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THE IMPACT OF THE WORLD BANK ON LEGAL AND INSTITUTIONAL CHANGE IN THE DEVELOPING COUNTRIES

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And if you lend where you expect to be repaid,

what credit is to you?

Even Sinners lend to each other

if they are to be repaid in full

(Luke 6: 34)

To HAWA, who was born

when I was learning.

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ABSTRACT

When the World Bank lends to a developing country, it lends in the form of concessional loans, to which are attached conditions, not just conditions of repayment, but also conditions that the recipient government must fulfill by changing some of its previously chosen policies. This Thesis argues that, quite often, the implementation of such conditions has major repercussions on the legal and institutional arrangements of the borrowing country.

The core of the argument is that, by making loans, the World Bank adopts a certain doctrinaire development approach, that it is insensitive to the individual situation of borrowing countries, and that the conditions imposed are ideologically biased in favour of the free market, and that it overrides national sovereignty and perpetuates dependency.

The Thesis then describes in depth the various types of conditions leading to substantial reforms in the developing countries. It goes on to consider the effect of such reforms on the legal, economic, political and social structures of the borrowing members. Overall, the thesis advocates that for the Bank's objectives in the field of development to be fully achieved, it is the institution which has to change its policy, and not the borrowers.

ABBREVIATIONS

AfDB	African Development Bank.
BAD	Banque Algerienne de Developpement.
BOG	Board of Governors.
CIS	Commonwealth of Independent States.
DAC	Development Assistance Committee.
DCs	Developed countries.
ECA	(UN) Economic Commission for Africa.
ECOSOC	Economic and Social Council of the United Nations.
EEC	European Economic Community.
EDI	Economic Development Institute.
EPE	Entreprise Publique Economique.
FAO	Food and Agriculture Organisation.
GSE	Gestion Socialiste des Entreprises.
IBRD	International Bank for Reconstruction and Development (also the World Bank).
ICSID	International Center for Settlement of Investment Disputes.
IDA	International Development Agency.
IFC	International Finance Corporation.
IMF	International Monetary Fund.
LDCs	Less developed (or developing) countries.
MIGA	Multilateral Investment Guarantee Agency.
NAC	US. National Advisory Council on Monetary and Financial Problems.
NIEO	New International Economic Order.
NICs	Newly Industrialising Countries.
OAU	Organisation of African Unity.
ODA	Official Development Assistance.
OED	Operation Evaluation Department (W/B).
OECD	Organisation for Economic Cooperation and Development.
UN	United Nations.

SAL	Structural Adjustment Lending.
SAP	Structural Adjustment Programme
UNCTAD	United Nations Conference on Trade and Development.
US	United States of America.
WB	World Bank.
World Bank Group	IBRD, IDA IFC, ICSID, MIGA.

Abbreviations for Citations.

AFDI	Annuaire Francais de Droit International.
AJIL	American Journal of International Law.
BYBIL	British Yearbook of International Law.
Dev. & Coop.	Development and Cooperation.
Dev. & Peace	Development and Peace.
Dev. Dial,	Development Dialogue.
Fin. & Dev.	Finance and Development.
GYBIL	German Yearbook of International Law.
ICLQ	International and Comparative Law Quarterly
ILM	International Legal Material.
Int'l Org.	International Organisation
JORA	Journal Officiel de la Republique Algerienne.
LGDJ	Librairie Generale de Droit et de Jurisprudence.
MEED	Middle East Economic Digest.
PYBIL	Polish Yearbook of International Law.
RCADI	Recueils des Cours de l'Academie de Droit International.
Rev. Alg.	Revue Algerienne des Sciences Juridiques Economiques et Politiques.
RBDI	Revue Belge de Droit International.
RGDIP	Revue General de Droit International Public.
UNTS	United Nations Treaty Series.
W. Dev	World Development.

INTRODUCTION

The International Bank for Reconstruction and Development (IBRD), more commonly known as the World Bank, (hereinafter the Bank), is a specialised agency of the United Nations (UN).[(1)] In the world of finance, the Bank is the major public international source of funds for economic development, consequently it has a significant impact on the national development of the members states, although juridically these latter are under no obligation to use the Bank's services.

The Bank was established by a multilateral treaty signed at the UN Monetary and Financial Conference, held at Bretton Woods, New Hampshire (USA), in July 1944.

The Articles of Agreement of the Bank were formally accepted by a majority of the participants by December 27, 1945. Six months later, in June 1946, the World Bank which opened its doors for business, moved from an initial emphasis on the post-war reconstruction of Western Europe, to a predominant emphasis on the development area; and gradually, from an initial policy based on commercial banking standards, to programme lending combined with policy changes.

The economic deterioration of many developing countries, which by the end of the 1980's began to show multiple signs of distress -namely chronic balance of payments problems and heavy external debt- led to an increasing role of the Bank in the field of development. The policy changes often "advised" by the Bank included changes to the existing laws and institutions in the borrowing countries and their replacement by new arrangements generally inspired from western models and patterns of economic development.

It is a striking feature in this thesis that exasperation with the World Bank members relationship is so thoroughly mutual. On the one hand, the newly independent nations of the developing countries maintain that they have turned to the World Bank in its capacity as a UN specialised agency, as a means of achieving conditions of economic well-being and social stability. They have done so because they consider the Bank as an institution of universal character which should recognise the sovereignty of each nation regardless of its size or wealth. Moreover, they thought that the help which they would receive from the institution would be coming from the international community as a whole and as being free of obligations to any one country or group of countries. On the other hand, the World Bank staff complain of drift, lack of seriousness, inability to maintain commitment, incompetent government, and therefore express reluctance to commit funds to those who patently require them most, in the classical banker's mode. In the end, the Bank see no option but to tighten conditionality.

- **Objectives of the Study**

There are three main reasons for this study on the impact of the World Bank on the Developing countries, presently the largest users of the institution's funds.

