SOMMERS, DAVIDSON - Articles and speeches (1950 - 1959)

DECLASSIFIED
WBG Archives

THE WORLD BANK GROUP

Talk By Davidson Sommers
Before Foreign Policy Semester,
The American University
April 18, 1984

Before talking about the World Bank, I should make clear that I am not an impartial outsider. I joined the Bank's legal staff in 1946, a short time after it began operations, became General Counsel in 1949 and Vice President in 1956. In 1959 I left for another job, but returned in 1972 and was an advisor to the President until 1982. So please note to begin with that I'm an admirer of the World Bank -- but this side idolatry. I have my questions about it and criticisms of it but on the whole, I think it's been a wonderful, and with the Monetary Fund, a unique example of international cooperation for a worthy purpose. It's a complicated subject because the "World Bank" is not the correct legal title of anything; its just the name that has come to stand for a group of institutions that I'll describe later, often referred to as the World Bank Group.

Q. Can I ask you a question?

A. Yes.

Q. Have they dropped the name IBRD?

A. No, that is the legal name of the bank part of the World Bank Group. The International Bank for Reconstruction and Development was the first part of this complex. It's appropriate to discuss it now because it was created almost exactly 40 years ago at the Bretton Woods Conference in 1944, where the International Monetary Fund, about which you're going to hear this week, and also the International Bank for Reconstruction and Development were created.

You should be reminded of the world as it was in 1944. It was not only in the middle of a disastrous war, but was also at the end of almost 15 years of depression, domestically and all over the world. It was a period when trade, international finance, all international economic relations had slowed down and nearly came to a stop. There had been huge defaults on international loans in the 20's and 30's and international lending had a bad reputation. There were exchange controls, so you couldn't get your capital from one country to another, you couldn't convert one currency into another. These were the problems that the Bretton Woods Conference was called to deal with. Under the leadership of the United States and the

British headed by Lord Keynes, the famous economist, the Bretton Woods Conference consisted of representatives of treasuries and central banks, mostly from Western countries and Latin America (I think about 44 countries in all). The Russians were also present with several other members of the Soviet Block. The conference concentrated primarily on the international liquidity and exchange situation, which was dealt with by creation of the International Monetary Fund (IMF), as you will hear on Friday. The IMF is in brief a central bank for central banks. It's a place where national central banks can get short term credit as needed for their liquidity problems. It was also intended to be a regulatory agency for international monetary affairs.

At the same conference, but as somebody said, almost as an afterthought, there was also created the International Bank for Reconstruction and Development, an entirely different organization, not a short-term credit organization but one designed to make long-term loans, first, to reconstruct the European countries whose economies had been devastated and, second, to develop what was then called the underdeveloped world but is now more tactfully called the developing world. This was something quite new.

I want to pause for a minute to give you some definitions of the four organizations that make up the World Bank Group. The first is the International Bank for Reconstruction and Development, that's the part that was created at Bretton Woods in 1944. It started operations in 1946 and is often called "the Bank". Next is the International Development Association, which is often called the soft loan arm of the World Bank, generally referred to as IDA. The third is the International Finance Corporation. The International Finance Corporation, usually called IFC, is an affiliate designed to promote private investment and production through the private sector in developing countries and to promote the flow of international investment into those countries. In the 50's there was practically no private investment money going into any of those countries. IDA and the International Finance Corporation were created in the 50's. The fourth member of the World Bank Group I won't do more than mention; it is called the International Center for the Settlement of Investment Disputes and is an arbitration tribunal; if anybody is interested we can go into that later. I'm going to concentrate my remarks on the Bank and IDA. I will leave some time for questions. If anybody wants to raise any questions while I'm talking, please don't hesitate to put your hand up.

The organizations that I'm going to talk about, the Bank and IDA (and IFC also) were organized under international treaties for similar purposes, to promote international cooperation for economic development. Although the 40's were a time of terrible trouble, the world was more idealistic then; people really thought that improvement could occur by international cooperation instead of confrontation and this was the spirit behind these organizations. However, in form they differed from the usual U.N. type of institution; they were organized on the model of business corporations. They have shareholders, who are governments, and they have boards of directors and a president and most significantly their members' participation is not, as in the U.N., one-country-one-vote, but is graded on the basis of a rough estimate of their relative importance in international trade and finance, needless to say with a certain injection of politics, too. India and China were pushed up, because of their big populations, into positions larger than they would have had on pure economic grounds. Just to show you the scale of gradations, the U.S., the largest shareholder, now has 20% of the shares and other countries' shares cover the whole range of percentages, the lowest participation being less than one-hundredth of one percent. The directors are elected by the government shareholders. A few big shareholders like the U..S. have enough voting power to nominate their own directors. Others have to band together to elect directors. I should add one thing more about all these organizations. Unlike the U.N., they are operating organizations. They're not places where people meet for public discussion on broad policy issues. They act by operating and don't get involved in big public debates as much as the U.N. organizations.

I'm going to start with the Bank, the International Bank for Reconstruction and Development. The unique thing about the Bank is that it was not intended to rely for its lending primarily on government financing -- government contributions. It was intended to get its funds by borrowing or guaranteeing loans in the capital markets of the world. It was to be a vehicle for siphoning off savings and private capital and channelling those funds into, first, reconstruction of Europe and, second, development of the developing countries. The Bank was intended to perform in the international scene, where the international bond market had almost completely disappeared due to defaults and exchange controls, the kind of role played by the domestic bond market in the United States. But recognizing that the private capital market might be very skeptical about foreign lending, the Bretton Woods Conference surrounded the Bank with safeguards. Loans could only be made to or guaranteed by governments. Loans had to be for productive purposes (that really means nothing more than that you ought to know when you make a loan what it is intended to be used for; they were trying to steer away from the scandals in the 20's and 30's when loans were made for showy palaces or other uneconomic purposes; I think one loan was made in Latin America to build a railroad which went to the outskirts of the town and was never carried any further). The Bank was put under obligation by its charter to make a careful appraisal of all loans, to be governed by economic considerations not political considerations and to have policies that would make some significant contribution to economic and social development. And there was one further condition, the Bank could only make loans when private capital was not available for the project. This was intended to assure the private investment market that IBRD wouldn't be a competitor.

The Bank's financial structure was also an innovation. Only a small part of the subscriptions to capital stock are paid in, now around 10 percent. The remaining 90 percent is subject to call only for the purpose of meeting the Bank's obligations on the bonds it issues and the guarantees it makes to raise money. So in effect this is a collective guarantee fund by the members of the Bank which can be used not for operations but only to pay off, if necessary, bonds and guarantees issued by the Bank in its money raising activities. That was intended as the basis of the Bank's credit-worthiness. It was a novel technique in the field of international finance. Let me read the comment made by one of the Bretton Woods Commissions: "The creation of the Bank was an entirely new venture; so novel was it that no adequate name could be found for it. Insofar as we can talk of capital subscriptions, loans, guarantees, issues and bonds, it had some claim to being a Bank, but the type of shareholders, the nature of subscriptions, the exclusion of all deposits and short-term loans are quite foreign to the accepted nature of a Bank. We still call it a Bank mainly because no satisfactory name can be found for this unprecedented institution." Keynes said that we should call the Fund the Bank and the Bank the Fund.

When the Bank started, it was tiny. When I joined in 1946, the total board of directors and staff, including messengers and laborers, was 100. There were 37 member countries. The Soviet Union, by the way, had refused to join. At that time, the Russians didn't want to go into any institution where they wouldn't have a veto power. Whether that was the reason I don't know, but they didn't join. From 37 member countries in 1946, the Bank has grown to 144; from a staff of 100 people, it has grown to a staff of 6,000. And the rate of performance has outdone the rate of growth in personnel.

The first task before the Bank, as indicated in the name International Bank for Reconstruction and Development, was the reconstruction of Europe. It started with loans of about half a billion dollars, $250 million to France, $100 million to the Netherlands, similar loans to Belgium, Denmark and one or two others. But it was soon realized that these were just tokens, that destruction and devastation in Western Europe was so great that the Bank's resources were completely incapable of dealing with the situation. So at this stage in came the Marshall Plan, in came the United States loan to Britain for some $3-1/2 billion and the Bank, with everybody's consent, dropped out of the reconstruction business because compared with amounts put out by the Marshall Plan the Bank's resources were minimal.

The Bank then turned to the problem of development. It started with the kind of lending that was familiar in long-term bond lending in this country. I think power and energy was the most important sector, followed by transportation, irrigation, communications and basic industry. As the Bank's understanding of the needs of the developing countries grew and as decolonization created new problems for the developing countries and poverty became a matter of more governmental concern, the Bank extended its field of operations. It entered more difficult areas such as education, which is full of local political problems, and urban development with all the difficulties familiar in this country in housing programs. The Bank has also gone into rural development; instead of concentrating on big projects like irrigation, it has tried to improve the productivity of the individual farmer by giving farm credit, agricultural instruction and things of that kind. The Bank has also entered the areas of population, health and nutrition. But essentially, the major lending programs continue as they were in early years, power and energy, transportation, communications and industry. But there has been one major change. Agriculture is now the largest target of Bank lending and will probably continue to be so in the years ahead.

The terms on which these loans were made have differed somewhat over the years but they are generally loans of 20-25 years, with a four year grace period, the interest-rate based on the cost to the Bank of borrowing plus a small margin for reserve. The growth in lending has been absolutely spectacular. In the early 50's, the Bank was lending at the rate of $3-4-500 million a year. By 1960 it was up to $700 million a year. By 1970 it was up to $2-3/4 billion and in 1983 the Bank committed for loans of $11 billion. Of course, we have to remember that by now a lot of money is coming back. Actually, the amount of current net output by the Bank is nothing like $11 billion because loans are being repaid by the early borrowers, but it had a total on a gross basis, in the years between 1947 and 1984, of $90 billion to 100 countries. And there has not been a single default on any loan in that time, which is a really impressive record. The Bank has always operated at a modest profit but no member government has ever asked for a dividend. Earnings are put into reserves and become another source of money available for lending.

I think that summary of Bank performance sounds like an impressive accomplishment, but it still was not adequate because the world had changed. In the old days if you wanted to help Africa, for example, you didn't deal with Africa, you dealt with England or France or Holland; the African countries were all colonies. As these became independent, they no longer qualified for guarantees by their former parent countries; they had to borrow on their own credit and most of them had no credit. It was not only that nobody would lend them money but that they couldn't afford to pay the nearly-commercial terms of Bank lending. There began to be a realization that another kind of international organization was needed to deal on easier terms with these poorer countries. There was a proposal for a "Special United Nations Fund for Economic Development" as part of the U.N. (which was handicapped by the fact that its acronym was SUNFED) but major countries didn't consider the United Nations a good place from which to operate a financial organization. From a variety of sources there was pressure for a new organization. The lead was soon taken by the President of the World Bank, Eugene Black, who, with the help of Senator Mike Monroney, persuaded the United States to sponsor the concept of what was called a soft loan affiliate of the Bank. To show you the atmosphere that prevailed in those days, I went with Black to call on Secretary of the Treasury Anderson. We said that if this organization was established, it would get at least one dollar from other countries for every dollar the U.S. put up. To this, the Secretary said "Oh, Gene, you know we have to put up all the money". In fact the U.S. is now putting up about 25 percent of the money.

The result of such discussions was that in 1960 a soft-lending affiliate of the Bank was created to make loans on easier terms than the Bank. It was called the International Development Association and is now generally known as IDA. It was designed not only for the African countries which were recently independent but for places like India, Pakistan, Bangladesh and Sri Lanka which were dreadfully poor.

There are two things about IDA that distinguish it from the World Bank. First, the money comes not from the market but from government contributions, pro rata in accordance with their World Bank capital shares. Not all Bank members joined, but most of the big countries did. Second, terms were much easier -- in fact, largely grants. There was some talk about making IDA a grant organization, but the Indians felt that taking grants was undignified although a loan that was 90 percent grant was acceptable. IDA now calls its loans credits. They are for 50-year terms with 10-year grace periods and no interest as such but with a service charge of 3/4 of one percent per year. Credits are given only to extremely low income countries; I think the current test is something like $450 per capita. Some countries are on the borderline and are given a mixture of Bank loans and IDA credits. IDA is now approving credits of up to $2 or $3 billion a year, with a total of $30 billion over the years from 1960, nowhere near as much as the Bank puts out, but vital for the poor countries.

One of the most controversial, and I think one of the healthiest, decisions about IDA was that instead of creating a separate institution with a separate staff, a separate Board and different standards, IDA is essentially just a separate pocket of money. Everything else is the same as the Bank, the Board is the same, the chief executive is the same, the staff is the same and all the criteria for lending except credit worthiness are the same. An IDA project has to be economicaly sensible; it has to be carefully appraised, it has to provide sound financial economic returns and so forth. By avoiding the creation of a separate bureaucracy, IDA avoided the inevitable tendency to develop entirely different lending standards.

As you may have read in the papers recently, IDA is now having some trouble. A new round of government contributions (called a "replenishment") is being negotiated and the United States is holding back. The other countries are pushing but the United States wants to cut the total considerably from a few years ago. Indeed the recent U.S. record in IDA has been bad. It has failed to meet its commitments year after year, delaying by two or three years and forcing other countries to step in to bail IDA out. Now the other countries are saying "No, we've had enough of that, we're not going to act until the United States acts." Negotiations are at a critical point.

This discussion of IDA funding leads us back to the Bank. How does the Bank raise the money it needs for lending? The people at the Bretton Woods Conference decided that the money should come from the private capital markets, but I doubt that they realized how difficult this would be. After World War II, the United States was the only country in the world where large amounts of savings were available for foreign lending. But as a result of the defaults of the 30's, laws had been changed and the major potential investors in long-term obligations, insurance companies, banks and savings institutions, were largely prohibited from buying World Bank bonds. In the circumstances, when the Bank began operations, the staff had to launch state-by-state lobbying operations. I have lots of stories of those days, but I'll just tell you one. I went out to Kansas, unfortunately on the day on which prohibition was repealed in Kansas, so I didn't get any high-priority attention. I appeared before a legislative committee and told them about the Bank and how good the bonds were and so forth. Afterwards the insurance commissioner came up to me and said "Mr. Sommers, those sound like good bonds. Unfortunately, as a result of my experience in two world wars, I just don't trust foreigners." This was the atmosphere that prevailed in those days, very hard to get anything done for a queer organization like the World Bank. But gradually, step by step, we got the laws changed. John McCloy who was the Bank's president at that time and Eugene Black, his successor, convinced legislators and the financial community that this was going to be a sensibly run institution and its loans were not going to be throwing away money. Financial people were particularly suspicious about domination by the U.S. and the Bank's being run for political purposes. Gradually, attitudes became more favorable and the Bank entered the market. There were experiments on how to issue bonds and some mistakes were made. One of my friends on Wall Street said to me "Someday I hope to participate in a World Bank bond issue in which I do not learn a valuable lesson." In the 1950's a mechanism for issuing bonds evolved and the bonds achieved an AAA rating. Now the Bank borrows all over the world. In 1975 it borrowed $3-1/2 billion, in 1980 it borrowed $5 million, in 1983 it borrowed over $10 billion. The World Bank has become the largest non-government actor in the international banking market. This is by no means draining money out of the United States exclusively. Twenty percent has come from the United States, practically the same amount from Germany, almost the same amount from Japan, from Switzerland (which is not a member but allows borrowing there) and from OPEC, the Arab countries. In addition the Bank has a $1-1/2 billion short-term borrowing operation. It borrows from world central banks and keeps renewing year by year.

I'll say just one more word. There have been replications of the World Bank Group on regional bases. The Inter-American Development Bank was started as a Western Hemisphere copy of the World Bank. It differs because for many years the U.S. was much more dominant there than it was in the World Bank. Next came the Asia Development Bank, also a copy. The major influence there is Japan. There are others. The African Development Bank never amounted to much. The Arabian institutions are pointed towards the Arabs and their money comes from Arab countries. However, the Export-Import Bank (Eximbank), which you are going to hear about this afternoon, is not a copy of the World Bank. It came before, and it was designed originally for, and is now used for, export promotion, export of U.S. equipment and products. Many other countries also have institutions like Eximbank and they are important actors in international trade. Like Eximbank they lend the currencies of their own country for expenditures in their own country.

In that respect, the World Bank is vitally different. A fundamental principal of the IBRD and IDA is that loans are not "tied" to particular countries. Loans are not made in dollars or D-marks on condition that they will be spent only in the U.S. or Germany. They can be spent in any member country, which makes the funds much more valuable to the borrowing countries. And to ensure efficiency in procurement, the Bank and IDA require contracts by borrowers to be placed on the basis of international competitive bidding.

Later on, after you've had a chance to ask some questions, I would like to put before you some questions that have been raised by others about the World Bank. But let me now close this part by saying that I still think the World Bank to be, with the Fund, probably the most effective and beneficial international organization in existence and it is widely regarded as such. Some of the communist countries dropped out but others have joined. Hungary has joined, Rumania has joined, Yugoslavia always was a member. Except for the Soviet Union, East Germany, Czechoslovakia, Poland, Bulgaria and Albania, most significant countries belong. It's a world organization and has done a tremendous job.

Now if you would like to ask some questions.

Q. I was just wondering where exactly is the main locus of the World Bank?

A. It's located at 1818 H Street, N.W. in Washington, D.C., but it has representatives in many countries overseeing its lending operations.

