods which were not available during the war and the accumulation of dollar exchange in the Latin American republics which resulted from the war. Nevertheless, there is still a great potential demand for capital goods throughout Latin America. On the other hand, the reserves of dollar exchange which those countries accumulated during the war have been greatly depleted during the past two years. Many Latin American republics are thus faced with a problem of financing capital goods imports.

As I have said, I am not equipped to attempt any predictions as to what the future flow of capital goods from the United States to Latin America may be. Moreover, it seems to me at this juncture more important to consider what are the factors that may affect that flow and the means by which it can be maintained and improved than to undertake to prophesy how great the flow will be. As one financial writer has recently said in another connection, the time has come when this country should address itself more to policy than to prophecy.



Accordingly, I propose to speak to you briefly, and with perhaps an exaggerated simplicity, of certain general factors which now have and in the future will have an important bearing on exports of capital goods from the United States to the various Latin American republics.

## II. The General Element of Confidence

A simple truth that is too frequently overlooked is the fact that all purchases of capital goods are based upon credit in the broadest sense of that term. I mean by that that any investment in capital goods must be paid for out of borrowed funds or funds furnished in the form of equity capital. In either case the lender or the investor is called upon to decide whether or not he will defer the present enjoyment of the accumulated wealth which is represented by the funds to be invested in exchange for the prospect that such wealth will be returned to him in the future with an increment of profit or gain in the form of interest, dividends or capital appreciation. The all important factor which must influence that decision is the extent of the particular investor's confidence in the future. Unless he can look forward with a reasonable degree of certainty to the ultimate return of his investment with a reasonable increment of earnings thereon, he will have little or no incentive to make a long term capital investment. In the making of his decision a number of diverse factors come into play.

## III. The Political Element

Uppermost among those factors today everywhere is the political situation. Unsettled political conditions in any country act as a brake on capital investment in that country, because they tend to impair confidence in the future. In a number of Latin American countries political uncertainties are an important restraint not only upon capital investment from abroad but also upon capital investment out of domestic savings.

I am not going to single out any particular country for comment. What I say is applicable in a greater or less degree to a number of them. The recent revolution in Columbia, which had not had such an uprising in over 40 years and which before that occurrence might have been classified as one of the most politically stable of the Latin American republics, shows that the political situation cannot be neglected anywhere.

Some Latin American countries are today being governed by governments which concededly do not rest upon the expressed will of the governed. In some of them the executive does not command the support of a majority of the legislature. That, of course, is true today in the United States. But here that means only a certain degree of ineffectiveness in the functioning of government. In Latin America, however, it more frequently happens that the opposing parties fail to reach a modus vivendi; an impasse results which can only be broken by a revolutionary change of government or by the executive assuming dictatorial powers. The resulting uncertainty and disorder tends to discourage capital investment and sometimes even encourages the flight of domestic capital abroad.

The future development of political conditions in the Latin American countries will, therefore, be an important factor bearing upon the export market for capital goods in Latin America.



#### IV. Communications and Transport

In some Latin American countries one of the most striking problems is that of internal communications and transport. Many of the Latin American countries are split by mountain ranges into several sections between which communication, except by air, is almost impossibly difficult. The economic and social consequences of that condition are immense. Of what use is it to ship agricultural machinery to a country in order to increase its agricultural production, if there are no adequate roads, railroads or waterways over which that machinery can be transported to the sections where it is needed? Of what use is it to increase the agricultural production of a fertile plateau in the Andes, if there are no adequate means by which the increased production can be transported to the more populous sections of the country where it is needed or to the coast for export abroad?

The same problem affects industrial development. Many Latin American countries are rich in natural resources, but they lack the industrial equipment to turn their resources into finished or semi-finished products. But here again, of what use is it to install a steel plant on a high plateau in the Andes, if there are not adequate facilities with which to transport the finished steel beyond the plateau? Or of what use would it be to install the same steel mill on the coastal plain where there is adequate access to markets for the steel, if there are not adequate facilities to bring the iron ore and coal from the mines to the mill?

As I said in the beginning, I am oversimplifying these problems. In most cases it is not a question of impossibility of transport but of excessive cost of transport. In one instance there is what appears to be an adequate railroad from the port over the mountain to the interior but the cost of trucking and transshipping at either terminal of the railroad renders the overall cost of railroad transportation excessive. As a result the single highway over the mountain is jammed with motor trucks which transport everything from steel beams to foodstuffs.