The first is to examine the various means by which the Bank has assumed key influence in Third World policy making and implementation. The debate is not only on the institution's leverage or conditionality, but also touches on the dynamics of policy making. That is, how the Bank interacts with its LDC policymakers to translate conditions into policy and how the implementation of such a policy affects the legal and institutional systems of the borrowing countries.

A second motivation for the study is to destroy the myth that the Bank's recommendations are the only solution to the economic problems of the Third World borrowers. The issue at stake is that the Bank itself is influenced by a minority of members who happen to be its main capital suppliers. Therefore any Bank action in the direction of the developing countries is bound to bear the "seal of approval" of the western countries which, it must be stressed, by engaging their money, have also engaged their ideology and economic model of development.

The third major purpose of this study is to fulfill a deficiency, that legal and institutional transplantations are not always conclusive in the process of the economic development of the Third world countries. This syncretic approach, i.e the adoption without distinction of foreign models, has been in fact a major cause of the rather limited success of the Bank's programmes. Official Third World condemnation of Bank policy, and the unpopularity of the implementation of such policy in the recipient countries, are evidence of the limited effect of the Bank's efforts.

- **Scope of the Study.**

The present research does not concentrate on any particular period of time. It has been placed into a larger time perspective in order to emphasise the evolution of the Bank's influence over its borrowing countries. Given the broad scope of the study, no particular country or a specific (regional) group of countries is selected. Likewise, no particular type of loan agreement (energy, agriculture, infrastructure, industry...), is selected for analysis. The study applies to a wide variety of appropriate situations in the developing countries. It seeks to obtain valid generalisations on the impact of the Bank's influence over its borrowers. It follows that, in order to understand some aspects of the Bank's policy, it is sometimes necessary to examine the system itself, of which the Bank is essentially an instrument. As K.Khan observed:

> [I]n assessing the compatibility of an international economic institution with the contemporary international legal order, it is necessary to examine that institution in all its relevant dimensions <u>and environment</u> (emphasis added).(2)

- **Outline and Arrangement of Topics.**

A short description of the Bank's internal structure and functioning in the first chapter is necessary to understand the Bank's influence on the LDC borrowers. It provides background material on the internal and external environment within which the Bank has to function and the pressure with which it has to cope if it is to remain assured of its finances, and thus its survival. The focus in this chapter is on the main characteristics of the Bank's decision making processes and financial resources. It shows from the very beginning, an institution heavily dominated politically, legally and institutionally by the market elite and where the vast majority of the Third World countries has no role to play.

Chapter two discusses at length the relation between the Bank and its borrowers. This chapter is mainly descriptive and narrative. It attempts to set out the various stages leading to the conclusion of the loan agreement, which is the prelude to the Bank's controversial influence on its borrowers.

In chapter three, an attempt is made to examine the various conditions imposed by the Bank through some concrete cases. The thrust of the argument in this Chapter is that loans have a direct impact on the borrower since these agreements are prepared and implemented within the context of different legal systems and institutional arrangements.

Through a thorough examination of privatisation, chapter four attempts to discuss the dangers of importing and imposing foreign institutions into Third World countries. It also shows that the real impact and function of the imported institution is to drive Third World economies into adopting models of the world's capitalist investment and trading systems for the sake of the First World.

Chapter five maintains that by making its future lending policy conditional on political reforms in the borrowing countries, the Bank has triggered revolutionary changes in the political institutions of its borrowers. Yet the new criteria imposed are neither common in conventional banking practice, nor do they derive from any explicit or implicit constitutional arrangements. The new criteria seem rather dictated by external events which are totally alien to the Bank's actual policy, which has so far relied basically on economic criteria in its lending practice. By responding to such external pressure, the Bank has cast serious doubts on the consistency of its previous policy of economic conditionality, and has damaged its political neutrality by interfering directly in the domestic affairs of its borrowers. From a legal point of view, this chapter argues that such interference, although immaterial, ie. non physical, is nonetheless unacceptable because it is indirectly coercive. From the economic point of view, the issue at stake is whether a combination of economic and political conditionality would prove salutary for the economic development of the Third World countries.

• Summary of Findings

The influence of the Bank on its borrowing members represents a far reaching change on the legal and institutional arrangements of the developing countries. It is a major trend that has been gaining ground since the institution began its operations in the late forties and has become even more pronounced in the last decade. This influence is basically due to the Bank's developmental policy which consists in forcing borrowers to undergo major reform in their economic and political systems of governance. To achieve such a purpose, the Bank has devised various kinds of leverage, some of which are extremely painful, with varying degree of economic, social and political effects on the borrowing countries. These problems demonstrate to a large extent the uneasy relationship that has been growing between the Bank and its borrowing members. At the centre of such a conflict is the Bank's conditionality policy, the terms on which it lends, and the influence it exercises on its borrowers.

One predominant argument in this thesis is that, the Bank is not limited to the supply of funds only. The indirect effects of the conditions which the institution imposes on its borrowers are sometimes more important than its financial aspect. In other words, what the Bank lends in terms of money is not commensurate with the important changes it demands from its borrowers. Furthermore, the implementation of such conditions do not seem to be always conducive to prosperous economic development in the recipient countries, as the institution claims. The reasons are manifold.

In the first place, there is a great deal of scepticism among the LDCs as to the "legality" or "legitimacy" of many of the Bank's actions, including its conditionality, whether economic or political. Moreover, many of the changes have been forced upon the LDCs will and are therefore coercive and disputable from the point of view of international law. Furthermore, the laws and institutions recommended by the Bank are not always adaptable to the specific conditions of the developing countries, despite their technical merit and efficiency elsewhere. Finally, there are at certain stages of the thesis some questions about the relevance of the Bank and its proper role, and in the examination of certain country cases, the question is asked whether the Bank's conditionalities (economic and political), and their subsequent effect on borrowers have not been counter productive, i.e. contributing to problems rather than to their solutions.