Q. You mentioned that IDA is a sub-pocket of the World Bank and I was wondering: if a country receives loans from the World Bank, are the three separate divisions in the World Bank mutually exclusive? Can you not get loans from each of those divisions?

A. For most countries if you are creditworthy enough to borrow from the World Bank, you can't get loans from IDA. You can get investments from IFC but that's a very much smaller organization. If you qualify for IDA it means that your credit rating isn't good enough to get much from the World Bank. But there are complicated countries like India, which is a very low-income country but also a sophisticated country in various respects. There the Bank and IDA give a mix. The effect is to reduce interest rates. IDA charges no interest and the Bank charges 10 percent interest; by giving a 50-50 mix you can in effect give a five percent interest loan. That is not usual but is sometimes resorted to.

Q. You stated that out of $90 billion in loans, there have been very few defaults.

A. None.

Q. How come the World Bank can get people to pay back their loans when the United States can't?

A. When it started, the Bank tried to get a universal acknowledgment that World Bank loans took priority. Nobody accepted that officially, but that has been the fact. One reason is that everybody realizes that the World Bank operates on a tiny margin. The Bank doesn't have big resources to fall back on like the United States. Another reason is that the Bank doesn't get involved in cutting off loans because of political disagreements. But the most important reason in my opinion is that the essential ingredient of creditworthiness is the willingness of the lender to go on lending. The countries know that if they pay their loans to the World Bank, by and large they're not only going to get their repayments refunded -- not as such but in effect -- but they'll probably borrow more and more over the years. I was in Brazil once and the governor of the central bank and I were discussing defaults on international loans and he said "Mr. Sommers, do you realize that the year in which Brazil is popularly credited with having defaulted on loans is the only year in Brazilian history in which Brazil paid back more than it got." It's like the AT&T, it's like the Chesapeake and Potomac Telephone Company; they borrow and repay, but by and large what they are doing is paying interest on a larger and larger continuing debt. That's what the United States is doing, except that the United States debt is growing much faster.

Q. Has the World Bank ever found a nation not using its loans for its intended purposes; and if so, what course of action did the World Bank take?

A. Well, the Bank never found a case in which the money was put in somebody's pocket and not used for the purpose intended. It has had several projects, not surprisingly, which took an unduly long time to get started or completed. But the real safeguard is that the Bank doesn't turn over the loan money to the borrower. It pays the supplier. In other words, if the borrower is building a power plant, the Bank doesn't give him the money outright. It says "You get competitive bids and when you've found the most effective bid, come to us and we'll approve it and if it's General Electric, we'll pay General Electric directly." That isn't to say that there aren't any shenanigans going on in terms of small bribery and so forth. In the whole developing world -- and I don't exclude the developed world -- there is a good deal of that, but by and large the Bank has not found anything on a major scale. When we made our first loan to Japan, which in those days was considered a developing country -- we had a lady lawyer and after the negotiations she received a cultured pearl necklace. That's usual Asian courtesy; after you've dealt with somebody you make him a gift. But we had a strict rule that we couldn't accept gifts. She asked me "What shall I do?" and I said "Send it back and say it's against the rules." So she returned it, and back came a double-string pearl necklace. At that point we established a rule, which was later copied by the United States government, that if it becomes embarrassing to return a gift, it should be turned over to the Bank and every now and then the Bank has an auction sale and gives the proceeds to UNICEF.

Q. You mentioned earlier the involvement of private banks and the current debt problems. What's the World Bank doing to attempt to correct this?

A. Well, that is a primarily a Monetary Fund issue involving mostly short term lending for commercial purposes; the main role is being played by the Monetary Fund. The World Bank is assisting the Monetary Fund and has adopted a particular type of loan procedure called the structural adjustment loan under which a country like Argentina or Mexico, which is in trouble because of liquidity problems, can first work out a deal by which it can draw short-term money from the Monetary Fund and then, in collaboration with the World Bank, work out for 6 or 8 years a plan to restructure its economy, for example by putting more emphasis on exports and cutting back on extravagant imports.

An earlier question asked what happens when one of the Bank's projects is not being carried out properly. Supposing a borrower isn't carrying out its covenants, the remedy is simple. The Bank has the right under its loan agreements to stop disbursements and it sometimes does so; and when disbursements are stopped on one loan, there is no chance of the borrower's getting any other loans until that's cleared up. The Bank has a strict supervision system and follows up year by year on what is happening in its projects. That is a very important part of its activities. Moreover, a separate division, responsible not only to the President of the Bank but also directly to the Board of Directors, makes continuing evaluations of the Bank's operations, how programs have worked and which ones turned out to be lemons and why.

Now, if you have no more questions, let me mention some that are often heard.

Is the Bank too conservative? Some academics and liberals think so. On the other hand others, including some of the people in the U.S. Treasury, think the Bank is promoting socialism. Well, the Bank was guided for the first 10 years by an absolutely essential need to build up its credit in the world markets. It had to operate reasonably conservatively and therefore it concentrated on established kinds of infrastructure which were also the kinds of projects that most of these countries needed first. The Bank was probably more conservative than it should have been if it had had an established credit in the markets. But in the long run, leaning to the conservative side in the early days has helped the Bank to be much more open to new ideas in the later days.

But is the Bank promoting socialism? Not at all. The Bank accepts the system of the country in which it deals. What the Bank is really interested in is not political structure but economic growth and less extreme inequality, including more power, more transport, more literacy, more health, better housing, more productive farmers, and so forth. Most of the countries it deals with represent neither pure capitalism nor pure socialism, but rather a mix, as is true of most developed countries as well.

Another question often asked is why should the industrial countries support organizations like the World Bank? I often answer this question by asking why does the richest family in a medium-sized town of the kind I grew up in, St. Paul, Minnesota, support organizations like the United Way. I say part of the reason is humanity; most of the world is living at intolerable levels of poverty and with rather stagnant economic machinery. A second reason is self-interest; in a small town those in charge of commerce and industry are better off if their customers become better off. Similarly, growth in developed countries depends in large part on growth in developing countries. In that connection we must remember that something like 40% of U.S. exports go to developing countries. That is more than go to Europe, Japan and the USSR together. In addition, many developing countries supply vital raw materials to the United States and other developed countries. The world is now an inter-dependent world and our self-interest is closely tied to economic growth and welfare in developing countries. And a third reason is fear; if things get too bad, explosions may occur.

As a part of the same question, it is sometimes asked: why must the U.S. provide such a large part of foreign assistance to developing countries? Actually, the United States share is not as large as many in this country think. In the World Bank and IDA, the U.S. contributions, including funds raised in the U.S. capital markets, amount to about 20% of the total. In fact, in official development assistance (often referred to as foreign aid) provided by industrial countries, the United States ranks next to last among the major industrial countries on a per capita income basis. Only Italy gives a smaller share on a per capita income basis. Even though United States contribution is in absolute terms the largest, this is hardly an impressive record.

Finally, one other frequently-asked question: why shouldn't the less-developed countries have a larger share of the vote in IBRD, IDA and IFC? One answer might be that voting by the Board is not as important on normal operational questions as it sometimes seems to outsiders. The most important part of the decision-making process on Bank operations, borrowing and lending, is played by the President and staff. Their recommendations are accepted in an overwhelming majority of cases. Board decisions are often reached by relatively informal concensus rather than by formal vote. Even when formal votes are involved, countries have more power to block action than to force action. But blocking particular lending operations is not a popular activity. Developing countries do not like to vote against loans to other developing countries for the reason that this might prompt other countries to vote against their loans; and for the most part developed countries would rather let the President and staff criticize and negotiate loan proposals than to be in the position themselves of appearing negative towards any particular developing country's application. Nevertheless, countries sometimes vote against loans. In recent years the U.S. has occasionally voted against particular loans on political grounds. This has sometimes been done on the initiative of the administration, sometimes by direction of Congress. A negative U.S. vote of this kind has seldom, if ever, blocked a loan proposal.

There is another and probably more important reason why, in the Bank, IDA and IFC, the regional development banks and the International Monetary Fund, voting power is based on financial and economic strength rather than on the principle of one-country-one-vote as in the United Nations. In the real world it is difficult to create operating organizations with large amounts of capital supplied both by governments and by access to the capital markets if all nations who are members are to have the same vote. That would mean control by the developing countries, that is, the countries to whom the money will be furnished rather than the countries who will provide the funds. The history of the attempts in the United Nations to create funding organizations with large amounts of capital under U.N. auspices, for example, SUNFED and also HABITAT, the housing agency, illustrates this point. In the case of SUNFED, no organization was created; in the case of HABITAT and some others, an organization was created but very little funds were provided. In other words, if significant amounts of capital are to be made available, power realities must be reasonably reflected in the organizational structure. They are so reflected in the World Bank Group and Monetary Fund. In the United Nations the power realities are under-reflected in the General Assembly where the one-nation-one-vote rule prevails and over-reflected in the Security Council where the largest countries can exercise a veto.

In conclusion, I think it is fair to say that the organizations of the World Bank Group have not been perfect. They have made some mistakes and there is room for improvement in certain respects. But on the whole, I believe that, with the International Monetary Fund, the World Bank Group remains the most effective and the most critically needed international organization. I hope that all countries, and especially the United States, will back them strongly in the future.

INTERNATIONAL BANK

FOR RECONSTRUCTION AND DEVELOPMENT

- - - -

ADDRESS

BY

MR. DAVIDSON SOMMERS

TO

PROFESSIONAL STAFF MEETING

ON

"The Early Days of the Bank"

- - - -

International Conference Room
1776 Pennsylvania Avenue, N.W.
Washington, D.C.
Thursday, May 5, 1960
11:00 o'clock a.m.

P R O C E E D I N G S

MR. KNAPP: It is my great pleasure to introduce to you a very distinguished representative of the American life insurance industry, Mr. Davidson Sommers, who is the Vice President and General Counsel of the Equitable Life Company.

I have heard for a long while how closely our affairs are followed by these institutional investors that buy our bonds, and indeed we realize that we operate in a sort of goldfish bowl here, but it wasn't until I got to talking with Mr. Sommers this morning, the first time we had met, that I realized how closely these things were studied. Our talk has brought home to me the fact that we do live in a goldfish bowl and that they are indeed very close followers of all the affairs in the Bank. I think we may, therefore, profit a great deal from this appraisal from Mr. Sommers. Without further ado, I shall ask him to go ahead.

MR. SOMMERS: Thank you, Burke.

Even if it spoils your joke, I would like to say that I feel at home. I am very glad to be here.

Don Fowler reminded me, somewhat unnecessarily to a veteran of professional staff meetings, that the purpose of these gatherings is not entertainment but to elevate and instruct. For that reason I am not going to give you a gossipy, nostalgic recital of the old days but have chosen a serious theme. There are several good serious themes, not wholly lacking in entertainment value, to be found in the early days.

One that occurred to me is the history of the Bank's staff organization and all the difficulties we had in arriving at the present scheme.

Those were the days in which one of our most learned staff members, no longer with us, said that employment of engineers was quite useful, provided they were kept under the supervision of economists. I will leave you to guess his profession.

I could also talk about the early grisly borrowing days, in which we tried a different method every issue in bringing out our securities, and usually the bond market dropped immediately after they were sold. A friend of mine who runs a small New York bond house said to me, "Dave, I hope some day to participate in a World Bank bond issue in which I do not learn a valuable lesson."

(Laughter)

In fact, what I would like to speak about is the development of the relationship in the Bank between the management and the staff, on the one hand, and the Board, on the other. I think this history will explain to many of you who came later a good deal of what now goes on in the Bank and how it operates. Besides, I think it is interesting, because in essence it is the story of a conflict -- I wouldn't be impolite enough to say a struggle for power, but at least a struggle for balance of power. It involved not only the conventional tension that sometimes exists between a management and a board, but also the differences in point of view between national representatives, on the one hand, and international staff, on the other, and the question of the possible influence of a large shareholder, in this case the United States. I think the story and how it was solved has had a good deal of influence on similar problems in other international agencies.

I would like to start with the explanation that on some of the things that I am talking about I have no first-hand knowledge, and some of those in the Bank know more about them than I do. I cannot guarantee to be wholly accurate, but I certainly will try not to be too discreet about it all.

To start with the beginning of the story, you have to go back before the Bank came into operation, to Bretton Woods and even pre-Bretton Woods. Right from the beginning there was a difference between the British viewpoint, supported by some of the Commonwealth countries and by some of the European countries, on the one hand, and the American viewpoint, on the other, as to the role of the Board in the Bank and more particularly in the Fund. You must understand that in most of this story the struggle concentrated on the Fund, and the Bank's formula was just adopted rather automatically after the battle had been fought out in the first instance in relation to the Fund.

The British viewpoint on the Executive Directors was that they should be important officials resident in their home countries, visiting the Bank at, say, quarterly intervals to concern themselves with high matters of policy, the day-to-day affairs of the organization being left to the management and staff.

The United States view was that there should be full-time Directors, who should be, although not actually carrying on the day-to-day operations, in much fuller control and with much more of the actual initiative in operation and policy. Some cynics, among whom I class myself, say that this was not unrelated to the question of possible U.S. domination of the Board and of the institutions. I think that is supported by the fact that the U.S. wanted the institutions to be in Washington, and at least some of the Europeans wanted the institutions to be located in New York.

In any event, at Bretton Woods the formula was that the Board should meet in continuous session, and to that extent the U.S. view prevailed. The issue was further discussed at Savannah at the organizational meeting, where the difference became more pointed and more bitter.

In relation to the question whether there should be full-time alternates and in relation to the level of pay of Directors and alternates, Lord Keynes made a very strong and bitter speech on the subject, which some of you might be interested to read sometime, and finally refused to vote for the formula which appeared in the by-laws. But the United States view prevailed.

That is the background against which the Bank opened its doors in 1946 in June.

I don't know how to try to give you the flavor of the first nine months, the pre-McCloy era. The phrase occurs to me, "In the beginning was the Board." And in fact at the beginning there was nothing but the Board, plus John Hooker as Acting Secretary.

At the time of the first Annual Meeting in September 1946, there were 72 staff members.

During the fall, the first President was engaged, Mr. Eugene Meyer, a very distinguished financial man, who had been Chairman of the Federal Reserve Board among other high offices, but who was no longer young. He was in his seventies.

Then a Vice President, the former Director of the Budget of the United States, Harold Smith, and then some familiar characters -- Mendels, Rist, Demuth, Hoar, Howell, and a lot of others whom you know -- gradually came to the staff.

You should not think of the Directors at that time as nonentities. There were some very strong characters among them: Mr. Beyen, of the Netherlands, former President of the BIS; Baransky, who had been Governor of the Bank of Poland; Mendes-France, who was here for a little while; Sir James Grigg, who was War Minister in England and who was an irascible and rather bitter man by the time he came to our Board; and the U.S. Director was a very able and aggressive man from the State Department named Collado.

They, not too harmoniously but very effectively, assumed the initiative in organizing and running the affairs of the Bank.

During the first six months there was no business done, but there was a feverish air of activity. The Board held two meetings a week. In addition there were many standing and special committees of the Board, on Membership, Organization, Financial Policy, Loan Policy, Liaison with the Fund, Administrative Matters, Interpretations, and many others. Between Board meetings and committee meetings, there was a meeting nearly every day.

I think perhaps I can give you the flavor of those days by describing the loan procedure which was adopted (but not carried out in full because there were no loans).

There was a Board document on loan procedure, which said that the President would receive an application for a loan and report the fact to the Board, which would then decide whether to accept or reject the application; and if the Directors decided to accept in principle, they would then authorize negotiations and issue negotiating instructions, terms of reference, to the negotiators, appoint a loan committee, and be kept informed of the progress of negotiations by weekly oral reports.

I did extensive research for this speech, and I found one quotation which most effectively recalls the atmosphere of those days. This is in the minutes under the heading "Ad Hoc Committee on Pending Loan Applications":

"The Executive Directors decided to defer consideration of the Fourth Interim Report of the Ad Hoc Committee on Pending Loan Applications regarding the progress report on the Chilean loan application until their next meeting, in order to allow additional time for study of the report."

The same kind of thing went on in regard to administrative matters. We had an Administrative Committee, which would spend hours deciding on whether people got three weeks or four weeks or five weeks maternity leave -- dealing with every detail of administrative regulations. The same procedure applied in regard to financial policy.

What I have been describing was what was obvious, but what was really important was the very predominant position of the American Director on the Board and the role that he played.

It was the normal thing for an applicant for a loan to stop on his way to the Bank and get the support of the U.S. Director. You can see the significance. The President of the Bank would obviously have been in an impossible position if he had said to an applicant, "We are thinking of a $25 million loan for you," and the applicant had said, "That is very interesting but the American Director has already said he is going to vote for $50 million."

All of this was in the air. I am not saying that the issue actually came to a head, because as I say there were no loans. But I remember one occasion on which the U.S. Director said at a Board meeting, "I don't see why we shouldn't soon make the Chilean $40 million loan."

The President or Vice President said, "We have hardly begun to study this project and this application yet."

And the U.S. Director said, "Oh, but I have been into it very carefully."

That was the atmosphere, and as a result a great deal of tension developed. Mr. Meyer, the then President was clearly unhappy. And, more importantly, the word got out in financial circles that the Bank was being run by national representatives, that the U.S. was very much in control, that the Bank was going to develop into an appendage of the U.S. Government, and that political lending was the inevitable pattern. This certainly was common talk in the financial community in this country in those days.