Most of the countries concerned are keenly aware of this problem and are eagerly studying the possibilities of solving it. In the meantime there is not much that the American exporter can do about it, except to consider all practicable means of packaging his product so as to overcome, in so far as possible, difficulties of local transportation. That is particularly applicable, of course, to heavy equipment which can be shipped broken down into small parts to be assembled on the site.

#### V. Man Power

It is, of course, of no use to export capital equipment to any country if it does not have the man power to operate the equipment when it gets there. The man power problem is not only a question of numbers, although that is important in some countries, but also a question of education or "know how".

In most Latin American countries today there is a growing shortage of agricultural labor because the relatively high wages in the cities are draining agricultural labor from the fields. As industrialization proceeds in those countries that will be a continuing problem. Immigration is not necessarily the



solution for that particular problem. The obvious solution is to increase the productivity of agricultural labor by increased mechanization, improved agricultural techniques, irrigation and improved drainage. But that requires an improved level of education of the agricultural population, in order that they can effectively use the mechanical equipment and apply the improved agricultural techniques.

I learned of one incident which can probably be multiplied many times. A representative of an agricultural machinery manufacturer was visiting an area where one of the machines was in use, but was not functioning satisfactorily. After watching it operate he pointed out that the operator had failed to make a simple adjustment in the mechanism. When the adjustment was made the machine worked properly.

This is a point at which the American exporter of capital equipment can be of direct help, by taking steps to insure that those who are going to operate the equipment know how to do so.

There is, moreover, the question of the upkeep of the equipment after it has been put into service. In some cases it may pay American exporters to establish some means of servicing the equipment which they export either by maintaining local service stations or by traveling service parties. That is already being done by some exporters. The important thing is not to sell blindly without regard to the ultimate fate of the equipment in operation.

#### VI. Monetary Problems

At present many Latin American countries are suffering from monetary ills. These have a direct bearing on importations of capital equipment. The back log of demand for goods which were not available during the war has rapidly depleted the foreign exchange resources of a number of countries, and internal inflationary forces have resulted in depreciation of their currencies.

Some of them have in force foreign exchange controls which in fact tend to discourage exports and subsidize imports, thereby aggravating the disequilibrium in their balance of international payments. The International Monetary Fund is doing what it can to induce those countries to stabilize their currencies and adopt sound exchange practices. In some countries, however, the political situation is such as to render it extremely difficult to bring this about.

The monetary uncertainties which arise from this situation tend to discourage long term capital investment and tempt investors into speculative enterprises as a hedge against inflation and in search of quick profit. Generally speaking, importers of consumer's goods with a quick turnover and relatively less capital investment at stake have less to fear from such uncertainties than importers of capital goods.

#### VII. Need for Equity Capital

In considering the prospects of capital goods exports to Latin America, one of the major problems is that today in most Latin American republics available local capital and the rate of local savings are not sufficient to finance their



needs for capital equipment. For the most part the capital to finance those needs must come from abroad in the form of loans or equity investments.

That is where the International Bank comes in. One of its major purposes is to assist in the financing of the development of the productive resources of its members by promoting international capital investment and, where private capital is not available on reasonable terms, by making loans itself.

In considering the extent to which the International Bank can or should make loans to Latin American countries to finance the development of their economic resources, however, two important factors must be taken into account. In the first place, the International Bank with the financial resources available to it cannot meet all the demands for loans for the development of productive enterprises in Latin America. Secondly, even if the Bank could meet all those demands, it would be economically unsound to attempt to finance all of the worthy productive projects by way of loans. A very substantial part of the financing of such development projects should be in the form of equity investments rather than loans and it is a part of the functions of the Bank to encourage and promote such equity investments.

There are two advantages to financing development projects with equity capital. In the first place, most development projects require time to bring them to a productive level which will afford a reasonable return on the capital invested, and even with time, the extent of the return which can be realized is often difficult to predict with any degree of accuracy. For that reason it is economically unsound to burden such projects with heavy fixed charges for debt service. That is especially true when the debt service must be paid in foreign exchange and, therefore, imposes a burden upon the balance of payments of the borrowing country. Loans for development projects in Latin America, therefore, should only be made with a weather eye to the prospective balance of payments situation of the borrowing country and great care must be taken not to overburden the country with fixed requirements for foreign exchange to pay the service of its external debt. Otherwise, as experience has shown, general defaults on the external debt of the country will result; its credit will be impaired; and its ability to finance capital goods imports will also be impaired.