• A Note on Sources

The primary sources for the material contained in this thesis are the documents to which I was given access by the Bank and interviews with Bank officials.

It is generally known that the Bank is not a noticeably open institution. Nevertheless, after a period of time, I was able to obtain, informally, access to a considerable number of internal documents that are generally labelled "confidential" and therefore not available to the public at large. Among these, were specific loan agreements and structural adjustment programmes of recent dates and particular countries.

In gaining access to such material I agreed to certain basic rules. I agreed to quote, without naming the country concerned, and without citing the date, the title, or any reference that may identify either the borrower, or the country to which the borrower belongs, if the loan was made to an entity other than the government.

During my stay at the headquarters of the Bank, I carried out approximately seventy interviews with Bank staff at all levels. Many interviews were informal and took place at lunch time or tea break. My interviewees were from different background and ranking in the Bank hierarchy. They include economic experts, consultants and various staff from different departments. Other few and more formal interviews were arranged for me in advance. They include five Administrators (two from the developed world and three from the developing world), several members including the President of the legal department, and few senior officials in the IMF. The talks took place in the offices of the interviewees and were subject to the Bank's regulations on giving interviews by the Bank's staff.

As expected, many interviewees talked to me on condition that their views and observations (which were not necessarily critical), remained anonymous. It is only legitimate that their wishes be respected. Part of the interviews in the thesis were carried out with Algerian officials in the Ministry of Finance, and with the staff of major Algerian banks which have direct contact with the World Bank.

Finally, the nature of the topic and the changing events that may affect the substance of its content made it necessary, in the absence of academic material, to resort to a wide range of respectable daily newspapers (eg The Financial Times), weekly magazines (The Economist) and sometimes radio and/or television broadcastings (BBC) This is especially noticeable in the last Chapter (Five), which deals chiefly with the emerging of a new form of lending policy based on political criteria and which is still in its formative stage.

It is hoped that such an attempt and efforts will not be interpreted as "vulgar journalism".

Notes To Introduction

1 IBRD/WB: The official and original title, the IBRD is rarely used and has been replaced through common usage by the World Bank, but the initial IBRD have been retained.

2 K. Khan, The Law of International Economic Institutions and the Principle of Universality in the Contemporary International Legal Order, in W. E. Budler, Perestroika and International Law, Martinus, Nijhoff, 1990, at 227.

• References throughout are to the US Dollar, unless otherwise specified

CHAPTER ONE

SPECIAL CHARACTERISTICS OF THE BANK.

> I never saw a more rigid institution...It is an institution, not a bank, why they call it a bank, I don't know...(1)

This was Georges D. Woods as he took office as President of the World Bank (1963-1968). Such a statement denotes to some extent the complex nature of the Bank which the present chapter tries to identify. Broadly speaking,the Bank is often looked upon by its own insiders as "an International financial institution whose main purpose is the economic development of its members."(2) This characterisation involves, in essence, more than one institutional case study:

a)- the Bank is an international organisation,

b)- specialised in finance related matters,

c)- with the specific task of promoting development.

The issue which arises is one of reconciliation between the three components, which, in the case of the World Bank, seems not easy to reach. This chapter argues that a comprehensive study of the Bank can only be made by looking in some depth into each of these three components. Far from compartimentalising the institution, such an analysis has the advantage of avoiding a number of misunderstandings which have often been made in the study of the Bank. For example, most of the Bank's analysts who are overwhelmingly economics experts, stress, or give pre-eminence to the financial aspect of the institution, while losing sight of the other two components. One such a view is well illustrated by economist B. Hurni's definition of the Bank, as she wrote:

> The Bank can be defined as a prototype public institution for politically neutral and untied investment in economic development, with its rules shaped more like those in a commercial corporation than an intergovernmental organisation.(3)

Generally speaking, what is important for economists, is how well the Bank is doing business. They are more concerned on matters such as the exchange rate affecting the borrowing capacity of the Bank, its volume of lending, the issue of interest, and like subjects which deal mainly and directly with money. It is this kind of approach which presently predominates in the Bank's literature, and it is favoured by most of the developed countries which are the main fund suppliers of the institution.

This technical approach, albeit indispensable, has the disadvantage of neglecting the other two aspects of the Bank as a development agency and above all as an intergovernmental institution. In respect of this latter aspect, the Bank is seen from a politico-legal point of view as an international organisation in the whole sense of the term. That is to say, the property of all member states with all consequences that such ownership implies in Public International Law.(4)

On the basis of such an assumption, a vast majority of member states, namely the LDC's, tend to think that the Bank in its present form and functioning totally eludes their control in many respects. Among the arguments which are in blatant contradiction with the Bank's status as an international organisation, the LDCs leaders invoke the decision making process and the human component of the Bank (ie. the personnel) which are both under Western control or influence. As will be seen later, it is this kind of structural imperfection that the LDCs want to eliminate in order to press the Bank to improve its role as first and foremost an intergovernmental financial institution.

This state of confusion between the various components of the Bank has led to many doctrinal as well as practical controversies as to the real nature of the institution. As E. S. Mason and Asher rightly remarked, it is a problem of identity:

> The line is indeed difficult to draw, and from time to time, the Bank as a bank has been contrasted with the Bank as a development agency, or as intergovernmental organisation leading thus to many controversies as to the real identity of the institution.(5)

Generally speaking, no matter how deep and scientific the study of individual aspects of the Bank may be, there is always the danger of reaching an incomplete view and, therefore, any solid judgement on the Bank's activities, policies, and objectives, must remain incomplete.

In the present chapter, an attempt is made to consider separately, and as succinctly as possible, each of these main institutional aspects of the Bank. The belief is that each of these aspects fulfills a certain function, obeys a different set of rules, and is integrated into an appropriate system, which, put together, plays a significant role in the shaping of the Bank, and explains to a large extent the originality, if not the uniqueness, of the institution.