Next we went from a period of Board predominance and Board control into a period of chaos. The first step occurred when Mr. Meyer resigned in December 1946, giving as his reason that he had only taken the job to start the Bank off and get the staff organized and that had substantially been accomplished. There was a good deal of truth in this but certainly the whole problem of relationships with the Board and with the U.S. Government played an important part in his resignation.

Attempts were immediately begun to find a replacement. The Bank's reputation was so shaky in those days that the Directors had a hard time finding any takers and offered the job to several people who refused it. Those concerned were beginning to feel somewhat panicky about the situation.

Then the situation became even more chaotic, because the then Vice President, Acting President Harold Smith, died a month later, and the problem arose of who was going to run the Bank in the meantime.

The suggestion was made that the U.S. Director should serve as Chairman of the Board of Executive Directors and also be Acting President of the Bank. This created a real row. My predecessor, as General Counsel, Chester Mclain, who was a very strong and intelligent man, to whom the Bank is much indebted, took the position that this would be unconstitutional. The Articles of Agreement say that the President cannot be selected from the Executive Directors. More importantly, he thought it improper to have somebody serving both as a national and as an international representative. Mclain threatened to resign and his threat was supported by several people on the staff of the Bank. As a result that move failed, and the U.S. Director acted as Chairman of the Executive Directors but did not assume the acting presidency.

The next stage was that the presidency was offered to Mr. John McCloy. As I have heard the story, he was at first very cool to the suggestion because of all the background that I have described, and a bright young banker in New York, Mr. Eugene Black, to whom he mentioned this fact, said "I think you are wrong. That could be turned into a good institution." Or, knowing Mr. Black, I think probably what he said was, "Those bonds could be sold."

(Laughter)

So McCloy studied the situation and began to get interested. He was probably assisted by advice from Mclain who had been his law partner previously. Finally he decided he would accept, provided he could get the United States and the Board to accept his conditions.

Although I don't know them word for word, I am sure I know what the conditions were in substance. They were three: first, that the United States should not interfere in loan negotiations; the U.S. would be perfectly free to vote for or against any loan, but applicants would be referred to the management of the Bank and not be given any prior indication of the U.S. attitude; second, that Mr. McCloy would have a free hand on administrative matters and on the hiring and firing of staff; and, third, that to implement these two conditions Mr. McCloy would have the nomination of the U.S. Director.

Those were pretty rigorous conditions, and I understand that when Mr. McCloy first put them forward to the United States, they were rejected. I don't know what intervened but finally Mr. Truman overruled his advisers on this and told Mr. McCloy that the U.S. would accept these conditions.

Mr. McCloy subsequently had a meeting with the Directors, in which something along the same lines was put up to them and they, after some difference of opinion, also accepted.

And then I understand Mr. McCloy went back to New York and said to Mr. Black, "You got me into this. You are going to be the U.S. Director," which is the way Black got into the Bank in the first place.

Mr. McCloy and Mr. Black and Mr. Garner showed up in March 1947, and to all of us who were here it was really as though life had been breathed into the institution. Things that had hung on dead center for months suddenly started to move.

One of the first things that I remember was that Mr. Garner issued a complete set of administrative regulations under his own signature and sent them to the Board for information. All the questions on which we had been working for nine months were settled -- I won't say necessarily rightly, but they were settled for the time being.

(Laughter)

Very much the same thing was done on loan policy. There had been endless debates on liquidity policy, on covenants in loans, on end-use supervision, as we now call it, on the level of interest rates and commitment charges. Now the management and staff got up a paper on loan policy and sent it to the Board with a memorandum saying the paper was to be issued for the guidance of the staff and was sent to the Board for its information. The Board noted it but did not approve it.

That is a very interesting document, R 97, which some of you might like to look at, most of which still holds good to this day. It gives the basis of our loan policy. It gives the outlines of our loan contracts. We never got around to writing any more policy statements until there was a Senate investigation, for which we prepared the well-known book on the Bank's history and policies. The 1947 statement covered such matters as the policy of not making one big loan, once and for all, to a particular country but rather of proceeding on what we called the principle of successive advances. It covered the question of fixing interest rates at 1/4 more than the estimated cost of replacement of money and of charging 1 percent commission not only on loans out of capital but also on loans out of borrowed funds. It even covered the negative pledge clause, end-use supervision, and many other subjects, which are familiar to all of you.

The third subject which was settled at this time, although by somewhat different method, was the question of organization and loan procedure. A memorandum on that subject was prepared and in this case approved by the Board. In effect this memorandum put down on paper some of the most important features of Mr. McCloy's original understanding with the Board and with the United States Government. That is the famous R 106, which still is, at least in theory, the governing document on loan procedure (although one Vice President of the Bank had been running our loan procedure very happily for a couple of years before he ever heard of it).

That memorandum covered a lot of points which are no longer important but which were burning issues in those days. In essence it provides that the initiative on loan negotiations is in the President, and that the Board acts on his recommendations and does not give him prior instructions.

All of this involved some fairly rough treatment of the Board in Mr. McCloy's early days. Meetings were held much less frequently, without much notice, without much advance circulation of documents. In the case of the first loan, the policy issues involved in our first loan contract (except to the extent that they had been disclosed in the paper that had been noted by the Board) were not brought up to the attention of the Board until they had been negotiated with the other side. There was feeling in the Board that the Executive Directors were being treated in a cavalier way, but the result was that the Bank blossomed into activity in the first three months. We not only got most of the troublesome questions out of the way, but we made at least one loan and one bond issue, and by July 1, 1947, a year after we opened our doors, we were in business, whereas before March 1947 we had been marking time. We had made a loan and we had come alive by borrowing money.

As you know, the first year of the Bank's operations after July 1947 was a slow one. I think that in the next calendar year we did only $16 million worth of business. It took a long time to fill our pipe lines. We had started with very large applications for general-purpose loans, $500 million from the Netherlands, $250 million from Iran, $700 million from Poland or Czechoslovakia, and other amounts of that kind. We made the first four reconstruction loans and then ran out of grist for our mill.

In the meantime there still persisted a good deal of tension between the management and the Board. A symptom of this developed in relation to the Second Annual Report. As you know, the Articles of Agreement call for an annual report of the Executive Directors. The management took the position that this should not be a report by the Executive Directors but a report of the Bank, signed by the President, and transmitted to the Governors with the authorization of the Executive Directors. This issue gave rise to much argument, and at one time there was even some thought of a minority report. But the issue died away and the formula of a report of the Bank which the Executive Directors authorize to be transmitted persists to this day.

But the basic issue was still not entirely dead, because there was revived — I think by Mr. McCloy — the old Savannah question of a part-time Board of Directors of high officials stationed in their home countries. (There was also revived the question whether the Bank should be located in New York rather than in Washington, but that was killed off rather quickly).

By 1948, when the matter was revived the United States had changed its mind on this old Savannah problem, at least in regard to the Bank. They came to the conclusion that, although they had been right in their position vis-a-vis the Fund, the Bank was different because it deals with outside people, not with itself as the Fund does. It deals with investors and with borrowers who are not governments. For that reason the relationship between the management and the Board might well be quite different in the Bank and the Fund.

At the Annual Meeting in 1948, an Ad Hoc Committee was appointed to consider the duties and remuneration of Executive Directors, a move which was not greeted with vast enthusiasm by some of the Executive Directors. There were appointed to this committee representatives of the United Kingdom, the United States, China, Latin America (Luis Machado) and Finland. The committee studied the matter, cross-examined Directors and staff for months and came up with a very interesting report, which I would say leaned toward the original British view of this issue, but did not go all the way. The Committee proposed that the weekly meetings (or the more-frequent-than-weekly meetings) which had characterized the Bank in the old days were unnecessary and that the Executive Directors should normally not meet more frequently than monthly; that it was desirable that members should appoint or elect men of the highest standing to the Executive Directors; that dual service of Executive Directors between Bank and Fund was desirable; and that in any event there was no justification for both full-time

Directors and full-time alternates, and that each representation should consist of one full-time service divided as might be thought most appropriate by the country in question.

This report was just rounding into final form when Mr. McCloy resigned to become High Commissioner in Germany, and Mr. Black succeeded him in the summer of 1949.

As soon as Mr. Black took office, it became apparent that there was going to be a good deal of unhappiness at the Annual Meeting about this report of the Ad Hoc Committee, and that he would be presented with a real hot potato at his first Annual Meeting.

The opposition, although stemming from the basic difference in viewpoint on the relationship between the Board and the management, focused on two particular points.

First was the provision for monthly meetings. Many of the Executive Directors thought that this was unfair interference by the Board of Governors and something which should be their business. Second, there was even more vehement opposition on the part of the smaller countries to the elimination of the full-time alternates to supplement the full-time Executive Director.

The opposition came on the floor of the Annual Meeting and into the committee sessions, where some Governors insisted on taking a vote. The Chairman called for a vote, despite the fact that there is no way of voting in committees in our Annual Meetings; there is no voting formula. You don't know whether you are voting by head or voting by amount of stock held. The result was that by head the opposition won and by number of votes the affirmative won. So the whole meeting got into a bad mess, and the mess was solved in a statesmanlike manner -- I might even say in the usual statesmanlike manner - by deferring the issue for another year. The Ad Hoc Committee was requested to continue its studies and report at the next Annual Meeting.

Mr. Black was very unhappy at this inauguration of his administration in the Bank, at assuming office in this atmosphere of ill feeling. He decided, very wisely, to get into the act himself and produce a solution.

His line was that, in starting his relationship with the Board, he didn't need the Governors to tell him how to set it up, that he could work it out with the Board, and that he wanted to get this issue out of the way before the next Annual Meeting and not have another acrimonious debate.

So he proposed to some of the Directors, and they were receptive, that the Board immediately of its own motion, institute a program of holding monthly meetings instead of the weekly or more frequent meetings that had been the rule in the early days, and worked out a system of meetings in which we would distribute papers well in advance -- I think the 7-day rule was introduced in those days --, and we would have reports on various aspects of our operations. Some of these details are not observed any more because we have inaugurated the system of semi-monthly written reports, but the material that is now in the semi-monthly reports was to be covered by oral reports at the monthly meetings.

This suggested procedure was put into effect, and then Mr. Black went to the Ad Hoc Committee and said, "Why don't you take out of your report anything about the frequency of meetings and just say that that can be worked out between the President and the Executive Directors? In fact, the monthly meeting is already in existence. And, in addition, why don't you come up with a compromise solution on the basic issue of alternates' service and say that there will be an exception to the rule of no duplication of service in special circumstances, one of which special circumstances will be that a Director represents a large number of countries. In other special circumstances duplication can be permitted if the Executive Director works it out with the President."

The Ad Hoc Committee, which didn't regard its assignment as one of the most pleasant in the world, was very glad to accept this formula and revised its report accordingly. And so, instead of reporting at the next Annual Meeting, we sent out the revised recommendations to the Governors and took a mail vote. The report was accepted and the whole issue was eliminated from future Annual Meetings.

This was a very good way for Mr. Black to come into office. The relationship with the Board improved immediately and has been pretty well maintained ever since. The era of better feeling was helped further by the fact that we began to be more active in loan operations and the Directors began to feel that they were playing a more important role in what was going on in the Bank.

So, looking back, we swung from a period of really excessive control by the Board, through a period of chaos, into a period in which the management had things very much in their own hands and treated the Board somewhat roughly -- and I think this was a necessary phase to go through -- into what has always seemed to me a very proper and sensible balance. The management has the initiative not only in operation and administrative matters but even in the formulation of policy, but the Board has full control of policy matters and even full control of operations by voting power, to the extent they care to exercise that ultimate control.

I might say also that it seems to me that the United States has very faithfully lived up to the deal originally made with McCloy and, considering all the temptations, they have been on the whole quite considerate in refraining from interference. This doesn't include the occasional call from a frenzied ambassador, but we have never had too much trouble in dealing with those calls.

Of course, this kind of a story doesn't end. The relationships change from day to day and will continue to change, but I think that completes the story of how the present modus vivendi between the management and the ~~Bank~~ Board came into being, and I suppose I should end by saying, in the old formula with a bureaucratic modification, "And they lived reasonably happily ever after."

(Applause)

MR. KNAPP: Dave has said he would be very glad to answer questions, although we realize this isn't a subject matter of the sort that lends itself to questions. But we would be very happy to entertain a few.

QUESTION: What was the genesis of international bidding?

MR. SOMMERS: Well, I think the genesis of international bidding was Spec Wheeler, as I remember, but you probably know more about that than I do. The problem was not relevant in the early days. We were not dealing with project loans. We were dealing with general purpose loans, and I don't remember any issue being presented. During our first project loans, as I remember it, we were dealing with Mexlight and Brazilian Traction, who didn't engage in competitive bidding, but we satisfied ourselves that they had shopped the market pretty conclusively.

The problem of international competitive bidding, of course, was not a burning issue in those days because there was hardly anything that could be obtained from anywhere but the United States. The pressures in the Board did not develop until other countries became suppliers. But, as I remember the origin of competitive bidding, it was that Spec Wheeler came in and said that this was the proper way to carry out large engineering projects.

MR. GARNER: There was a specific example. On the Indian steel project, Koppers came in and said, "We will make a turnkey job." And Spec talked to him and said, "That's fine. We know you are good, but we think that we would rather have some competition."

So General Somerville, who played quite an important part in the war in procurement, said, "Spec, who is your boss?"

And Spec said, "Bob Garner."

So he said, "I will go up and see Bob Garner."

And I went through this thing and said, "General, that is fine. I know you are going to take care of your interest, but I want to know who is going to take care of the Bank's interest and the borrower's interest, so we would rather have some bidding and rather have some independent supervising engineers."

So he said, "Who is your boss?"

And I said, "Gene Black."

So he invited Gene to Pittsburgh and gave him a big dinner, and at the end of it he got the same answer, and after that there was not much more question.

QUESTION: During the period of chaos, who really ran the bank (laughter)?

MR. SOMMERS: Chaos ran the bank. There weren't the same kind of things to run then. We used to formulate policy by having Schmidt write letters saying what we could or could not do, but I don't remember if he was here as early as that. I think the leading figure in the Bank in those days, without any question, was Chester Mclain, but that was because the issues that required running in those days were issues of the relationship between the ~~staff~~ Board and the management.

MR. GARNER: Furthermore, Chester, like his successor, had pretty broad shoulders on which everybody liked to cry, and I think the General Counsel has fulfilled that role.

MR. SOMMERS: The other thing that was being run was there was a great deal of activity about getting in our capital subscriptions, about excusing some countries, of whom you have heard, from paying part of their subscriptions, about investing in gold, and there was a great deal of activity in the field of interpretation of our Articles of Agreement, such questions as whether our loans should have a gold clause in them or not. We were all pretty busy. There was also a long series of studies about how disbursement procedures should work and how end-use supervision should be carried out and how the first contract should be drawn up. But it was really done on the committee system, and the question of who ran the Bank didn't present itself, because no decisions were being taken. Everything was getting ready for decision, but nothing was decided.

QUESTION: Can you recall any of the names of the persons who rejected the presidency of the Bank before Mr. McCloy took it?

MR. SOMMERS: If I could I probably wouldn't (laughter). Or rather I can and would prefer not to.

MR. GARNER: Look at the newspaper files and you will find out.

QUESTION: A legend has come down dimly through the later days that there was a particular incident which persuaded Mr. Meyer that the time had come for him to resign. Is that correct?

MR. SOMMERS: I have talked to Mr. Meyer and talked to Phil Graham about this, and I don't believe there was any particular incident. Certainly Sir James Grigg got under his skin, but not only once. (Laughter)

QUESTION: What was the working party arrangement that was decided on?

MR. SOMMERS: The working party arrangement, as I remember, was started at the time of the first loan, or even before. Did we have one for France? I know we had one for Denmark and Luxembourg and Chile, and this was something that in those days never was an issue. This was started from the beginning. The roles of the various departments were somewhat different, and various specialists used to get in each other's hair more — maybe I should say even more — than they do now, because the lawyers and engineers were going over economic reports, and vice versa. But this was necessary in the early days.

QUESTION: Do you think the Bank's organization and policies have been accepted outside of the Bank as something which is the right type for this type of organization, so that for example our neighbor across the street could profit from it, or do you think they have to go through a similar period of chaos?

MR. SOMMERS: That is a very complicated question. No, I wouldn't say that there is universal acceptance of our pattern. I think that the smaller countries and the underdeveloped countries, many of them, think that they should have a bigger voice vis-a-vis the larger countries. That is a question of the voting structure, and depending on how that issue comes out, they might or might not want to have the Board have a bigger say vis-a-vis the professional staff.

I would say that among the larger contributors there is a great deal of recognition that our type of organization, though it prevents them sometimes from having their way, is very advantageous to them in insulating them against a lot of decisions they don't want to have to take. Even in the Fund there has been a very steady movement in the same direction, although its history has been very different from ours. In the Fund, as you know, there were years of straight divisions on every little issue between the U. S., the Middle East, and Latin America, plus the Chinese maybe, on one side more or less, and the Europeans and the rest of the world on the other side. Almost everything that came up, administrative matters and so forth, was decided that way. Now, the Managing Director of the Fund has gradually built up his own position to a comparable point — of course, the parallel can't be carried too far because it is a different kind of an organization. Its transactions have more of a multilateral character, but I would say the Fund has been influenced very much by our history, as has the Special Fund in the U. N.