In the second place, equity capital has a tendency to remain in the country and an attraction for additional capital when required for expansion under favorable conditions. The most economically healthful means of financing industrial expansion is by ploughing back a part of the earnings of existing facilities. Earnings on debt capital are rarely so ploughed back. But when equity capital is realizing good earnings there is every incentive to plough back a substantial part of those earnings. This is important because the continued progress of economic development requires constant expenditure of large amounts of new capital for renewals and expansion of existing facilities. Recent statistics indicate, for example, that in 1947 capital expenditures for new plant and equipment in the United States aggregated over 15 billion dollars, and that over \$9 billion of that was financed by ploughing back earnings of existing enterprises.

#### VIII. The Role of the International Bank

In considering applications for loans for economic development in Latin America the Bank must take into account all of the factors to which I have referred.



Under its Articles the Bank is forbidden to interfere in the political affairs of any of its members and must base its decisions solely on economic considerations without regard to the political character of its members. Nevertheless the Bank cannot fail to take into account political conditions which affect the economic and financial stability of a country and the prospects of repayment of the loan applied for. In countries where there is a high degree of political uncertainty the Bank may well find it impossible to make loans or at best it may have to confine its loans to projects from which the foreign exchange required for the service of the loan can be realized or which are of such a character that any new government will find it necessary to continue to support them.

In making loans for agricultural improvement the Bank must consider whether the prospective increase in the production of agricultural products can be transported to market at costs which will make them marketable. Likewise, in making loans for industrial development the Bank must consider whether the particular enterprise can obtain the raw materials required at reasonable cost and can reach the market for its products at reasonable cost. So also the Bank, in making loans for any particular project, must consider whether the man power and the know how are available for the operation of the project and also its possible effect in the draining of man power from other productive enterprises.

For reasons which I have already indicated the Bank is keenly interested in the promotion of foreign equity investment in the Latin American countries. How much it can do in that direction will depend on the attitude of the governments of the particular countries concerned and also the degree of cooperation which the Bank receives from those who have capital to invest.

It is true that in some Latin American countries there is a tendency to discourage foreign equity investments. In part that is due to a mistaken belief that foreign equity capital always exploits the economic resources and manpower of the country and always takes out more wealth than it puts in. That belief is sometimes fostered by political demagogues who use it for campaign purposes.

While it is only natural that foreign investors, especially those who invest in highly speculative projects (and many development projects are necessarily speculative) should seek to obtain as high a return as possible on their investments, it is nevertheless true that in the long run and in the aggregate foreign equity capital leaves much more wealth in any country than it takes out. Countries in need of economic development should, therefore, welcome rather than fear foreign equity capital.

On the other side of the picture the foreign investor in his own interest should adapt his investment to the particular conditions of the country in which it is made. Where a foreign concern operates a local enterprise it should seek to avoid management policies which tend to aggravate local political or social conditions and thus lead to trouble. Wherever practicable it should encourage local capital to participate in the enterprise. That is especially important because the participation of local capital helps to counteract the natural tendency to regard absentee owners of local enterprises as exploiters.

Exporters of capital equipment can also be of great help in promoting the sound development of the productive resources of Latin American countries. They should not look upon their prospective markets in those countries solely with the



eye of a salesman. In the Bank we are sometimes presented with projects for loans the plans for which have been developed by or with the assistance of American manufacturers of capital equipment. In some cases the projects are over ambitious from the point of view of the needs of the particular country and its ability to pay the cost of the capital required. In other cases plans for the project have been developed without due regard to local conditions especially as related to transportation and available markets.

The Bank frequently seeks the advice of American producers of capital goods, especially with regard to the practicability of the projects presented to it and with regard to the availability of the materials and equipment needed for the projects. We hope that as time goes on American exporters of capital equipment will not hesitate to consult the Bank, especially as regards the economic soundness of the projects on which they may be figuring and the relation of those projects to the general economy of the country in which they are to be installed. We believe that such mutual consultation between the Bank and the producers of capital equipment will help to avert many of the headaches which in the past have been attendant upon capital investment abroad and help to promote sound international investments.