I-The Bank as an International Organisation.

For the purposes of the present thesis, it is unnecessary to go through the history of the antecedents of the World Bank.(6) It is necessary, however, to draw attention to the main features of the institution and, in particular, to concentrate on three main aspects of the Bank as an international organisation, which are: the rules governing membership, the relation of the Bank with its members, and the issue of the Bank's decision-making. These aspects, although typical to all existing international organisations, do bear some peculiarities in the case of the World Bank. Their examination helps to understand the various contradictions that explain the present functioning of the Bank. Furthermore, these three aspects demonstrate certain central points of this thesis which are the voting procedures, the so called autonomy of the Bank *vis a vis* its members, and the pertinent issue of the domination by a minority of states of the remaining vast majority.

A- Membership.

The rules regarding membership in the Bank made it compulsory for states to acquire prior membership of the International Monetary Fund (hereinafter, the Fund or IMF) (Art. II, sect.1a).(7) Despite objections by some delegations during the Bretton Woods Conference, that "the country's freedom would be jeopardised if membership of one organisation was made contingent upon the other", the link between the Fund and the Bank was ultimately sealed.(8) Explaining to the delegates the reasons for such a close relationship, one architect of the draft outline said:

> Basically, we wanted to force countries to agree to standards in the monetary field as a condition to get the benefits of the Bank.(9)

This has enabled the Bank to acquire a much wider transparency in the members' conduct of their monetary policies and eventually helped the Bank to assert with accuracy whether prospective borrowers will be able to meet their financial commitments. Membership procedures provide for new members to be admitted by the action of the existing members. It is the Board of Governors which has the power to admit new members and determine the conditions of their admission. This practice differs from that of other agencies in which members are admitted by a formal acceptance of the terms and agreements of the institution concerned. So far there is no precedent of a state being refused membership by the Board of Governors.(10)

In 1946 when the Bank opened for business, it had 45 members, of which 14 were European countries, 18 Central and Southern American, 9 from Asia (including Australasia and the Middle East), and 2 from Africa.

Growth in IBRD membership.

Region	1947	1957	1967	1977	1987	1991
Africa	2	2	34	44	49	50
Asia	3	13	17	20	24	25
Australasia	1	1	2	5	7	8
Cent&S/Amer.	18	20	22	26	28	28
Europe	14	16	20	21	26	28
Middle East	5	6	9	14	14	14
North/Amer.	2	2	2	2	2	2
	45	60	106	132	150	155

• Source: Compiled from various World Bank Annual Reports.

At present membership totals 155 countries, the increase being due mainly to the entry of the newly independent states of Africa and Asia and more recently the former socialist countries.

Unlike most post war international organisations, the Bank's Articles do not require membership of the United Nations.(11) In practice, however, only states in the full meaning of international law are members. This may be inferred from the treatment by the Bank of non-autonomous entities and non-independent territories. In the Bank's Articles, these non-independent territories and the like entities which lack international personality and recognition are made subject to the administration of their respective tutors or colonial powers (Art. XI sec.3 (g)). In other words, a country under the rule of another country (colony, mandate, protectorate, suzerainty.), cannot directly claim assistance from the Bank. It is the administrator country which, as a formal representative, is responsible for the request of loans to assist in the economic development of its colony.

Such practices were more common during the years of colonialism, ending in the early 1960's. Examples of loans made by the Bank to the colonial powers for the benefit of their colonies include: $ 70 million to Belgium (1951) to assist in financing a development programme in the Congo; $ 59 million to France (1958) to build a hydroelectric dam in Algeria, to cite only these two examples.(12)

Needless to say such practices have become obsolete with the U.N. resolution on The Right of Peoples to Self Determination.(13) Perhaps the only question that remains unanswered so far is whether the Bank's action at that time was for the benefit of the poor, colonised, territories, or to help Europe in the expansion (or maintenance) of colonialism in Third World countries. Without falling into any kind of subjectivism or demagogy, it can be argued that it is time that such provisions disappeared from the Articles of Agreement because they are psychologically incompatible with the noble mission of the Bank, which is the assistance of the poor countries. Unless colonialism is a political issue and the Bank does not want to get involved in political activities as directed by its Statutes.

All the members of the Bank are equal. In theory, there is no distinction between a developed or undeveloped country as it is found in several post-war international organisations such as FAO and UNCTAD.(14) The distinction between members in the Bank is subordinated to the date of their entry into the institution, *viz*, whether original or non original members (Art.II sec.1). Original members are those who participated in the Bretton Woods negotiations who acquired membership before 31 December 1945 according to Article XI sec. 2 (e). In the Articles of Agreement, original members are referred to in Schedule (A) and were admitted to the institution without prior negotiations of their subscriptions, nor were they instructed on the methods of its payment. Non original members are the states which joined the Bank after the deadline set by the Bank's Articles. Their entry into the Bank is governed by the complex provisions of Article II, section 1 (b) as interpreted and completed by Article XX of the Bye Laws.

In practical terms, the distinction between original and non original members is only fortuitous, and is strictly limited to the conditions of entry. It does not reflect the real structure of the Bank's membership. For taxonomical reasons, the Bank divides its members into three categories. This "politique de classement" or "graduation process" as it is known in the Bank's jargon," is an important index of the progress made by the borrowing countries since the IBRD and IDA were established.(15)

• Category A:

Although the Bank was initially set up to lend to 'any member' there are, however, some states which have been explicitly deprived of the Bank's resources. The decision to discard some members from the Bank's funds was taken by a resolution of the Board of Governors, after it had ascertained the economic conditions and progress of the members concerned.(16) It appears from the arguments put forward in the resolution, that the reasons for disqualifying the 'richer' members are threefold:

Firstly, the Bank's ability to borrow is limited by the provisions of Article III, section 3, under which the total amount of outstanding loans held by the Bank must not exceed the total of its subscribed capital, surplus and reserves. This limitation known in economic parlance as 1:1 ratio, is seen as an extremely prudent prescription, and prevents the Bank from lending more money than it originally possesses.(17)