QUESTION: You mentioned at the outset that in the early days getting permission to sell our bonds took quite a bit of time. I wonder if you could give some illustrations of the problems that we ran into at that time.

MR. SOMMERS: Well, I could tell a few stories. These really are not stories about selling bonds.. These are stories about the legislative process in the United States, which I can tell for the benefit of those whom I am now somewhat painfully learning to call foreigners.

I remember, for example, two stories. One concerned our efforts to make our bonds legal investments for insurance companies in the District of Columbia. You may not know that when we started out almost no institutions in the country could legally buy our bonds. We had to go around getting legislation all over the country, and we had great success with that; but we couldn't get any legislation enacted in the District of Columbia. This was annoying to us as an anomaly, because this was a part of the Federal Government, which had set up the Bank and had the biggest stake in it.

Year after year we would get the Secretary of the Treasury to introduce a bill. You may know that District legislation as a practical matter only can be adopted in Congress by unanimous consent, because otherwise it always gets lost in the legislative shuffle. And year after year we would get a favorable report or action by one house and fail to get the bill passed because although nobody was opposed, nobody had any affirmative interest.

One year I asked Dick Bateson to prepare a letter for the Secretary of the Treasury to sign, and he looked up the Congressional Record and found that the bill had passed the House but failed of enactment in the Senate. So we prepared a letter for Mr. Humphrey, saying that an identical bill had passed the House without amendment and failed of enactment in the Senate.

The next thing that happened was that Elting Arnold from the U. S. Treasury called me saying, "A terrible thing has happened. You have made the Secretary of the Treasury make a misrepresentation to the Congress."

So we called up the Clerk of the House, and he said, "Yes, it is true. There was an amendment in the House."

We said, "But it didn't get printed in the Record."

And he said, "No. Nobody knows about it but me, but it is a fact. I have it here. The amendment went through in the last minute and didn't get picked up in the Congressional Record."

So Elting Arnold called up again and said, "You will have to apologize to the committees of Congress and exonerate the Secretary of the Treasury."

So Dick and I went down to the committee hearing, and I testified. The usual somnolent row of congressmen was in front of us, and I got up and said, "I want to start off by apologizing for having caused the Secretary of the Treasury to make a misrepresentation of fact to the committee, for which I am completely responsible."

They all woke up for the first time and thought that some dark plot was under way and cross examined us about the facts, and then after all this cross examination began to take an interest in the subject matter. They asked us about the bill and about the bonds and about the Bank, and they turned to the insurance superintendent who was there and said, "Are these good bonds?"

And he said, "Yes, sir, they are fine bonds."

From then on we had no trouble, and the bill sailed through without any opposition at all.

I warned Bateson against profiting by this example. (Laughter)

The other story I have concerns Massachusetts. The story has I think been improved slightly over the years, but there is a fairly strong element of fact in it.

The key to our whole legislative program in this country was Massachusetts, because the Massachusetts savings bank legislation is very well regarded and is taken as a model by many other States. If you can become a legal investment for savings banks in Massachusetts, that is a sort of hallmark.

We tried one year, with a lot of preparation, to get legislation passed. We had it pretty well lined up until Mr. DeValera came to Boston. After he had been there for a week no institution of which the United Kingdom was the second largest shareholder could get to first base in any legislative procedure.

So we waited for another year, until Mr. DeValera's memory had faded into the background and tried again. This time we thought we had the way prepared. But at the last moment the word came from our scouts that one Irish assemblyman, still fired with DeValera zeal, was going to make an attack on the Bank and on the bill. Thereupon we got in touch with Mr. John McCormack, a Congressman from Massachusetts, who was the Democratic Majority Leader in the House, and asked him if he could help. He said he would do what he could.

Then the scene shifts to the State House in Boston, the Massachusetts Legislature, where at a late session the red-faced legislator was on the floor, pounding the table and well launched into a vehement attack on the Bank and the bonds and the bill and the project to drain the savings of the widows and orphans of Massachusetts into this international rathole. At that point a page boy came out on the floor with a little yellow telegraph form and handed it to him. He picked it up and looked at it, put it down, and said, "So much for the arguments against the bill."

(Laughter)

I think that gives you a fair insight into the legislative process. I have nothing more to add.

(Applause)

(Whereupon, at 12:05 p.m., the meeting was adjourned.)

SOMMERS

2-24-50

Legal Problems Arising in the Bank's Loan Operations

In my first lecture I discussed some legal aspects of the Bank's juridical personality. Tonight I shall deal with some of the legal problems that arise in the Bank's lending operations. It will not, of course, be possible to mention all of those problems, or even most of them, and I have therefore selected four which seem to me of particular significance to an understanding of the Bank's juridical status and of the legal implications of its activities. These four questions are as follows:

1. In what tribunals are the Bank's loan agreements enforceable?
2. What law governs the interpretation of the agreements?
3. What legal standards determine whether the obligations incurred are binding upon the borrowers and guarantors and how should the Bank assure itself that these standards have been complied with?
4. What security should the Bank require for the obligations of its borrowers and guarantors?

As to each of these questions, I shall discuss the legal considerations which have influenced the Bank in framing its lending policy and shall explain how the problem has

Mr. Sommers, Mexico
March 2, 1950

been solved by the Bank in practice.

Before proceeding further, however, I must mention two basic principles to which the Bank's lending operations must conform, under the expressed provisions of its Articles of Agreement. The first of these principles relates to the lending standards which the Bank must seek to apply. The Articles of Agreement require that the Bank shall pay due regard to the prospects that its borrowers and guarantors will be able to carry out their obligations. In other words, the Bank's loans must offer reasonable prospects of repayment. On the other hand, the Bank must not make loans which can be obtained on reasonable terms in the private market. The Bank's loans must fall within the area bounded by these two limitations. They are not loans of a commercial character, since they involve a greater element of risk than the private market is willing to assume; but nevertheless they are serious loans which the Bank and its borrowers expect will be repaid, rather than gifts disguised as loans.

The second principle relates to the legal persons to whom the Bank may lend. The Articles of Agreement permit loans to be made directly to members, to political subdivisions or instrumentalities of members, and to private enterprises in the territories of members. However, when a loan is not made directly to the government itself, the government or its central bank or similar agency must guarantee payment of principal, interest and other charges on the loan. In actual practice, the Bank has obtained a guarantee by the government itself in all such cases. Accordingly, in considering the questions which I have mentioned above, we must bear in mind that at least two different kinds of loans are involved: first, a loan directly from the Bank to a member government; second, a loan by the Bank to a governmental agency or private enterprise, with a guarantee by the member government. In the former case the documentation will consist of a loan agreement between the Bank and its member government. In the latter case the documentation will consist of a loan agreement between the Bank and the borrower accompanied by a guarantee agreement between the Bank and the member government.

With that background in mind, let us turn to the first one of the four questions I have mentioned:

1. In what tribunals are the Bank's loan agreements enforceable?

At the outset we are faced with the same element of duality which I discussed in my earlier lecture. On the one hand a loan or guarantee agreement may be a contract between a sovereign state and the Bank. Since the Bank is a juridical personality which derives its status from international law, and since it possesses, vis-a-vis its members, the immunity which international law accords to sovereign states, the agreement between it and its member has some of the attributes of an international agreement. On the other hand, a loan agreement may be a contract between a private legal person and the Bank. In such a case the agreement, since it is entered into on the one side by a private party entitled to no immunity from suit and on the other side by the Bank, which, in its relations with private parties is not immune from suit, may be said to possess some of the attributes of a private agreement. And in many instances a single transaction involving a loan to a private enterprise guaranteed by the government will involve agreements of both types.

Obviously if controversies arise under the Bank's loans (and the possibility can certainly not be excluded) it is desirable that some means be found of adjudicating the entire controversy, and determining the rights of all the parties, in a single proceeding. If the Bank were forced to pursue its remedies against a private borrower in national courts and to proceed against the guarantor, a sovereign state, in whatever international tribunals might be available to it, an appalling confusion might result not only as between the Bank and the borrower and guarantor, but also as between the borrower and the guarantor themselves.

As a solution to this problem, the Bank has chosen arbitration as the method of determining controversies and claims arising under loan and guarantee agreements, whether the loan is made to a government, to a government instrumentality or to a private person. This decision has taken the form of a loan regulation which has been approved by the Executive Directors of the Bank and is normally incorporated by reference into all its loan documents. The regulation provides that all controversies and claims arising out of any loan between the Bank and the borrower or between the Bank and the guarantor are to be determined exclusively by an arbitral tribunal. The arbitral tribunal is to consist of one arbitrator appointed by the Bank and one arbitrator to be appointed by the borrower (or in the case of a guaranteed loan by the borrower and guarantor). The third arbitrator is to be appointed by agreement of the parties or, in the absence of agreement, by the President of the International Court of Justice. The loan regulation contains detailed arrangements for the conduct of the arbitration and provides that the procedure there prescribed shall be exclusive of any other procedure for the determination of claims and controversies arising out of the loan.

This solution represents a compromise between a number of courses that might have been selected and seems appropriate to the status of the several parties. As between the Bank and the borrower, it establishes a procedure for determination of controversies without requiring a waiver of their immunities from judicial proceedings under national law. Arbitration is a usual and respected method of settling disputes in the field of public international law and seems particularly suitable to disputes between a cooperative international institution and one of its members. On the other hand, arbitration recognizes the right of the Bank and a private borrower to submit their rights against each other to impartial adjudication. Although an arbitration proceeding may not afford either the Bank or a borrower all the remedies available in judicial proceedings, it should be able to accomplish an adequate adjudication of their rights.

The solution of the problem of adjudication, however, leaves unsettled the problem of enforcing the award. Here the Bank has thought it desirable to let the status of its borrowers and guarantors be the determining factor. Thus the loan regulation provides, insofar as it applies to private persons or government instrumentalities as borrowers, that judgment may be entered upon the award and proceedings to enforce the award may be undertaken. However, where a member state is involved, a different course is adopted. There provision is made that the Bank shall not be entitled to enter judgment on the award or to enforce the award by execution except as such remedy may be available independently of the loan regulation. In effect, therefore, the loan regulation preserves whatever immunity from execution may be available to a member government itself.

That this procedure is a fair and appropriate one is indicated, I believe, by its history. The loan regulation has been universally acceptable to the Bank's borrowers and guarantors.

2. What law governs the interpretation of the agreements?

The second question relates, as you will recall, to the choice of law governing the interpretation of the contract. Here practical considerations are important. It is clearly desirable to the Bank that language used in its loan contracts should be uniformly interpreted. Accidental factors, such as the place of execution, do not have the significance, in regard to the contracts of an international organization doing an international business, which is often attributed to them in private transactions. In the case of guaranteed loans, it is equally desirable that the same standards of interpretation should be applicable to the loan agreement and to the guarantee agreement, which usually contain a number of parallel provisions.

For these reasons, the Bank has concluded that the standard of interpretation to be applied to its agreements should be expressly provided for, rather than left to later determination. The agreements therefore contain provisions designating the law of the State of New York in the United States as the law which is to govern their interpretation. There are persuasive reasons for the choice of the law of New York. Since the official texts of the agreements are in the English language, reference to the law of a jurisdiction in which English is the official language seems clearly appropriate. In addition, owing to New York's standing as a financial center and the volume of litigations involving financial transactions which takes place in New York courts, its law is particularly helpful and authoritative on problems of interpreting financial documents.

The third question which we have to consider relates to the validity of the execution of the Bank's loan documents. What legal standards determine whether the obligations are binding upon the borrower or the guarantor and how should the Bank satisfy itself that those standards have been complied with?

Each loan agreement or guarantee agreement entered into by the Bank provides that it shall not become effective until its execution on behalf of the borrower or the guarantor has been duly authorized by all necessary corporate or governmental action and until the Bank has received satisfactory evidence to that effect. Where the borrower is a private corporation, its capacity to enter into the loan agreement and the formalities required to authorize or ratify its execution are determined by municipal law. Often that law presents questions of considerable complexity. A public utility corporation, for example, proposing to borrow to finance an expansion of its electric power facilities may require the consent of one governmental agency to construct transmission lines, of another to divert streams and of a third to issue securities representing the loan. The Bank, in such a case, would wish to be satisfied that all these conditions have been fulfilled. In addition, it would require assurance that the proposed borrowing operation, including the granting of any security provided for in the loan agreement, is within the corporate powers of the borrower, and that the execution of the necessary documents has been duly authorized by the Board of Directors or other appropriate organ of the corporation. Sometimes the law of more than one jurisdiction is involved. That will be the case, for example, under a proposed loan to The Mexican

Light and Power Company. That will present questions of Canadian as well as Mexican law.

To examine and pass upon questions of such complexity, involving the laws of many different countries, is beyond the resources of the Bank's legal staff.

The lawyers in its Legal Department are recruited on an international basis. Among them they are familiar with several systems of law. Nevertheless, it is obviously not possible for the Bank to maintain a staff which is expert in the law of each of its 48 member countries. For this reason, and in conformity with normal legal practice in relation to financial matters, the Bank looks to its borrowers to furnish it with opinions of counsel on all matters of this kind. The lawyers who give the opinions are selected by the borrowers, but must be acceptable to the Bank. Through the use of this technique, the role of the Bank's lawyers consists chiefly of satisfying themselves that the opinions have been furnished by lawyers of recognized standing and ability and of reviewing the opinions to make sure that they cover all questions which are presented, are convincing in their reasoning and supported by statutory or judicial authority, when particularly difficult or complex problems arise, but Bank retains counsel of its own in the country where the project is located to assist the Legal Department in these tasks.

Where one of the Bank's members is a party to the agreement, the legal problem assumes a different aspect. In such a case, as I have previously mentioned, the agreement has at least some of the attributes of an international agreement and there is reason to believe that it is governed by principles of public international law. Assuming that to be the case, the question arises whether the Bank may rely on the execution of the agreement by an appropriate official of the member government or whether the Bank has the burden of satisfying itself that all requirements of the municipal law of the member country have been complied with. As you know, one of the most controversial problems in international law is whether one party to a treaty may rely upon a ratification by the other party as an indication that all requirements of municipal law, primarily constitutional law, have been satisfied. Or, to put the question in other words, whether a treaty which has been executed on behalf of one sovereign state by the appropriate official of that state, but without necessary legislative authorization or consent as required by its constitutional practice, is binding upon that state in international law. This subject has been the subject of copious, and sometimes vehement, discussion by many learned writers. There is no general agreement on the point. However, the weight of modern authority, particularly in the Western Hemisphere, seems to favor the rule that such an agreement is not binding in international law in the absence of circumstances which constitute an estoppel, although perhaps it may be the basis of a claim for damages or other form of compensatory relief. This rule may be limited to cases of major constitutional defects, such as failure to obtain the necessary legislative approval. Whether it also covers less substantial and more technical requirements of municipal law is doubtful. In any event, there appears to be ample ground for caution in this field. Moreover, even if the opposing view should prevail, there would be no certainty that the Bank would be protected by it. The view that one party to a treaty need not take heed of the constitutional requirements of the other party has been developed in relation to states. The Bank is not a state and even if some of the principles of international law were held applicable to its agreements, this particular doctrine might be considered inapplicable.

Because of these considerations the Bank has felt it necessary to satisfy itself that constitutional requirements have been complied with by its member governments in entering into loan and guarantee agreements. In the normal case, the most important constitutional requirements is legislative approval. Therefore the Bank has usually required evidence of legislative authorization or ratification. In some cases this has taken the form of a legislative ratification of the particular agreement after its execution. In other cases, including for example the case of Mexico, it has taken the form of specific enabling legislation authorizing the executive to contract or guarantee a particular loan from the Bank. Sometimes legislative authorization has been given in the form of general enabling legislation conferring on the executive all the powers necessary to enable it to contract or guarantee a loan from the Bank, but not limited in its application to loans granted by the Bank. In at least one case, that of India, these powers are clearly conferred upon the executive by the constitutional document itself and no legislative action was therefore required. In all cases the Bank receives a legal opinion, usually furnished by a high government legal official, stating that the agreement is valid and binding upon the member state.

I do not mean to imply, by what I have just said, that the Bank regards legislative approval of its loans as a matter of purely legal significance. On the contrary, since the service on the Bank's loans may constitute a substantial item in the member country's budget and in its balance of payments, and since the selection of projects for financing may be of substantial significance in the country's economic development, the Bank believes that it is normally desirable, even in the absence of constitutional requirements, that its loans should have the support of an elected legislative assembly. If there is to be political opposition to any loan, the Bank feels that it should be given full opportunity to be expressed before the loan becomes effective. The Bank has found that most of its member countries agree with this point of view. Accordingly in some cases the Bank's loan agreements have been submitted for specific legislative approval even though legally such approval was unnecessary.