Secondly, by denying loans to relatively wealthier members, the Bank will undoubtedly have more resources available for those who are in real need; and therefore have priority in the use of the Bank's resources. This is not only fair and just, but particularly helpful for the less developed countries at a time when traditional suppliers of the Bank's funds (official and private) tend to be more reluctant in providing such funds to them.(18)

Thirdly, the Bank's Articles made it clear that the institution does not intend, nor is it allowed, to compete with private lenders (Art.III sec. 4 (ii)). One of the main conditions for lending imposed by the Bank is to ascertain that the prospective borrower cannot obtain finance on reasonable terms from other (i.e. private or bilateral) sources. Therefore, if a relatively rich member needs financial support, it can seek help from private sources of lending, which, it must be recalled, is obtainable on terms and conditions which are substantially different from those of the Bank

• Category B:

According to the Bank's own calculations, this category comprises all members whose annual per capita GNP has reached a limit of $ 410 (1983 figure). In effect, this means that members in this category are judged on their ability to borrow and meet the obligations deriving from such a borrowing. By the Bank's standards, the economy of these countries is deemed deficient, but worthy of assistance without risking eventual defaults. However, members in this category who have achieved substantial economic progress may become eligible for category (A) and thus become ineligible automatically from Bank assistance. This was the case of Japan, for example, which until 1976 was a heavy borrower from the Bank and now has become one of the main fund suppliers. Venezuela, on the contrary, was in the 1970's, in category (A) but was downgraded to Category (B) in the mid 1980's because of a sharp decline in her oil revenues, which constitute the main financial resource for the Venezuelan economy. With respect to the Bank's volume of operations, Category B covers most of the Institution's activities and areas of intervention. Moreover, it is Category B, not surprisingly, which consumes almost the entire lending operations of the Bank in terms of development financing.[(19)]

• Category C:

This category comprises all the countries which are not in a position to borrow from the Bank because of their inability to meet the financial requirements which follow as a result of their borrowing; namely repayment of principal plus interest. These countries are excluded from the Bank's loans because of their extreme state of poverty. By lending to the countries in this category, the Bank, as it is framed, would inevitably 'go bust' as one Bank official puts it. The economy of these countries is so depressed that profitable business is virtually impossible. Furthermore, the economic situation in these countries is often aggravated by natural calamities such as drought, famine or epidemics which may diminish even further the Bank's hope of contemplating any form of security for its repayments. As a financial institution, it would be unprofitable to do business (in the capitalist sense of the term) with this category of members.(20)

To remedy the situation, the Bank, acting on the basis of its implied powers, established in 1961 the International Development Association (IDA).(21) Through the IDA, the Bank has somewhat restored its credibility *vis-a-vis* its lenders and borrowers. The Association works in a close relationship with the Bank, and carries out practically all the tasks that the Bank cannot statutorily do. IDA provides credit (not loans) in the form of grants to the least developed countries. It lends only to governments, without interest, except for a nominal administrative charge (0,075 %) of the allocated amount. The major weakness of the IDA however, is its total reliance on the will of the rich industrial countries.(22)

The system of classification operating within the Bank is very flexible and states may, as an exception, take the advantages of one category, while being officially in another. Thus, countries in Category A, although by the Bank's criteria are not eligible for the Bank's loans, may nevertheless benefit from the Bank's expertise and the like technical assistance. Similarly, countries in Category B may exceptionally benefit from IDA.'s concessional grants (which are designed for Category C), and from the Bank's conventional loans. This extract from one of the Bank's publications is quite informative:

> Of the 34 very poor countries that borrowed money from IDA in the earliest years, more than two dozen have attained sufficient economic strength for them to need IDA money no longer. Of these, two -Columbia and the Republic of Korea- have not only moved from reliance on IDA credits but have attained sufficient economic strength to be able to contribute to IDA. Similarly, about

> 20 countries that formerly borrowed money from the IBRD, no longer need to do so - an outstanding example is Japan. For a period of 14 years it borrowed from the IBRD. Now the IBRD borrows from Japan.(23)

In all the three categories of members, the Bank has an active but different relationship.

B- The Relationship Between the Bank and its Members.

In dealing with its members the Bank has, as an international organisation, developed a special relationship, the purpose of which is to avoid as much as possible direct contact with governments in their capacity as political organs. Article III section 2 is very strict on this point:

> Each member should deal with the Bank only through its treasury, central bank, stabilisation fund or other similar fiscal agency, and the Bank shall deal with members only by or through the same agencies.

This Article should not be construed, however, as barring governments completely from the Bank's scene. The provisions of the above cited Article have simply introduced some limitation on member states' interference in order to give the Bank a greater autonomy in the conduct of its business. For, it is believed, too much involvement of states in the Bank's activities goes contrary to the very nature of the Institution's purpose, which is a bank before anything else. As such, it must keep distant from governments and politicians. The reverse is true for the Bank. It must deal with its members only through the same channels (i.e those enumerated in Art. III sec. 2), and it must not interfere with the politics of its members.

The Bank's Articles provide that the Institution cannot be guided in its decisions by political considerations. Only economic criteria are relevant to the Bank's lending decisions.(24) The Bank is thus neither allowed to interfere in the domestic politics of its members, nor to take into account the political character of the prospective borrowers. However:

> These prohibitions... do not mean that [the Bank] must not take into account political situations or developments in member countries which may have an impact on their economic situation. Economic policy may be linked to political policy and thus Bank decisions may be influenced by or have an influence on the domestic affairs of a country.(25)

The Bank's non political stance has raised many controversies which have been shown in several writings.(26) However, recent developments confirm the view that the Bank has become more and more involved in politics, notwithstanding its Articles which prohibit it from such activity. At the risk of over-simplification member states come into contact with the Bank on very few occasions such as:

- By subscribing their shares to the capital of the Bank at the time of the state's entry into the institution (Art.II sec. 3 a)
- Through the 'supply' of guarantees whenever the loan is made to an entity belonging to the member state.(Art. III sec. 4(i))
- In case of litigation where only the state, be it a borrower or guarantor, may be a party in a conflict with the Bank. (Art.VI sec.4)

While clearly attempting to diminish government intervention in the Bank, the drafters of the Articles were faced with the corollary question of how the Institution is to be linked to its members. Were the Fund and the Bank purely financial institutions whose direction could be entrusted to a group of international civil servants? Or did their operations have such economic and political implications as to require close control by the member governments?(27) In other words, would the representatives of the member states represent the views of their respective governments, or would they owe complete allegiance to the Bank ? As with several questions, this one has no answer in the Articles, and it seems to have been left deliberately to the discussion of the conference.

In their study, Mason et al, supported by a large majority of authors, argue that Bank officials, especially the Executive Directors, although showing complete obedience to the Institution, do nevertheless work in close contact with their respective governments.[28] In all other major aspects of the Bank's functioning, policies and activities, the Institution has developed its own methods independently from any direct governmental interference, but heavily influenced by the views of the Western powers and especially those of the United States. America's influence on the Bank is so important that it deserves special attention.[29]

a)- US Dominance.

Being the promoters of and by far the largest contributors to the Bank, it was quite natural that the Americans had their own blue print on the institution. "This was inevitable", as Bank officials admit:

> because of the location of its [the Bank's] headquarters, the financial strength of the United States and Western Europe vis a vis the rest of the World... (30)

But it was not always easy for the Americans to secure such privileges. The first worry facing the US delegation in 1944 was to secure a *locus* for the Bank on American soil. After slight resistance from the British delegation, the Americans succeeded in having the Bank not only on their territory, but in the very place they wanted it to be, Washington.[31] That is to say, under close surveillance of Congress and in permanent (informal) contact with Wall Street.

The following step for the Americans was the utmost necessity of having a US citizen at the top of the institution. There too, they have been more successful than they may have anticipated because, since 1946, all the Bank Presidents have been US nationals, totalling an unbroken record of nine Presidents in nearly half a century.(32) Through the Articles of Agreement, US predominance is also omnipresent. It is either expressed openly, such as in Article XI section 2 which starts in the following terms: "The government of the United States of America..." Or it may be insidiously hidden under the cloak of paraphrases such as in Article V section 9 (a), which reads: "The member holding the largest share...", knowing that they are referring to themselves.

Perhaps, the most direct and concrete American influence on the Bank comes from the US Congress, which voted in 1945 to establish the National Advisory Council on International Monetary and Financial Problems, (NAC).(33) The NAC was set up:

> in order to coordinate the policies and operations of the representatives of the US in the Fund and the Bank and all agencies of the government which make or participate in making foreign loans or which engage in foreign financial exchange or monetary transactions.(34)

The Council consists of the Secretaries of the Treasury and Commerce and the heads of the Federal Reserves Board, the Exim Bank and experts on monetary and financial issues and acts as a watch-dog. The Council has two main functions. It is an advisory body to the President (of the USA) and, in this capacity, it coordinates US foreign economic policy at the cabinet level. Secondly, the Council is the supervisory body of the US representatives in the Bank and the Fund. Thus, whenever the approval, consent or agreement of the US is required before an act may be done by the respective institutions, the decision as to whether such approval... must be given by the NAC under the direction of the President. The Council meets regularly and reports to the Congress on all aspects of the Bank's activities. Among other things, the NAC makes various recommendations to the US Executive Director (in the Bank); it instructs him to oppose loans to specific countries, and orders him to veto any decision which runs counter to U S interests.(35)

Even if the domination of the US was an inevitable consequence of its financial contribution, certain acts were disproportionately symbolic of American prevalence. Thus, until 1962, for example, a newly admitted member in the Bank signed the Articles of Agreements in the Department of State, presided over by an Assistant Secretary of State. Ideological hostility towards public enterprises, particularly in non service areas, is also another feature of American influence. English is also the only official language; and some half of the top officials in the Bank are US citizens.(36)

One major factor contributing indirectly to the "Americanisation" of the Bank was the absence of the former Soviet Union and her allies from the institution. The Russian delegation participated in all the stages leading to the Bretton Woods conference. It signed the Final Act, but never ratified the IMF and IBRD Articles of Agreement, and thus never became a member. In Bittermann's words:

> the Russians did not believe that the Bank should require general economic information and they insisted that countries with state trading should receive loans without prior investigation.(37)

At the meeting of the UN General Assembly in 1947, the Soviet representative charged that the Bretton Woods institutions were merely branches of Wall Street and that the Bank was subordinated to political purposes which make it the instrument of one great power(38) Russia's "defection" deprived the Bank of one of its potentially most influential members and presumably, the only country which, ideologically, could have counterbalanced the Western capitalist doctrine upon which the entire Bretton Woods system was founded. Without serious competitors, the US dominance over the Bank had no difficulty in expanding comfortably. This led many writers and politicians in the Third World to express their worries, and to question the real independence of the Bank.(39) As Hoon Mok Chung remarked:

> Too close association between [the US and the World Bank] would only deprive the Bank of its greatest asset- a reputation of being an international agency. Without

> this, the Bank would not be immune from the charges of undue political pressure of the LDCs. Thus there was and still there is a great need for the Bank to achieve a delicate balance between being international and being "dependent" on the largest stockholder.(40)

As a consequence of this unmatched capital subscription, the Americans enjoy a privileged position in the decision-making process of the World Bank. This position is in fact so important that it deserves careful examination.

C- Decision Making Structure and Procedure.