An interesting variant of this practice has recently been adopted in El Salvador. During the year 1949 the Bank has negotiated with the Government of El Salvador a $12,500,000 loan to finance the Rio Lempa Hydro-electric Development Project. The loan represented a rather substantial undertaking for a country of the size of El Salvador. Moreover, El Salvador was at that time governed by a revolutionary junta which had not been elected by constitutional procedures. The steps taken by the Salvadorean Government to insure that the loan should be validly binding and should be supported by public opinion were unusual. First, after the preliminary negotiations had been concluded, the government appointed a public commission, composed of government officials and private citizens, businessmen, lawyers and bankers, representative of all major political groups, to study the proposed loan documents with a view to determining that their acceptance was in the interests of El Salvador. This committee examined the project and the loan documents exhaustedly, raised with the Bank a few points for change or clarification, all of which were settled to the satisfaction of all parties, and reported in favor of the acceptance of the loan. Then, at the suggestion of the Government of El Salvador, the loan documents themselves provided, there being no elected legislative assembly then in existence, that the loan should not become effective until after it had been ratified by a duly elected constituent assembly which the Salvadorean Government proposes to convoke during the present year. This seemed to the Bank a praiseworthy recognition of the fact that the incurring of foreign debt is a serious matter and that it is generally desirable, if a loan is substantial in amount or significance, that its acceptance be supported by public opinion.

The last question which I wish to discuss is the question of security. Should the Bank require security from its borrowers and its guarantors and, if so, what type of security? Obviously, this question like the question of legislative authorization which I have just mentioned, involves considerations of policy at least as much as questions of law. In fact it is difficult to keep the two entirely separate.

In considering the question of security it is well to bear in mind the dual aspects of membership in the Bank in relation to loans granted by the Bank. The Bank's members participate in loans both as debtors and creditors. On the one hand, a member may undertake a direct obligation to the Bank as a borrower or a guarantor and is then a debtor. On the other hand, a member who is not a party to the loan, shares the financial risk of the loan as a subscriber to the Bank's capital stock. In relation to loans to others, the member is in effect a creditor. A default on a loan will impair the value of the member's rights on withdrawal from the Bank or on liquidation of the Bank and may result in an obligation to make payment on account of the unpaid portion of its capital subscription. This aspect of the Bank's structure, the assumption by all members proportionately of the risks of each loan, is a novel feature of public international lending and is the best assurance that the Bank will maintain its cooperative and international character. It gives particular point to the express injunction contained in the Bank's Articles of Agreement to the effect that the Bank shall pay due regard to the prospects of repayment of its loans and shall act prudently not only in the interests of the member to whom the loan is granted but also in the interests of all the members.

Obviously, to act prudently in the interests of all members, the Bank must give some thought to the question of security. But the problem is not simple. Security for debts of governments is usually not readily available, particularly for debts which, like the Bank's loans, are payable in foreign exchange. For that purpose, security capable of yielding only local currency is generally useless. Experience under the international loans made in the 1920's, where pledges of revenues payable in local currency were common, has indicated that foreign lenders often receive no benefit at all from security devices of this kind. And since the invention of inconvertible currency and the development of foreign exchange controls, security consisting of pledges of revenues in local currency have become less valuable than ever.

Moreover, the doctrine of sovereign immunity makes any security device of doubtful value, particularly if it must be enforced in the territories and before the courts of the government in question. There are at least good reasons for apprehension that a government which had defaulted on the service of a loan would not be likely to permit its enforcement against government property within its own territories.

In addition, there are often valid objections to security arrangement on broader grounds. The Bank is interested in the credit standing of its member countries. It desires to further, rather than hinder, the development of their borrowing powers and their access to private markets. An undue insistence on security might be inconsistent with these objectives.

For reasons such as this the Bank has not made it a practice to ask that the obligations of its member governments under loan and guarantee agreements be secured by mortgages, pledges or similar security devices. However, no inflexible policy in this regard has been adopted. Some member countries have foreign exchange resources which could readily be devoted to payment of a loan and could be made the subject of a practicable security arrangement. Where such a security arrangement is available, the Bank may, in view of the economic situation of the country in question, be in position to grant a larger loan with proper security than without. In such a case, it might well be in the interests of the member to whom the loan is made and of the members as a whole that the Bank should require security for its loan. In practice, however, these cases have not often arisen.

However, where the Bank deals with its members on the basis of their general credit without requiring security, it feels that it is entitled to some assurance that no other external creditor will be preferred to it.

In the Bank's opinion, the interests of its members and its cooperative character justify it in asking that, when it makes a loan without security, subsequent external creditors shall not be given more favorable treatment by means of pledges and charges on governmental assets and revenues. With this objective in mind, the Bank includes in its loan contracts a provision that no such pledges or charges will be granted to secure external debt except with the Bank's consent.

When the borrower is a private enterprise rather than a government, the Bank must take other factors into account. Even though a particular security arrangement may not be of great value in producing foreign exchange directly, as for example a mortgage on real property, it may be of considerable value in determining the priority of the Bank's claim in relation to the claims of other creditors. In that respect not only the Bank's interests, but the interests of the member country which guarantees the loan, require consideration. Take for example a case like the proposed loan to The Mexican Light and Power Company, Limited, which when granted, will be guaranteed by the Mexican Government under a law recently enacted by the Mexican Congress. Assume a loan to a private company which has outstanding several different classes of securities, mortgage bonds, income debentures and stock. Unless the Bank's loan is secured by a mortgage, the Bank's position as creditor will be subordinate to the claims of the existing first mortgage bondholders. And in any reorganization or recapitalization proceeding, those first mortgage bondholders would receive more favorable treatment than the Bank. That would be disadvantageous not only to the Bank but also to the government which guarantees the loan. Under usual rules of law the guarantor, if it were called upon to honor its guarantee and pay off the Bank's loan would be subrogated to the rights of the Bank against the borrower. The guarantor might well feel that it was inadequately protected, if its rights against the borrower arising by subrogation were junior to those of other creditors. Rights against the properties of the borrower would be of substantially more value to the guarantor than to the Bank, particularly if the properties produce revenue only in local currency.

Thus, in dealing with private borrowers, the Bank has normally asked for security for its loans, in its own interest as well as the interests of its members acting as guarantors. Where foreign-exchange-producing security is available, it is of course of special value; but even when the security yields only local currency, there is usually ample reason for requiring it.

You can readily appreciate that security arrangements of this kind, involving as they do in rem rights in movable and immovable property, give rise to very difficult problems of local law. You might be interested in two specific examples, as indications of the kinds of problems presented. In 1948, the Bank made loans to four Dutch shipping companies to purchase cargo vessels. Each loan was secured by a Netherlands ship mortgage, the drafting of which required familiarity with Dutch mortgage law, and also with maritime law since problems of marine risks and insurance were involved. Fortunately the Bank had on its legal staff a Dutch lawyer well qualified to deal with those questions.

In 1949, the Bank approved a loan to Brazilian Traction, Light and Power Company, Limited, to finance a telephone and hydro-electric project in Brazil. The borrower was a Canadian corporation with movable assets in Canada and the United States, owning subsidiaries with substantial properties in Brazil. The loan was secured by an indenture which created (directly and indirectly) a charge, known to Canadian law as a floating charge, on the Company's assets in Canada and on the immovable property of its subsidiaries in Brazil. This kind of charge is not recognized by the laws of the United States. It is valid under the laws of Canada. After a good deal of study, the Bank concluded that it is also valid under the laws of Brazil, in so far as property in Brazil is concerned, although it would there be called by a quite different name and would have a somewhat different legal effect. In this case, the legal aspects of a single security arrangement involved the laws of three different members of the Bank, and in the three jurisdictions there were three different answers to the same basic legal problem. To deal with this problem the Bank required the advice of Canadian as well as Brazilian counsel.

The four questions which I have discussed this evening do not of course cover the whole range of the legal problems arising in the Bank's loan operations. Nevertheless, I think they are typical in several respects. The fact that the Bank deals with governments as well as with private borrowers means that each problem must be studied from two aspects, in the light of the juridical status of the party to the particular loan agreement. Moreover, since the Bank is a novel type of institution, existing rules of international and domestic law frequently offer no clear guide. The Bank's lawyers feel from time to time that they are approaching the frontiers of presently established legal doctrine and must

oc

overcome a lawyer's natural reluctance to push into unexplored territory. If this makes their jobs difficult, it also makes them interesting. And they feel the weight of a real responsibility.

Return to Public Relations - 1111

Ha.
Marketing techniques

THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

By Davidson Sommers, General Counsel Approx 9/20/50

In financial circles the International Bank for Reconstruction and Development usually is thought of primarily as an instrument for raising funds in the American market. I shall try to give enough of a description of the Bank to furnish a background against which one can appreciate its marketing operations, and then mention a few of the principal problems that we have met in raising funds.

The Bank was organized at the United Nations Monetary and Financial Conference held at Bretton Woods, New Hampshire, in 1944. There our charter, which is called the Articles of Agreement of the Bank, was formulated and agreed to by representatives of the 44 countries attending the Conference. The Bank came into existence in December 1945 when 28 of the 44 countries signed the charter, and operations began on June 25, 1946. At the present time 48 countries are members of the Bank, including most of the important countries in the world except Russia, Spain, Argentina, New Zealand, and Switzerland. Sweden's application for membership is pending, Poland has just withdrawn from membership.

We are often asked what kind of an institution the Bank is. Is it a corporation, an association of nations, or some other form of cooperative association among nations? Technically, the Bank is an international institution, existing under an international agreement. The Bank has corporate form and status and the easiest way to understand its organization is to compare it to a private business corporation, which it resembles in many respects.

Like a private corporation the Bank is granted by its charter "full juridical personality," that is to say, full capacity to own property, to make contracts, to sue and, unlike most international organizations, to be sued in courts of law. It is owned by stockholders and its capital is raised by issuing shares of stock. In our case, since shares of stock can be subscribed only by governments and are not transferable, our stockholders, whom we usually call our members, are governments. They exercise ultimate control over our operations through their voting rights as stockholders.

The Bank's administration follows the usual corporate pattern. Its operations and policies are under the general supervision of a board of directors, or, as our Articles of Agreement call them, Executive Directors, who are selected by the stockholders. The chief executive and chairman ex officio of the Board of Executive Directors is the President of the Bank, who conducts its business and is responsible for selecting and organizing the operating staff. The President, officers and employees are recruited on an international scale, some 27 nationalities being represented at present, but they owe their duty to the Bank as an organization, not to any of the member governments.

Perhaps the most complex aspect of the Bank's organization is its capital structure. There we depart somewhat from the normal corporate pattern.

The Bank has an authorized capitalization of $10 billion, expressed in terms of United States dollars of the weight and fineness in effect on July 1, 1944, and divided into 100,000 shares of the par value of $100,000 each. Of this total authorized capital, approximately $8,400,000,000 has been subscribed. That does not mean that the Bank has over $8 billion available for its operations. The unusual feature of its capital structure is that each subscription to shares of stock is divided into three parts, each part being payable by the stockholder in a different manner.

The first 2 per cent of the subscription price of each share of stock is paid to the Bank, in gold or United States dollars, when a country accepts membership.

These funds are usable by us for any of our corporate purposes--to make loans, to pay operating expenses, or to pay our debts. From that source we now have approximately $165 million.

The next 18 per cent of the subscription price of each share of stock is also paid to the Bank when a country accepts membership, but in this case payment is made in the currency of the particular member. In other words, the United Kingdom, for example, pays in pounds sterling, France in francs. This 18 per cent capital, as we call it, may be used by us for administrative expenses, and, if necessary, to pay debts, but its use by the Bank is subject to one important restriction. These funds may not be used in the Bank's lending operations except with the consent of the government whose currency is loaned.

The purpose of that rather unusual provision becomes clear when you consider the economic position of many of the Bank's member governments at the time of the Bank's organization. A loan by the Bank in any currency results in an export from that country without any immediate return in foreign exchange. From the economic point of view it is the equivalent of an export of capital on credit. When the Bank was organized it was recognized that very few of its member governments could afford to export capital on credit immediately after the war. Most of them needed all their domestic production for purposes of internal reconstruction or, if they had excess production, they needed the excess to acquire an immediate return in foreign exchange for purposes of importing food, raw materials or equipment. Consequently, as was contemplated when the Bank was formed, not all member governments have released their 18 per cent capital for lending purposes. The United States has released its entire 18 per cent capital, amounting to about $570 million and there is a growing tendency on the part of other members to permit us to use their currency for loans but the aggregate amount freely available in non-dollar currencies is still relatively small.

The third part of the subscription price of each share of stock, 80 per cent of the total, is never paid into the Bank for use in its lending operations. It is subject to call by the Bank, but only when needed to meet its obligations on securities it has issued or guaranteed. In other words, this 80 per cent liability, as we call it, is in substance a guarantee fund by which the member governments jointly and severally (but indirectly) guarantee the Bank's obligations to its security holders. This liability is payable either in gold, in dollars, or in whatever currency the Bank needs to discharge the obligation for which the particular call is made.

We have had a number of questions about the technical nature of that liability, which reflect the interest in the mechanics. If the Bank should need to meet a $50 million obligation on its bonds, and did not have liquid funds available for the purpose, it could make a call for $50 million to be paid pro rata by the various member governments in proportion to their stock subscriptions. If any members should fail to pay the amount due by them, the Bank could make a further call on the others, assessing against them the amounts which were not collected on the first call, and so on until the full amount was collected. The only limitation on the amount payable by any member government on a series of calls of that kind would be that no member could be required to pay in the aggregate more than the unpaid amount of its stock subscription. The amount of stock subscribed by our various member governments varies greatly. The largest stock subscription is that of the United States, $3,175,000,000, approximately 38 per cent of the total subscribed capital. Next in order comes the United Kingdom, with a total subscription of $1,300,000,000, or about 16 per cent of the total and then the others in amounts ranging from France, with approximately 6 per cent down to Panama, with less than .005 per cent.

The United States subscription is of particular importance not only because it is by far the largest but also because our marketing operations have been, and undoubtedly will be in the foreseeable future, concentrated largely in the United States market. As I mentioned previously, the United States has subscribed to $3,175,000,000 worth of stock, $635 million of which has been paid in. The remainder, the United States' 80 per cent liability, is $2,540,000,000. The Bretton Woods Agreements Act, under which the United States joined the Bank, authorized the Secretary of the Treasury to pay the United States subscription to the Bank when and as due and to use for that purpose, "as a public debt transaction" proceeds of securities issued under the Second Liberty Bond Act. In view of that provision no Congressional appropriation or further Congressional action is necessary to enable the Secretary of the Treasury to meet the United States' obligation on its capital subscription.

The capital structure is the basis of our credit and defines the scope of our operations. It was devised with two objectives in mind: First, to insure that the Bank's obligations would be of high investment quality; and second, to insure that in its operations the Bank would have to rely very largely on the private market as the source of its loanable funds.

I should like to discuss briefly the job which the Bank is supposed to do. You will remember that during the decade before the war private capital, which had previously played an important role in stimulating world trade, had practically disappeared from the international scene. Private foreign exchange credit was almost unavailable to countries and businesses that needed imports to expand their productive facilities and resources.

The International Bank was created to fill the gap left by the disappearance of private capital from the field of medium- and long-term productive foreign investments. Its job is, first, to stimulate the return of capital to that field by participating in and guaranteeing loans for productive purposes made through the usual market channels and, second, when private capital is not available on reasonable terms, to supply the capital itself by making loans, to governments or to private businesses, out of its own capital and other funds or use of funds raised in the market. In carrying out these objectives, the Bank may engage in three principal kinds of financial activities. First, it may participate in and guarantee loans made by private lenders. Second, it ~~It~~ may make direct loans for productive projects in the territories of its member governments. Third, it may raise money for these purposes by issuing securities. It is the third phase that I will discuss in some detail.

First I must mention a requirement that applies to all our marketing activities. Before we can sell securities in the market of any of our member countries, we must have that country's approval. Accordingly, you must assume, in the discussion that follows, that in every case such approval has already been obtained. In the case of the United States, the approval is given by a body called The National Advisory Council, which was created to coordinate the United States Governments activities in the field of foreign financial and monetary transactions. It consists of the Secretaries of the Treasury, State and Commerce, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Export-Import Bank and the E.C.A. Administrator.

Turning to our actual marketing operations, I should mention two misconceptions as to their potential scope and nature, which prevailed at the time of the Bretton Woods Conference. At that time it was widely believed that since the Bank's unpaid capital, its 80 per cent capital, would amount to $6.5 billion, the Bank would have no difficulty in issuing securities in the American market up to approximately that total. As it turned out, that was a highly optimistic view. By 1947, when our first bond issue appeared, the world economic and political picture was much darker than had been generally anticipated in 1944 and the American market placed less confidence in the obligations of the Bank's other member governments than had originally been expected in some quarters. In fact, in judging the Bank's securities American investors tended to look primarily at the United States capital. As a result, it was evident even as we opened for business that for the first years of our operations, at least, and in the present state of the world, we could not expect to raise funds substantially in excess of $2.5 billion, the amount of the unpaid United States subscription.

That presented no immediate problem to us. In fact we have not yet needed in our lending operations anything like $2.5 billion. The other misconception, however, did involve a policy problem. At the time of the Bretton Woods Conference, the Bank was thought of primarily as a guaranteeing agency, one which might perhaps make a few loans itself and issue some of its own securities, but would concentrate on guaranteeing loans floated in the public market. It was thought that the bulk of the Bank's operations would consist of placing its guarantees on bond issues floated in this country by foreign borrowers through the usual underwriting mechanism.

We gave a good deal of thought to this matter at the time we commenced operations and we decided that guaranteed public loans could not be made the main feature of our marketing operations. We feared that guaranteed obligations might not be generally acceptable or, if they were acceptable, would tend to confuse, rather than establish, our credit. We felt, for example, that if the bonds of a country with a good credit standing, sold with our guarantee, ~~might~~ should sell on a different yield basis than bonds of another country with a poor credit standing and that if this situation persisted in the market during the early years of our operations, it might be difficult to prove to ourselves and to potential investors what our own independent credit was worth. Accordingly, at an early stage we rejected guaranteed public bond issues as the principal type of public marketing operation, although we have used the guarantee technique in connection with one or two private placements of securities and may very likely continue to resort to that technique from time to time in the future. We decided that our first marketing operation should consist of an issue of the Bank's own undon itional unsecured obligations, and that appears to be the probable pattern for the future.

With that background in mind, I should like to summarize what we had to offer when, in July 1947, we went to the American market with our first bond issue, consisting of $150 million of 3 per cent 25-year sinking fund bonds and $100 million of 2 1/4 per cent 10-year term bonds. At that time we had made one loan of $250 million to France. That constituted our loan portfolio. We had assets of about $475 million entirely apart from a much larger sum in non-dollar currencies. We had the right to call on the $6.5 billion which our member governments were obligated to pay on their 80 per cent liability, including over $2.5 billion for which the United States was obligated.

All that constituted a substantial backing for a $250 million issue. But we faced many serious problems. First and by far the most important, was the fact that very few potential ——————

investors or securities dealers knew anything about the Bank. Hardly any of them were familiar with its purposes or its capital structure, even to the extent of the brief explanations I have given you this morning. Those who had heard something about the Bank were very suspicious as to the way in which it might conduct its business, as to the type of lending operations in which it might engage. They were afraid that instead of making loans for sound and productive projects, on the basis of full economic, financial and technical investigations and analysis, it might throw its money away without knowing the purposes for which the funds would be used or whether the alleged purposes had any basis in economic or technical reality. It was widely said that the Bank was just another relief agency, a device to give money away without worrying about the prospects of repayment.

Experience thus far has shown that those apprehensions were rather wide of the mark. Actually, under the Bank's Articles of Agreement we are required to operate in a very different way. Our loans must be for productive purposes and made without political motivation. We must investigate carefully, and particularly pay attention to the prospects of repayment. But in 1947 these requirements were not widely known.

Accordingly, our first job was to explain to the public by sessions of this kind throughout the country how the Bank was organized and how it intended, in fact how it was required by its Articles of Agreement, to operate.

The next major problem that faced us was the so-called eligibility problem, the legal restrictions governing investments by institutional investors, principally savings and commercial banks, insurance companies, trust funds and pension funds. Since our bonds are high grade taxable bonds, these institutional investors constitute by far our largest potential market. The market afforded by private investors, excluding those who prefer tax-esempt security bonds, such as state and municipal obligations, or government savings bonds which can be redeemed at par at any time, is relatively small. If our marketing operations were to succeed, we had to reach the institutional investors.

But at the time we opened for business there were practically no important states in the country in which institutional investors could legally buy any substantial amount of our bonds. Most states, particularly those in which large volumes of institutional funds are available for investment, have so-called legal lists, and statutes governing the types of investments that are permissible for insurance companies, savings banks, etc. These statutes are usually detailed and specific. Since the Bank is an unusual institution, not a government on the one hand or a private corporation on the other hand and since it had not previously had securities outstanding on the United States market, it did not fit into any of the usual categories contained in the various statutes authorizing institutional investment.

Before we could go to the market, therefore, we had to try to get legislation or administrative rulings authorizing investment in our bonds at least in a few of the more important states. That involved an extensive legislative program. As you may know, in many states it involves a separate statute for each type of institutional investor, each involving reports by a different administrative official and hearings before a different legislative committee. And, more important than the complexity of the task was the fact that state legislators, state insurance commissioners and state banking commissioners were at least as unfamiliar with the Bank and its purposes and operations as was the general public. In addition, many of these officials, with memories of the thirties in their minds, wanted no further dealings with foreign bonds and until they had an opportunity to analyze our securities, were unable to appreciate how the United States subscription in effect insulates the American investor from the risks of foreign lending.

In spite of these difficulties we undertook the legislative program and during the last three years have met with considerable success, more success than we anticipated in the early days. Almost thirty separate pieces of legislation making our bonds eligible for institutional investment have been enacted by the various states and in even more instances the same result has been achieved by administrative rulings. At the present time I think it is fair to say that almost all the institutional market is open to our securities.

However, at the time of our first bond issue in 1947, that was not the case. We could not even consider a bond issue until we had obtained a ruling from the Comptroller of the Currency permitting national banks to invest in our securities and until New York, Connecticut and a few other important institutional states had similarly authorized investment in our bonds.

Closely related to the problem of eligibility was the problem of ratings. In 1947 none of the recognized rating services had established a rating for our securities. At that time they knew very little about the Bank. We had engaged in no operations and they had no experience pattern to judge by. Here again we were faced with the job of trying to familiarize others with the Bank, its structure and operations.

Ratings were of importance to us for two reasons. First, ratings would give the market the benefit of a judgment by experienced securities analysts as to the quality of our obligations. Second, some of the state investment laws make ratings by recognized rating services a test of eligibility. Accordingly, we discussed the rating question with the leading services and, by the time of our first bond issue, had achieved a rating of "AA" by Fitch and "A" by Standard & Poor's. This was sufficient for our purposes at the time. Since then each of these organizations has raised its rating and a third, Moody's, which did not rate our bonds at all in 1947, has now given them a rating of "A." Next, we had to choose the method by which we would offer our securities. We had a choice of several methods. We might have had a negotiated sale to an underwriting group. That would have given us the advantage of obtaining the sponsorship of some of the leading investment banking houses, but it would have presented obvious difficulties in the matter of selecting one group rather than another. We thought that, as a public institution, our first issue should be open to investment dealers generally, with all having a fair opportunity to participate, particularly if, as seemed likely at that time, the offering would be successful. For this reason we rejected the technique of a negotiated sale to an underwriting group. For the same reason we rejected selling on a commission basis through a small sponsoring group although that would have involved the same general technique.

Competitive bidding was another possible method of offering but that, we thought, presented difficulties in connection with our first public issue. We finally chose the technique of selling the bonds on a commission basis through dealers. We fixed the price ourselves, as well as the commission, and permitted all recognized dealers to participate.

There was a very broad participation, with over 1700 dealers sharing in the distribution, the largest group that ever took part in any bond issue in this country aside from government issues. In other respects, too, the issue was successful. It was oversubscribed and sold quickly. A strong demand developed for the bonds and they rose in price, somewhat faster in fact than we would have liked since a certain amount of buying for a quick turnover occurred. For a time the market was disorderly. At the peak the long-term bonds went to a price of 103.

Shortly after our first bond issue a decided weakness developed in the government bond market, which affected the entire market. Bond prices generally fell, our bonds following the others. At the low point our long-term bonds sold under 95.

Throughout this entire period the market performance of the International Bank issue compared favorably with the performance of the high grade bond market as a whole. Subsequently, the market strengthened generally. By the end of 1949, International Bank bonds were selling above their call prices. The long-term bonds are now selling above 103.

After this first issue the Bank considered various means of improving marketing methods for subsequent issues. One of the factors that appeared of most importance was that the National Banking Act, as it then existed, did not permit commercial banks to deal in or underwrite International Bank bonds. As you know, several of the large commercial banks in this country have bond departments and are a very large, if not the largest factor, in the market for government bonds, state bonds and municipals. Although these banks were permitted to invest in International Bank bonds or to buy them for their customers on order, they could not deal in the bonds for their own account or participate in any underwriting or bidding syndicate.

It seemed to us of great importance that the commercial banks should be permitted to participate in the distribution of our securities. In the first place, we desired that result for its own sake since the participation of the commercial banks would substantially broaden our potential market. But there was also an important psychological factor. Since the separation in the early thirties of the commercial banking and investment banking functions of United States banks, the bond business in this country has tended to fall into two separate patterns. On the one hand there is the government, state and municipal bond business and on the other the corporate bond business. These two types of business are usually dealt with by separate departments in the various securities firms and, since the corporate bond business is subject to the federal securities laws, are carried on in a very different manner. We thought our bonds had the character of government, rather than corporate obligations, and felt that it was important that they should be handled by the same people and traded in the same way as government, state and municipal bonds.

For these reasons we requested the United States Government to introduce into Congress legislation permitting national banks to deal in International Bank bonds and classifying those bonds as exempt securities under the Federal Securities Law. That legislation was enacted in 1949. It was of great advantage to us since it not only broadened the market for our bonds by allowing national banks to participate in their distribution but also solved a number of technical problems under the securities laws which we had encountered in our first issue.

Our next public issue in this country took place early in 1950. That was an issue of \$100 million for the purpose of refunding the $2\frac{1}{4}$ per cent ten-year bonds which we had issued in 1947, and which were blocked by their call price from any further market rise. For this issue we chose a different kind of marketing technique. We determined to offer the bonds at competitive bidding and encourage the formation of large syndicates with national representation and including both commercial banks and securities dealers. Four such syndicates were organized, each including a large number of securities dealers and banks. The result was favorable to us. We received a very good price for our bonds due to the broadened market, our improved credit standing, and the fact that the offering was made at a time when the government bond market was at a high point.

This offering resulted in our refunding a $2\frac{1}{4}$ per cent coupon bond with a 2 per cent coupon bond having the same average maturity and in addition receiving a premium of over \$500,000.

I should like to add a few words about the Bank's efforts to establish markets in other countries. We are only beginning our efforts in that field but we intend to push those efforts during the next few years.

The Bank has placed two issues of Swiss franc bonds in Switzerland but has not yet tried to borrow non-dollar currencies in any of its member countries. Obviously, as long as we have unused capital available to us in sterling and French francs, for example, we have no need to borrow those currencies in England or France. What we have tried to do in member countries outside the United States is to open a market for our dollar obligations and we have met with an encouraging degree of success.

Our bonds have been made eligible for investment by banks in a number of our member countries and substantial amounts have been bought in Canada, Mexico, Cuba and Western Europe. Recently, our bonds have been introduced into the Dutch market and we expect that similar transactions may take place in several other European markets.

We do not expect that this process will bring us a very large volume of

Speech file

SUGGESTED OUTLINE FOR MR. SOMMERS SPEECH TO
A.I.B. CHAPTER IN MINNEAPOLIS, APRIL 14, 1953

I. History and Organization.

The International Bank for Reconstruction and Development, popularly known as the World Bank, is a curiousity among international organizations in that it is a business rather than a political organization. It is similar in many respects to a commercial bank with which members of this audience are very familiar, etc.

The Bank was founded as a result of the United Nations Monetary and Financial Conference held at Bretton Woods, N.H., in July 1944. The Bank's purposes: to finance postwar reconstruction and development of its member countries and to help restore conditions favorable to private international investment.

Since it began operations in 1946 the Bank has made 77 loans totaling $1,857,766,464 in 29 countries. These loans have been made for productive purposes to governments or private concerns with government guarantee. The Bank's loans meet the foreign exchange costs; local costs which are met by the borrower are greater. The total cost of nearly 300 projects the Bank is helping to finance is over $3.5 billion.

Most of the Bank's loans have gone to finance basic facilities in underdeveloped countries on six continents. They have provided the foreign exchange costs of projects for the development of electric power; transportation - railroads, roads, ports; communications; irrigation and flood control; land clearance; grain storage; industry; and in support of general programs of economic development.

The first four loans made by the Bank totaling nearly half a billion dollars went to finance postwar reconstruction in Europe. This was before the Marshall Plan. Since early 1948 the Bank's resources have been used primarily for financing in its less developed member countries.

Lending Principles: Creditworthiness
Project study - technical, engineering, econ.
Relation of proj. to gen. devel. program, etc.

Breakdown:	(Approximate Figures)
Reconstruction in Europe	$500 million
Electric Power	400 million
Transportation & Communications	250 million
Agriculture and Forestry	150 million
Industry	140 million
General Development programs	100 million

Before telling you about some of these loans and their effects, let me explain how the Bank obtains the money to carry on its lending operations. There are two main sources- capital paid in by the Bank's fifty-four member countries and funds obtained by the sale of the Bank's bonds in the money markets of the world. The capital stock of the Bank, subscribed in the currencies of its member countries, is the equivalent of about $9.4 billion. Two percent of each member country's subscription is paid to the Bank in gold or dollars; 18% is paid in the currency of the respective member country; and 80% is held by the member country, subject to call by the Bank only if it is ever needed to meet the Bank's own obligations. The 18% paid-in portion of each member's subscription can be used for lending only with the consent of the country whose currency is involved.

Through its subscribed capital the Bank's lending funds: from 2% subscriptions - $180 million; from 18% in local currencies, about $700 million, of which $570 million is U.S.

The Bank's lending funds depend more and more on the sale of its bonds. Outstanding dollar bonds now total $500 million; equivalent of $60 million sold in Canada, the United Kingdom and Switzerland; and about $60 million of portfolio sales. The bonds of the Bank are held by insurance companies, banks, trust funds, etc......

They are backed by the Bank's reserves which now total over $100 million, by the 80% standby guarantee of our 54 member governments. The U.S. guarantee is $2-1/2 billion.

As I said in the beginning the Bank is a business organization and has been earning about $15 million each year.

II. For our borrowers, investments also bring gains, in the form of increased earnings for increased production, or in savings of many kinds. Let me give you a few specific examples:

Agriculture:

India: Bank loan for clearing land of a strangle weed called kans grass. The loan has helped finance over 200 tractors for rooting out the kans grass from about 2-1/2 million acres of fertile farm land. So far about 600,000 acres of the land have been cleared and are now being brought back into the production of food. When the project is finished, the cleared land should be able to grow about a million tons of wheat a year - wheat that at current prices would cost the Indians $95 million to buy abroad.

Pakistan: The Bank made a loan to finance tractors and other equipment to clear, irrigate and plant a section of the Thal desert. Investigation showed that his irrigation project is technically feasible, export crops such as wheat and cotton can be grown on the former desert, and opening up the area should stimulate the country's economic activity generally. The Bank loan of $3-1/4 million. The estimated value of additional crops to be grown on the reclaimed land alone comes to about $24 million a year.

Thailand: In Thailand the Bank lent $18 million for a project to irrigate the country's rice-producing central plain and, through irrigation, to bring still more acres on the plain into production. The source of water in Thailand is the Chao Phya River, which is as important to Thailand as the Mississippi is to our own. The river not only waters the plain, but it is the highway on which much commerce travels. The seasonal flow of this river is uneven; sometimes there is too much and sometimes there is too little. The Bank's loan is helping finance a dam and sluice system which will even out the flow of the water and give the farmers an extra growing season. Instead of being able to grow a single crop each year, they will be able to grow two crops of rice. Annual exports of Thai rice should increase by nearly 500,000 tons; so that our $18 million loan should help Thailand earn an extra $50,000,000 a year of foreign exchange.

Peru: The Bank made a loan of $1.3 million to finance agricultural equipment such as tractors, plows, threshers and scrapers needed to improve methods of agricultural production, to reclaim old and open new land for cultivation. With the Bank financed equipment, it is estimated that about 50,000 acres of land can be tilled and seeded each year in Peru and 12,500 acres can be reclaimed each year. The added production from this reclamation operation alone, should total the equivalent of about $1 million each year.

Transportation:

Peru: We made a loan of 2-1/2 million to Peru for cargo handling and storage equipment to modernize the congested port of Callao. It is estimated that the new methods will cut unloading time for ships from 10 days down to one or two days, and reduce freight charges considerably. By using piping equipment instead of canvas slings to unload wheat, Peru should eliminate losses from spillage worth about half a million dollars a year.

Colombia: The Bank has made two loans to Colombia for transportation improvements. $16.5 million loan for highway construction and rehabilitation. Completion of the highway project will provide a continuous network of all-weather roads serving the more important business and agricultural sections of the country. Because of Colombia's mountainous terrain, it must depend on its highway system for most of its surface transport. This project will be a major contribution to the country's continued economic development.

Last year the Bank made its first loan for the construction of a railroad.

The loan of $25 million to Colombia provides the foreign exchange for construction of a railroad in the Magdalena River Valley. When the line is completed it will connect the country's eastern and western rail networks, providing rail transport between the Bogota area and the Pacific coast and a reliable river-rail route between central Colombia and the Caribbean ports.

Electric Power:

Most of our development loans have been for development of electric power - $414 million in Africa, Europe, Asia and Latin America.

India: $18.5 million for a steam power plant which has recently come into operation at Bokaro. This is the key power project in India's scheme for development of the Damodar Valley, the richest in India. New power will go for many industries, including coal, steel, cement, fertilizer plants, locomotive shops. The Damodar Valley, with its rich mineral deposits, is a favorable site for a number of heavy industries using iron, steel and other basic raw materials. Development of these and related industries is dependent on an adequate supply of electrical energy. The project will also supply a small amount of water for irrigation in the lower valley. Later the project will be integrated into the unified scheme of development under which the thermal plant will insure maximum power production.

El Salvador: Electric power development is also the key to development of the smallest country on the mainlands of North and South America. For generations its two million people have depended on the production of a single crop - coffee - for a living. Although income from coffee has been good, the key to future growth of the economy of this small country depended on the development of new industries, and diversifying their agricultural production. Most communities had no lights or running water; large areas of land suitable for cultivation could not be irrigated; and industrial expansion was impossible without additional electric power.