The capacity of the Bank to adapt to the changing environment and expand the scope of its functions unhindered by national governments is, to a great extent, the result of its internal structure. Therefore, a brief examination of the Bank's internal organisation is necessary because it determines directly or indirectly the quality and the features of all decisions taken within the institution, as well as the influence of the rich contributors on the Bank's functioning.(41)

a)- Internal Organisation.

The internal structure of the Bank is very simple and can be summarised briefly.

(i)- The Board of Governors.

The Board of Governors is one of the five constitutional organs of the Bank together with the Executive Directors, the President, the Advisory Council and the Staff Loan Committee. The Board of Governors is the highest organ in the Bank's hierarchy. It is composed of representatives of all the members who are generally Ministers of Finance. Each Governor is seconded by an Alternate. The Board is the supreme decision-making body in a formal sense since " all powers of the Bank [are] vested in the Board of Governors."(Art.V sec.2a) The Board retains certain non delegable powers (admission and suspension of members, international agreement making and approval of amendment to the Articles...), but has delegated most of its authority to the Executive Directors (Art.V sec. 2b).

(ii)- The Executive Directors.

The Executive Directors are responsible for the conduct of the general operations of the Bank (Art.V sec.4a). They exercise all the powers delegated to them by the Board of Governors. The Bank's Articles fixed the number of the Executive Directors at twelve; consisting of five appointed by each of the five major shareholders (US, UK, France Germany and Japan); the others are elected by the rest of the members. The Articles left the number of the Executive Directors flexible. The number has been gradually increased to twenty two as a result of the admission of new members.(42)

The Executive Directors elect the President of the Bank, determine all loan proposals as well as their conditions, make recommendations on the admission and suspension of members. They are, in practice, the Bank's supreme decision making body. Although the final decision (as to loan or other major activities) must be made by the Executive Directors, the initiative for all actions lies with the President and his staff.

(iii)- The President.

The Bank's Statutes define the President's role in a very simple way. According to Article V section 5b, the President is the chief of the operating staff. He conducts the ordinary business of the Bank in collaboration with the Executive Directors, and is responsible for the organisation, appointment and dismissal of the staff. The only constitutional constraint imposed on the exercise of his powers are the requirements to discharge his duty in the interests of the international community and to be subject to the direction of the Executive Directors. In practice, however, these constraints are of little significance, and the President is a major source in the Bank's policy and decision-making process.(43)

b)- The Decision Making Process.

The issue of decision making has been, and still is, the most controversial area where frictions between the DCs and LDCs are the most pronounced.(44) To the repeated calls from the Third World countries to change the voting rules, the Bank has responded by proposing a mid-way answer. It has tactfully dropped the formal rules and instituted instead a smoother procedure in the form of consensus in almost all its decisions. This led to the emergence of a dual system of decision making which has no comparison in any other international organisation; one theoretical, the other practical.(45)

(i)- The Theory.

The pivotal principle affecting the Bank's decision making is the weighted vote.(46) Thus, the actual size and importance, the voting power and the ability to influence the Bank's decisions vary widely between the members. Voting power on the Board of Governors and among the Executive Directors is weighted on the basis of the number of shares held by each member (Art. III sec. 2). That is of the amount of capital subscribed by each member, allocated on the basis of economic strength as expressed in the IMF holdings. Each member has 250 votes. In numerical terms, it amounts to 11 percent of the votes distributed on the basis of one state, one vote. In Gold's opinion these:

> basic votes were intended to give expression to the classical doctrine of the equality of states in international law and to provide some safeguards against shares in total voting for some members that might seem to be absurdly small that their voices could be ignored.(47)

The remaining 89 percent are allocated on the basis of shares of stock held by each member. The value of each share is $ 100.000 in terms of US Dollar of the weight and finesse in effect on July 1, 1944. An application of these voting arrangements gives the following result. For example, Costa Rica's subscription is $ 131 million, it has thus, 250 votes plus 131 equal 381 votes; which is, in terms of percentage, 0.04 percent of the total voting powers. A small arithmetical exercise shows that nearly 400 Costa Ricas are needed to equal the USA.

Voting power thus ranges from the US current 17 percent to the 0.04 of both Costa Rica and The Republic of Lao. The ten most developed countries hold slightly less than 56 percent of the total of votes. The proportion becomes nearly 63 percent, if five other developed countries are added. Whereas, a hundred and twenty one LDCs has each less than 1 percent of the voting power and hold together 19 percent, slightly more than the US. Of the LDCs, only China holds 3.27 percent. Because of the few members holding large shares of stock, the numerical expansion of membership did not affect the distribution of voting powers as it did in other UN Specialised Agencies.(48) Potential influence of the OECD countries, for example, as a whole has been diminished during the years as increase in membership may indicate. Gradually, the voting power of the US, UK and France have been proportionally reduced, but it was due mainly to the admission of Germany and Japan. Total voting power thus pertaining to the OECD remained proportionally more stable than the voting power of individual members.

Statement of Subscriptions to
Capital Stock and Voting Power
of the Five Major Western Members.
June 30, 1991.

	Subscriptions					Voting Powers	
Members	Shares	percent total	Total amounts	Amounts paid in	Amounts subj. to call	Number of votes	percent of total
United States	206,257	17.89	24,881,813	1,785,899	23,095,914	206,507	17.32
Japan	93,770	8.13	11,311,944	703,452	10,608,492	94,020	7.89
Germany	72,399	6.28	8,733,853	542,921	8,190,932	72,649	6.09
France	69,397	6.02	8,371,707	520,634	7,851,343	69,647	5.84
United Kingdom	69,397	6.02	8,371,707	539,526	7,832,181	69,647	5.84

• Source: World Bank Annual Report 1991.

As a consequence of increase in membership, the total voting power of the US has dropped from the original 42 percent in 1947, to the present 17 percent (1991). This means that the US, which is still the biggest shareholder, is in no position to block a decision by its own vote alone.(49) They need the concurring votes of at least six major shareholders to do so, because the Bank's Articles require, for most purposes, a simple majority (Art.II sec.3). Such figures and mechanistic voting calculations may look dramatic, but their real significance is far from reflecting reality, since the practice is all together different. For few, if any, matters of importance are decided by a mere tally of votes.