Through the heart of El Salvador flows a river - the Rio Lempa - the people saw the answer to their power shortage in its resources. A Government Commission surveyed the Lempa in 1945 and found a site 36 miles from the capital that was suitable for hydroelectric development. The Commission asked the Bank to help finance a dam and power plant at this site. In December 1949 the Bank loaned the Commission $12.5 million for this purpose.

When this plant starts operations sometime this year its output will nearly double the existing power supply in the entire country. Transmission lines are being put up to carry the added supply of power to plants now operating on limited schedules, to factories now being built in anticipation of the added power supply, to pumping stations for the irrigation of new land and to cities and communities, town and villages to bring light into schools and homes.

Industry:

India: A loan of $31.5 million to the Indian Iron and Steel Company. This is expected to help increase India's total output of finished steel by one-third, and reduce imports costing $30 million a year.

POWER CHANGES MEXICO

Power Changes Mexico was produced by the Bank in 1951. It deals primarily with the effects of two loans, totaling $54 million, which the Bank made to Mexico's Federal Electricity Commission for power development. With the aid of these loans, and of another World Bank credit of $26 million to the Mexican Light and Power Company, Ltd., Mexico will be producing nearly twice as much power in 1955 as she was in 1945.

Power is something which we in America take more or less for granted. But in the less-developed countries, it often produces sudden and dramatic effects. Because Power Changes Mexico is a short picture — only thirteen minutes long — it can't begin to show every phase of Mexico's vast power development program. But it does give an impression of that development and what it is doing for four types of communities: the metropolic, the medium-sized city, the small town, and rural areas.

# # #

Mr. Burland speaking to Minot, Bismarck and Grand Forks Chapters of the American Institute of Banking - April 16, April 18 and April 19.

Outline for Mr. Sommers - April 10, 1956; also for Mr. Burland.

Mr. Sommers speaking at Regional Meeting commemorating the 50th Anniversary of the Founding of the American Society of International Law at the University of Southern California, Los Angeles - April 14, 1956

OUTLINE: THE WORLD BANK

A. History: Charter drawn up at United Nations Monetary and Financial Conference, held at Bretton Woods, N.H., in July 1944. Bank started operations in June 1946 with 38 members, now has 58.

B. Purposes: To assist member countries in raising production levels and living standards by -- finance -- technical advice -- by stimulating international investment from other sources (to promote flow of private capital and not compete - bridge over a turbulent stream - natural fears of private capital after war.)

C. How purposes are achieved:

1. Lending

a. Facts about Bank lending

141 loans, $2.4 billion, 41 countries, over 500 projects

Loans by area:

Europe	$ 940
L.A.	645
Africa	267
Australia	260
A & M East	360

b. Making a loan

(1) Statutory requirements:

Lend after other sources exhausted; cannot compete with private capital

Lend to member governments, their agencies, or with government guarantees to private borrowers

Productive projects

(2) Relation of loan project to general development of the country

Basic facilities: related to basic needs of a country

Reconstruction	$497 million
Electric power	671 "
Trans. & Commun.	615 "
Agric. & Forestry	250 "
Industry	245 "
General Development	140 "

(3) Processing the loan:

Mission

Working Party

Staff Loan Committee

Negotiation

Approval

Signing

c. Following up a loan

(1) Disbursement procedure
Loans not tied
Disbursed as goods and equipment bought and projects built — Documentary evidence
$1.8 billion disbursed: $1 billion spent in the United States (approximately 60% of total disbursements) with 5,000 suppliers

(2) End-use reports and on-the-spot missions

2. Technical Assistance:

Although not specifically outlined in the Bank's charter, T.A. has become an important instrument in the Bank's work.

Four general categories:

a. T.A. related to loans
In preparation and execution of loan projects

A continuing relation of Bank-borrower

b. T.A. in planning long-range economic development
The General Survey Mission: 1st to Colombia in 1949
14 General Survey Missions: Colombia, Turkey, Guatemala, Cuba, Iraq, Ceylon, Surinam, Jamaica, British Guiana, Nigeria, Malaya, Syria, Jordan and Nicaragua.

Composition: Seven to fifteen specialists — Bank staff consultants. Fields: general economics, public finance, agriculture, industry, transportation, power, water resources, irrigation, social services, public administration.

Purpose: Comprehensive study, formulate recommendations which government can base a concrete program of long-term development.

c. T.A. through training programs
(1) Bank trainee program
(2) Economic Development Institute

d. Other types of T.A.
As requested, Bank provides wide variety of assistance in all fields. (Over 30 countries provided some type.)

Indus River Conference

3. Source of Lending Funds

a. Government subscriptions: (2%, 18%)
$954 million

b. Sale of portions of loans: $211 million ($156 without guarantee)

c. Sale of Bank's own bonds ($849 million outstanding)

d. Principal repayments to Bank ($147 million)

e. Profits and exchange adjustments ($135 million)

D. Results:

1. Operating at a profit: Making development pay for itself.
Reserves: $200 million ($127 Supplemental; $66 Special)

Repayments and Prepayments made by borrowers: $217 million (over $100 prepayments)

2. Effects of loans: Peru, El Salvador, India (Kans and Damodar)

Summary of Mr. Davidson Sommers speech to Minnesota Employers Association, Minneapolis, Minn.
April 25, 1956

FOR THE PRESS

Davidson Sommers, General Counsel, International Bank for Reconstruction and Development (World Bank), Washington, D.C., today addressed the annual meeting of the Minnesota Employers Association in Minneapolis.

In its first nine years of operations, Mr. Sommers said the Bank has made 141 loans totaling $2.4 billion in 41 countries for over 500 development projects. These loans have helped finance development of electric power, transportation, communications, agriculture, industry and general development. The Bank's earliest loans totaling about $500 million went to finance postwar reconstruction in Western Europe.

The Bank's Charter was drawn up at the United Nations Monetary and Financial Conference meeting at Bretton Woods, N.H., in 1944. The Bank started operations in 1946. Its purposes are to provide and encourage international investment for increasing production, raising living standards and helping bring about a better balance in world trade. The Bank has 58 member countries comprising almost every nation in the Free World. The subscribed capital by these countries totals $9.3 billion; 35% of this is the United States portion. The Bank is authorized to use 20% of this capital in its lending operations; the balance is subject to call by the Bank.

Apart from the funds the Bank has available from capital subscription, Mr. Sommers said the Bank raises additional funds for lending by selling its own bonds to investors in the world's money markets. The Bank has outstanding 21 bond issues totaling the equivalent of $850 million. These include 9 issues of U.S. dollar bonds totaling $695 million, and the equivalent of $155 million in 12 issues of Canadian dollars, pounds sterling, Swiss francs, and Dutch guilders.

Mr. Sommers explained that disbursement of a loan may take years, depending on the size of the project, the availability of equipment, and many other factors. Proceeds of Bank loans are for equipment, services, or goods with suppliers in many countries. Of $1.9 billion disbursed by the Bank, $1.1 billion has gone to over 5,000 U.S. manufacturers and suppliers. During 1955, disbursements in Minnesota totaled nearly $2.5 million and went to 27 manufacturers.

Although the Bank was designed primarily as a lending institution, advisory and technical assistance to undeveloped countries has become an integral part of the Bank's work, Sommers said. The Bank has provided technical assistance on a variety of problems ranging from particular issues to development programs for entire countries.

The Bank, is also a profitable undertaking, unique among international agencies. In nine years of operations, it has accumulated reserves totaling $216 million.

(Mr Miller delivered)

May 8, 1957

(Final copy)

Mr. Davidson Sommers' Speech at General Meeting on International Co-operation for Economic Development - XVIth Congress of I.C.C.

Achievements and Perspectives of the World Bank and International Finance Corporation

I am very happy to talk to such an important group this afternoon on the World Bank and the International Finance Corporation - where they stand today and what they see ahead of them. This subject fits in well, to my mind, as a continuation of the very interesting remarks that you have just heard from Mr. Swensrud and Mr. Keenleyside. The two institutions for which I speak, although they were built upon inter-governmental co-operation, share as a basic objective the enlistment of private capital and initiative in support of worldwide economic development.

In Tokyo two years ago one of my Bank colleagues described to your Congress the preparations that were then being made to bring the I.F.C. into being as an affiliate of the Bank. Therefore I ought perhaps to open by reminding you that the I.F.C. came into existence on July 24 last year. It now has ~~48~~ 49 member countries and a total subscribed capital of more than $~~90~~ 91 million. It has established its own staff - a small one because it makes considerable use of services provided by the Bank - and is receiving a steady flow of investment proposals, several of which have now reached an advanced stage of preparation.

Chile just joined Apr 15

As for the Bank, its own growth has by no means come to an end with its achievement of parenthood. In its eleven years of life it has lent a gross total of $3,063 million in 44 countries and territories. Its rate of lending has been going up, and the total of $507 million lent in 1956 was more than in any other calendar year. It has nearly twice as many member countries as when it started business eleven years ago, and its membership now covers nearly the whole of the non-Soviet world.

The Bank's lending has been concerned mainly with public utility services; power and transport have taken more than half the total so far lent. For such purposes the loans have necessarily been made chiefly to governments. But improvements of basic services, in whatever ownership, is often the most effective way of encouraging the growth of private industry, stimulating the search for minerals and bringing more land into production. The Bank has also lent substantial sums for machinery and other investments required in agriculture, and has made loans that have helped to foster all-round development in Australia, Norway and elsewhere. Loans directly for private industry have included more than $140 million for steel in India and $33 million for steel, shipbuilding and other heavy industries in Japan.

The Bank could not have started to operate without the subscriptions made by its member governments; but it could not now carry on, let alone expand its operations, without the steady support of private investors. The main channel through which private funds reach the Bank is through the sale of Bank bonds. These bonds, which had not even been heard of ten years ago, are today traded on all the main capital markets of Europe and North America. A total of more than $1 billion, held in about 30 countries, is now outstanding.

We could hardly have hoped to draw so heavily on the support of the capital market were it not for the fact that, judged by financial standards, our lending operations have been decidedly successful. We have built up reserves of nearly $300 million and our income now exceeds our expenditure by $35 million a year. This income comes, of course, from the interest that we charge on our loans. We set our charges at a level which fully covers our own main cost - that is the cost of borrowing money in the capital markets. To arrive at the interest rate for a particular loan we take what it would cost us to borrow in the capital market at the time, and add to it a 1 per cent commission provided for in our Articles of Agreement, plus a fractional charge to cover our administrative expenses. This brings us out at the moment at a charge of 5½ per cent.

But the main credit for our financial success must be given to our borrowers, and to their strict observance of their obligations. We have had not a single default in payment of principal or interest in our ten years of lending.

So much for statistics and financial details. I think I have already said enough to indicate the scale of the Bank's borrowing and lending and the soundness of its operating record. To my mind the record of the first ten years clearly demonstrates that the Bank has been able to build up the kind of effective working organization needed for the job set for it at Bretton Woods. Many of you will probably remember the fears that were frequently expressed at about that time, when the Bank was still a mere paper organization. It was feared that the Bank, being owned by member governments, would be dominated by individual national interests, so that loans would be made on the basis of political motivation. It was feared that an international staff could not sufficiently divorce itself from national viewpoints to apply sound lending techniques on the basis of objective economic judgments. And it was doubted whether an institution taking risks unacceptable to private investors would be able to finance its operations by selling bonds in the private market. I believe that the record shows that, whatever uncertainties the future may bring, the Bank need not be haunted by these apprehensions of the early years.

What about the Bank's record in terms not of financial results but of the international attack upon poverty in the under-developed regions? The poverty of those regions is, after all, perhaps the supreme challenge of the second half of the 20th century. I should therefore like to be able to take enough time to give you a picture of the economic realities that lie behind such bald statements as "The Bank has lent $3 million for the development of agriculture and light industries in Costa Rica", or "With Bank help the Chainat Barrage in Thailand, which will provide irrigation water for two and a quarter million acres, has been completed". But rather than attempt a full account of the various ways in which loans have contributed to higher production rates and better living standards, let me simply cite two examples. The first shows how a modest but strategically placed investment made 7 years ago has effectively helped to build up a whole economy. The second shows how Bank funds have supported the international effort required by one of the most far-reaching development projects ever attempted in Africa.

In Ethiopia a trunk highway system built up before the war had become impassable. Agricultural exports could only with difficulty reach the outside world, sizeable towns were almost inaccessible, and the economic and political growth of the country was severely stunted. Seven years ago the Bank lent $5 million to help in rebuilding the trunk roads. It also co-operated in setting up a new highway authority capable of keeping the roads in good condition. Completion of the Bank-financed program has cut travel time between main cities from a matter of weeks to one or two days, and reduced freight charges on coffee and other major exports by 40 per cent or more. This has helped to make possible a doubling of the volume of Ethiopia's exports of coffee and oil seeds. Fired by this success in a country where formerly even the most essential maintenance had been carried out only sporadically, the Government of Ethiopia is now regularly putting aside large sums for road work. Plans are already in hand for the building of new feeder roads and for further improvements to the main roads.

The other example is provided by the loan of $80 million that we made last year to help in harnessing some of the energy of the Zambesi river in Africa. The completed Kariba project - which will create the largest artificial lake in the world - will more than treble the total power supply of the Federation of Rhodesia and Nyasaland. But the cost of the entire project, which will take some 15 years to complete, will be £115 million; even the first stage, including the installation of less than half of the generating units, will cost £80 million. To raise this sum the Federation drew to the limit on its own resources; it borrowed as much as it could in the London market; it enlisted financial help from the copper companies of the Northern Rhodesian copper belt, which will benefit substantially from the new power supply. Even after all this there was still a gap of nearly £30 million, which was filled by the Bank loan. Engineering know-how and the necessary equipment for this project are also being provided on a broad international basis. The main designs for the dam were prepared by a leading French expert. Supervision of construction was entrusted to two British and two French firms of consulting engineers. The main construction contract was awarded, after keen international bidding, to an Italian consortium. Italy, France, Germany, Britain and America are all supplying substantial quantities of the equipment, and the work on the project is now well under way. In ways such as these the Kariba project illustrates the new co-operative international approach to development work - an approach from which both the borrower and all the other participating nations can greatly benefit.

Now what should I say of the road ahead for the Bank and I.F.C.? I think there is no doubt that the Bank will continue to find many ways in which it can stimulate economic growth in the less-developed countries. But no good purpose would be served by trying to predict in what areas the Bank is likely to be most active, or what future level of lending it is likely to achieve. I shall therefore simply point to two recent trends in Bank operations that may become increasingly important in the future.

In the first place the Bank is having some success in encouraging private investors to play a direct part in the financing of economic development. For several years we have been selling parts of individual loans to commercial banks, insurance companies and other investment institutions. Although conditions in the capital market naturally affect these sales, we have found that investors have developed quite a taste for this direct participation in our lending; up to now we have sold a total of over $300 million mainly in early maturities in our loans. More recently, we have also found readiness on the part of investors to lend their money abroad alongside ours but independently of it. We have arranged five joint operations in which a Bank loan supports direct borrowing by a foreign government in New York. The most recent of these joint operations occured three months ago when India borrowed a total of $17 million to buy jet planes in the United States. Two-thirds of this sum came from New York investment institutions, the Bank being called on to provide only the remaining third.

The establishment of the I.F.C. gives a further indication of the increasing interest of private investors in foreign ventures. As you know, the I.F.C. has still to make its first investment. But the proposals so far received by it suggest that it will not lack for deserving projects in the field on which it proposes to concentrate in its early years - that is, private industrial enterprise in the less-developed regions. If it had been set up earlier I think it would have had considerably difficulty in finding so many investors prepared to set up foreign enterprises in association with it.

This will still be true as of May 6

The second trend that I might mention is the way in which successive Bank loans in a particular country are tending to reinforce each other and thus have a cumulative effect in quickening the economic pulse. In some cases this result is achieved by a series of loans made for separate but interrelated projects. Thus an irrigation system will raise farm production, a road program will reduce the cost and difficulty of marketing the product, and industrial expansion that includes processing and canning plants will improve the quality of the product and eliminate wastage. In other cases the Bank has made a succession of loans for a long-term development program, with the result that the effects build up as the program proceeds.

An example of this second approach is to be found in this very area where your Congress is being held. Before you return to your home countries I hope that you may have an opportunity to see something of the work that the Cassa per il Mezzogiorno is doing to promote the economic growth of Southern Italy. Since 1950 this special government agency has been engaged on a 12-year program for which the Bank has now lent a total of $165 million. The objective is no less than to abolish the extreme poverty from which this region has suffered for generations. The Cassa's funds, which come from government sources, are being used mainly to improve power supplies, roads, ports, irrigation, drainage and other public services. But this in itself is acting as a potent stimulant to private investments in farm improvements, industrial plants, trucking services, hotels and other ventures; a sum of $44 million lent by the Bank over the last two years represents only a part of the investment in 17 privately-owned industrial plants that have been attracted to Southern Italy as a result of the Cassa's activities. Total public and private investment under the program now amounts to the equivalent of over $1 billion, and has already been reflected in an increase of about 150,000 in permanent employment in the area.

To my mind the achievements under the Cassa program are among the most impressive that can be found anywhere. They certainly provide a graphic illustration of the way in which the combined and well-directed efforts of private enterprise, of governments, and of international agencies can increase the pace of economic progress and improve the conditions for investment and trade. They also provide an example of the kind of work that the Bank expects to undertake in many different situations and many different countries in the decade ahead.

FORM No. 14
(4-58)

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION

REQUEST FOR PRINTING AND DRAFTING SERVICES

Department	Date Wanted	Time Wanted	To Be Used by Prt'g. and Drf'g. Only
Office of Information	1/14/58 9	A.S.A.P.	Requisition No.

Requested By	Room No.	Extension
Doris R. Eliason	228	3038

Title or Identification
Aid + Trade, East + West - Speech by Mr. Sommers - Commercial Club of Chicago
Jan 12, 1959
NOT TO BE ATTRIBUTED

Document, Form or Report No.

SPECIFICATIONS

[ ] New Copy [ ] Re-run

Quantity 30

No. of Pages 6

Size letter

[x] Assemble [ ] Fold [x] Staple

[ ] Pad (Sheets per pad ________)

[ ] Punch (No. of Holes ________)

(Top [ ] Side [ ])

[ ] Other ________

KIND OF WORK

[ ] Drafting

[ ] Typing

[x] Mimeographing

[ ] Printing

[ ] Photostat

Copy to be:

[ ] Same Size

[ ] Reduced

[ ] Enlarged

CLASSIFICATION OF MATERIAL

Kind of Report:	Color of Cover:
[ ] Draft	Buff
[ ] Confidential	Green
[ ] Restricted	Grey
[ ] Unclassified	Blue
[ ] Consultant's	White
[ ] Secret	White/red border

Questions concerning the above should be referred to the General Files and Correspondence Section, extension 3165.

Masthead: (if masthead is to be used specify which masthead is wanted.)

List and identify any additional material which is to be included in the document:

[ ] Map(s)
[ ] Chart(s)
[ ] Appendices
[ ] Other

Indicate the order in which material is to be assembled:

Purpose of Document
For Mr. Graves

Delivery Instructions

30 Copies to	Doris R. Eliason	in Room No.	228
Copies to		in Room No.	
Copies to		in Room No.	

Other Instructions or Remarks

Date 1/14/58

Authorized Signature

In magnitude the communist aid and trade program so far is not impressive.

Let's look first at trade. Soviet exports in 1957 to all countries outside of the communist bloc -- industrialized countries and underdeveloped countries together -- were on a par with the exports of Denmark, slightly over $1 billion or not much more than a twentieth of American exports. The trade of the whole communist bloc with the underdeveloped countries amounted to less than 5% of the total foreign trade of those countries. And, most significantly, very little communist trade with the underdeveloped countries involved capital goods. To all of the Middle East and Asia in 1957 the communist bloc shipped only $85 million worth of capital goods and the biggest items, accounting for a large share of the total, were trucks and other automotive equipment rather than heavy machinery.

Since the communist bloc entered the aid business in 1955, the bloc as a whole has advanced an estimated $2.5 billion in credits for military and economic aid. But estimates of communist aid are deceptive and require qualification. Leaving aside Yugoslavia as a special case to which I will refer later, it appears that as of six months ago upwards of 90% of these credits had gone to four countries -- the United Arab Republic, India, Afghanistan and Indonesia. Communist aid overtures to Africa and Latin America have as yet produced very little in concrete terms.

But students of the subject estimate that only about 40% of these credits have been drawn upon and most of this has been for military equipment. Perhaps as much as 75 to 80 per cent of the strictly economic aid still consists of promises to deliver in the future, in some cases several years in the future. It would appear safe to say that communist economic aid actually disbursed in the Middle East and Asia has amounted to but a small fraction of American aid disbursed in the same countries over the same period of time. And this is saying nothing about the disbursements of international organizations, such as the World Bank, or about private foreign investment.

If these are the dimensions of Soviet trade and aid, it's tempting to ask: Why all the fuss? Why the fascination? Particularly, why is so much attention paid here in this country to each trade and aid move the Soviets make when the total is so meager in comparison with all that the Free World is doing?

It is clear, I think, that both communist aid and communist trade involve a mixture of political and economic motives and that the mixture varies from place to place and time to time. Given the Cold War it is not surprising that people in this country concentrate on searching out the political motive. The Russians, in fact, invite such a search. We have Mr. Krushchev's word to a Congressional delegation three years ago that he "values trade most for political purposes and least for economic purposes."

But to get a realistic idea of the economic importance of Soviet policy you have to try to strip off the political wrappings. And once this is attempted the evidence suggests that Soviet aid and trade tactics are dictated fully as much by the nature of the communist economic system and by the geography of the communist empire as they are by the existence of a grand political strategy.

It is most significant, I think, that the great majority of the trade of the Soviet bloc today is still made up of raw materials and lately of semi-manufactures like tin and aluminum. Even Russian aid, with one or two notable exceptions, consists largely of materials and technical assistance rather than machinery. These facts alone suggest caution in assuming any radical new departure from the traditional autarkic isolationism of Russian economic policy.

Traditionally, exports from the Soviet Union have been made up of accidental surpluses which have occurred in their rigidly-planned economies, rather than of production which is specifically undertaken for export. Traditionally, these surpluses have been bartered or sold for foreign exchange, anywhere and everywhere that the Soviets could get the supplies and equipment they needed to speed the completion of specific projects and programs in the prevailing five-year plan. We think that this is still the major purpose of communist bloc trade. The current visit of Russia's foreign trade boss, Mr. Mikoyan, suggests that the Soviets, and presumably the Chinese, still want a good deal from the non-communist world -- very probably a good deal more than they can buy with the materials they have available for export.

This is not to say that the Soviets do not now have larger surpluses than ever available for barter. It should surprise no one that a continent as large as Russia, and one which has been developing as fast as Russia, should produce increasing quantities of some kinds of raw materials -- and of things like tin and aluminum -- which are, in fact, in excess of their planned needs. What we must remember is the fact that the Soviets have been unwilling, and very probably have been unable because of their ideology, to become part of the world trading system. They have been unwilling or unable to enter into long-term, reliable trading relationships with non-communist countries; so each trade has tended to take on the appearance of a one-shot operation. Since they do not, by and large, produce things which the world trading system can easily absorb, they have practically been forced to offer many of their wares at discount prices in order to attract buyers.

One does not have to search for political motives to explain why Russians act like the bull in the china shop when trading on the world market. No doubt political considerations enter in, but the competition would very likely be of the same kind without them. It stands to reason that whichever way the political winds blow, we can expect more and larger sorties onto the world commodity markets by the Russians in the near future. They have made it plain that foreign trade is supposed to provide an important share of the machinery and equipment required for their present ambitious industrialization program. Already tin and aluminum producers have felt the effects of their here-today-and-gone-tomorrow trading tactics; I wouldn't be surprised to see similar raids on the wheat, rice and cotton markets. We should expect repetitions of spectacular deals like Russia's sale of benzene to Dow Chemical well below the market price, for payment in Dutch guilders.

Any increase in this unconventional kind of competition is bound to be felt by many non-communist traders. But the real losers are likely to be governments of the underdeveloped countries, some of whose leaders seem at times to most welcome Soviet trade overtures. Most underdeveloped countries are, of course, peculiarly dependent on their own raw material exports, often on the export of a single commodity. The fall in price of one of these commodities by as little as 1% in a given year can more than wipe out all the aid and investment from abroad which a given underdeveloped country might receive in that year. Since over a wide range of commodities the Soviets are exporting the same things, the growth of these countries may in many instances be disrupted by Russia's trade tactics.

Bolivia, Malaya and Indonesia all had their economic prospects temporarily darkened last year when the Soviets suddenly dumped large quantities of tin on the market just as the new international tin stabilization program was getting underway. There are several possible explanations of why the Russians chose this particular moment to move into the tin market, but I would suggest that the timing was an indication of the fact that the demand for foreign exchange to buy needed imports is much higher in the order of priorities in Russian trade than is generally credited. If the timing was the result of political strategy, it has the earmarks of a blunder.

I do not mean to minimize the all too obvious opportunities which the Soviets have to use trade for sheer political opportunism. When an underdeveloped country finds itself with an embarrassing surplus of its staple commodity export -- either as a result of a recession in the market or a breach in economic relations with the non-communist world -- the Soviet government with its monopoly on foreign trade is in a fine position to step in with an attractive offer. When that commodity is cotton or rice or something else which is produced abundantly in the communist empire, it is no great difficulty under the Russian system to absorb a quantity of imports while at the same time exporting an equal quantity of home production. The appearance of an increasing supply of Russian cotton on the world market coupled with large shipments of Egyptian cotton to Russia suggests this is happening in that commodity.

But I would not jump to the conclusion that the Soviets put this kind of maneuver ahead of their own hell-for-leather industrialization program. What I do suggest is that the political dividends are largely by-products of Soviet policy and they do not always redound to the benefit of the Russians.

The fact is that despite Russian offers and promises, Russian trade today competes with the trade of the underdeveloped countries more than it complements that trade. It may be that over a period of years the Russians will discover that it is to their economic advantage to rely more on the import of raw materials in exchange for exporting more capital goods. But a marked swing in that direction would amount to a revolution in Soviet policy. While Russian exports of capital goods will inevitably increase somewhat in the near future, there is little reason to expect that the Russians will be willing to become dependent on the underdeveloped countries for any significant percentage of their raw material needs. And so long as they hold to their tradition of autarkic self-sufficiency, we need not expect that their capital goods exports will approximate in volume those of any of the larger western trading nations.

What gives more substance to the belief that the Soviets have embarked on a new course of economic imperialism is the fact that they have recently jumped on to the foreign aid bandwagon. It is undeniably a great departure for Russia to provide a non-communist nation with a steel mill on long-term credit as has happened in India. In fact, Krushchev went to the length of justifying it to his own people in a special broadcast.

So far there has been very little experience on which to judge Russian aid. It appears that a typical communist credit runs for 12 years -- sometimes less but so far no more -- and bears an interest label of 2½%. On the surface this looks cheap, although you can't tell whether or not there are additional charges in the prices of the goods covered by the credit.

The Soviets claim that they offer aid with "no strings attached." In practice this amounts to saying to the borrowing country: "We can't finance all the things you want, but tell us a project you are particularly anxious for and we will tackle that. Interest is only $2\frac{1}{2}\%$ and we will take the principal back in goods and foreign exchange you can spare." They would not think of demanding anything like an economic justification for the projects they finance, such as is common practice with World Bank loans. In fact, they righteously denounce such practices as "interference in the internal affairs" of the borrowing country.

This does not mean that the projects to which the Russians tie their credits are not carefully chosen. They appear to be tailored to the individual market with some care. In Afghanistan it's paving the streets of the capital city of Kabul; in Egypt it's a nuclear physics laboratory and a down payment on the huge Aswan Dam; in India, in addition to the steel mill, there is an offer pending to build a pharmaceutical factory, providing it will be state-owned; in Syria the Russians claim they are building 30 different power plants and small industrial enterprises. Some of the latter, incidentally, were taken out of a survey report conducted for the Syrian government several years ago by the World Bank!

This aid has one further attraction worth noting. Unlike aid from the affluent West, Russian aid undoubtedly has a special appeal in the underdeveloped world because there is a feeling that it represents a real sacrifice by the Russian people. Aid from the West is regarded more as an inconvenience to the lender, if not actually a welcome pump primer to the economies of the West with their unused productive capacity.

We in the World Bank are not surprised that the Soviet approach gets an interested reception in the underdeveloped world. In view of the overwhelming demands for economic growth in most underdeveloped countries any new help, and any new source of help, is bound to be welcomed. Governments which refused at least to explore what the Soviets offered might well find themselves in trouble with their own people. Perhaps the attraction is greatest among the newer nations, all of which are in a hurry to develop their economies and feel they cannot afford delay.

Nevertheless we in the Bank do not conclude that in the foreseeable future Soviet aid will be a very important factor compared with what the Free World is doing now. In addition to the fact that the demands of the home front would seem to preclude any significant outpouring of aid, we do not believe that the communists can become seriously interested in fostering economic growth under any auspices but their own. Their ideology tells them that self-sustaining growth in an underdeveloped country today is impossible except under communism. It seems to us, therefore, that the Soviets will probably withhold any consistent, long-term aid programs until and unless a country falls into the Soviet orbit through its own disintegration or through the mistakes or failures of the Free World powers.

Syria is a case in point. The concentration of Russian aid in Syria today is potentially dangerous; the danger is that the Syrian economy may become so closely tied to Russia that the Syrians will not be able to disentangle themselves before being swallowed up in the communist empire. But in this instance Soviet aid is being used not so much to create the proper political conditions for subversion as to consolidate a political windfall that came with the Suez crisis.

Except as the result of extraordinary failure, I find it hard to believe that any underdeveloped country today would be duped into selling its independence for a mess of Russian aid. As the Yugoslav case has shown, Soviet aid in the final analysis has more strings attached to it than a kitchen mop. Not only did Russia cut off Yugoslavia without a ruble of aid last year when the Yugoslavs refused to mold their foreign policy to the Russian model, the Yugoslavs also found themselves exposed to difficulties in conducting current trade. I would not be surprised if other countries now receiving substantial Soviet aid did not suffer the same disillusioning experience, with the result that distrust of Soviets bearing gifts will spread.

* * * * * *

If the story ended here, we in the World Bank would not be unduly alarmed by the new fashion in international economics. Insofar as Russian trade and aid actually succeed in adding to the goods and equipment the underdeveloped countries need without compromising their independence, we would even welcome it. Communist practice as regards quality and delivery of goods and services, while not especially good, is regarded as adequate by most countries. (There is a story in Washington about a Russian official who is supposed to have said: "Russian trucks are like my wife; not very well-designed, but adequate for normal purposes." This seems to be the consensus among those who do business with Russia.)

But the story does not end here. Back of the communist aid and trade overtures stands the picture of two countries, Russia and China, which today appear to be growing faster than any other major economic powers in the world except Germany and Japan. Over the past several years, Russian gross production has been rising between two and three times as fast as that of the United States. And in the perspective of history, according to a recent study, one can say that under communism Russia has accomplished its industrial revolution faster than any major country -- though, as a matter of fact, not much faster than Japan or South Africa.

I do not cite these facts to make the Russians out to be ten feet tall; growth rates, we all know, are not measures of total economic strength; the United States, growing at 3 or 4 per cent a year, is still incomparably the strongest economic power on earth and promises to remain so. I cite these facts rather to give a further and, I think, much more important reason for the fascination with Russia and China which exists throughout the underdeveloped world today. Whether we like it or not, many of the leaders of the underdeveloped world see in Russian and Chinese experience something much more relevant to their own problems than anything they see in the West.

Russia and China started in the recent past as poor, backward countries -- at least they were closer to being backward than any European or North American country. They have in a remarkably short time grown, if not rich, at least powerful under communism. If in the process their people have undergone great sacrifices and been reduced to the status of ants, the standard of living -- in Russia anyway -- has finally gone up and is higher today than that which prevails in most underdeveloped countries.

It is against Russian economic progress that many in the underdeveloped world tend to measure their own growth. It is not that these people are blind to the hideous scars which the Russian system has left. They hope to avoid these scars. At the same time they know their people, too, will have to make sacrifices to grow. And in a country like India where there is still mass starvation in the teeming cities and in the over-populated and run-down countryside, they wonder how the people can be brought to accept the necessary sacrifices except by coercion.

These countries start from such a low point on the economic scale that the experience of the affluent West seems hopelessly irrelevant to them. They sometimes feel that no other model than totalitarianism exists to give them hope of eventual escape from the humiliation and degradation of a life of abject poverty. If the Free World has an alternative way to economic development that can approximate the rate of growth under communism without the terrible cost to humanity which communism entails, they do not yet see how that alternative applies to their particular situation.

Here we have, I think, the real nature of the competition that exists between the Free World and communism. We must ask ourselves, "Do we truly have an alternative that applies in the underdeveloped world?" Then we must ask, "Is it in our interests to pay the necessary price to see that our alternative has a real chance to work?" And let's not engage in the old American habit of fooling ourselves; the price will not be cheap; the job will not be done quickly; and no one will be able to guarantee results. With all those reservations is it worth our while to try?

These are the real economic questions posed to us by the co-existence of communism and the half of the world that is in revolt against a life of abject poverty. Those questions are not altered in any significant way by the new fashion in communist aid and trade. If we see the competition in terms of these incidentals rather than in terms of the broader challenge, we will indeed waste our resources.

A wise man recently wrote that "people who do not stand for anything are in danger of falling for anything." We must reconsider what the Free World stands for and see if it involves trying to make our experience relevant to the dire problems of these far-off countries. If it does, then we must calculate how much of our wealth and ingenuity we should throw into this objective, not just over one year or two, but over as many years as may be necessary to give our ideas a fair chance to take root and grow. Then we should cultivate the institutions and the careers necessary to manage this program wisely and consistently. And we should avoid pulling up plants by their roots every year or so to see how they are doing.

It is these long-term questions, not just what the Russians are doing from day to day, which should be commanding our attention. And it would seem to me that if we cannot demonstrate in the underdeveloped world the effectiveness of our own approach to economic growth, we are likely all too soon to find ourselves out of touch with more than half of the world's population and confronted with a horde of converts to the thesis that communism is inevitable.

####