(ii)- The Practice.

The procedure of the weighted vote so far described is only theoretical; in the sense that at least it reflects the meaning and spirit of Article V section 3 as it reads in the Bank's Statutes. In practice, however, voting power is not all important in decision making. Executive Board decisions are often based on general consensus arrived at through debate rather than voting. It has become a fashion within the Bank (and the Fund) to state that an affirmative vote is often less important than a wide consent. As one Bank official put it "it is more important to ascertain the sense of the meeting than to observe formal voting procedures." One major consequence of the consensual method is that the Directors are rarely, if ever, asked to decide issues and problems on which a prior consensus has not been already reached.(50)

The Bank has always argued that such a consensual approach is advantageous to both LDCs and DCs. For the former, it is an opportunity for them to have their opinion expressed; henceforth, they will psychologically feel as being part of the decision making process. Therefore, they will be more ready to accept the outcome of the decision thus reached. For the latter, the consensus method gives them the opportunity to present the Bank as a democratic institution governed by all the members without discrimination.

The use of consensus remains from the point of view of law unclear. For, such a method is neither part of the Bank's Articles of Agreement, nor has it been formalised in any other subsequent document. It may be sometimes confusing for an institution to operate on a dual system, one formal the other informal, especially when it is the latter which seems to prevail. For many authors such as A. Fatouros, the Bank deliberately maintains such a duality to keep the developing countries under pressure; and at the same time to avoid internal conflict between Bank officials should formal voting be used. Said the above mentioned author:

> From the very start, the Bank's management has chosen to follow a policy of total avoidance of confrontation (and divided votes at the level of Directors or Governors) and has adopted instead a decision-making process which functions smoothly by means of continuing consultations and informal contacts between Executive Directors and Bank officials at various stages of the lending process and before a loan is formally submitted for approval.(51)

While consensus is voiced proudly in the Bank, in the background however, the spectre of the weighted vote lies dormant. For, in practice, any member who is not satisfied by a decision taken by consensus, has the right to ask for a formal vote. For, whoever asks for a formal vote, will be in fact asking for a weighted vote; therefore a vote to the advantage of the DCs minority. Indirectly thus, it is not to the advantage of the LDCs to resist any consensus, since a formal vote will be also unfavourable to them. The widely held view that the Bank works on consensus is no more no less than misleading propaganda. Otherwise, why are the LDCs still asking for a revision of the decision-making process in the Bank ? The issue of decision making is particularly crucial for the LDCs, because it affects the way the Bank's funds are allocated to them.

This leads us to consider the second and main characteristic of the Bank as an international financial institution.

II- The Bank as a Financial Institution

Proving that a bank is a financial institution, may not be a usual exercise. However, in the case in hand, the issue whether the Bank should be called a bank is worth exploring since it may help to shed light on several aspects of the institution that will be considered in the course of this study. The question, in fact, arose immediately during the Bretton Woods conference, and was the subject of futile exchanges between delegates.(52) Without going into the core of the debate, it is sufficient to state that the delegates eventually retained the name Bank "only for a want of a better word."

> 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, issue of bonds, the new financial institution may have some apparent claim to the name of Bank. but the type of shareholders, the nature of subscriptions, the exclusion of all deposits and of short-term loans, the non-profit basis, are quite foreign to the accepted nature of a Bank. However, it was accidently born with the name Bank, and Bank it remains, mainly because no satisfactory name could be found in the dictionary for this unprecedented institution.(53)

As a financial institution the Bank is, in many respects, different from other international organisations, because of its overall structure which R. Lavalle describes as follows:

> Elle [la Banque] ressemble a une societé commerçiale de capital variable, dont les associés seraient les Etats membres...(54)

Like any financial institution, the Bank needs at least two main supports: **A**)- capital, and **B**)- shareholders. Since it is not an ordinary bank, there may be some others **C**)- peripheral functions worth examining.

A- The Sources of Funds for the Bank.

The Bank draws its funds from two main sources: **a**)- payments made by member subscriptions and **b**)- borrowings from capital markets.(55)

a)- Member Subscriptions.

Upon their entry into the institution, states contribute to the Bank's funds by fixed quotas determined on the basis of formulae that reflect their economic strength. In broad terms, country quotas are decided by a resolution of the Board of Governors, according to a procedure closely linked to the member participation in the IMF. However, unlike the case of the Fund, there is no relation between a member subscription and the amount of money, or the number of loans it may request and receive from the Bank.(56)

According to the Articles of Agreement, member subscriptions are divided into two parts. A small part, representing 10 percent of the Bank's subscribed capital, (Art.II sec. 5 (i)) constitutes the member states permanent contribution to the Bank' s equity assets. Of this 10 percent there is 8 percent paid in gold or US dollars and is usable by the Bank without restriction in general operations (Art. II sec. 7 (i)).(57) The largest part (i.e. 90 percent) still remains with the member country, but may be called in at any time by the Bank to meet its financial obligations arising from its own borrowings (Art.II sect. 5 (ii)). This callable part is often referred to as the guarantee fund, which provides the Bank with an essential element of credibility within the international financial community. It serves exclusively as protection for the Bank's creditors. In addition, the callable portion may in any case be the subject of bargaining by other members should any one of them fail to honour it. In other words, if the Bank needs funds and calls on members to provide their unpaid share (i.e the remaining 90 percent), and in the event of one member refusing to fulfill such an obligation, the other members cannot rely on the default of that one member to abstain from paying in their share.(58) If, on a call, the amount of money received is insufficient to meet the obligations of the Bank for which the call is made, the Bank has the right, and is bound, to make further successive calls, until the aggregate amount received by it is sufficient to meet such obligations. However, no member may be required on any such a call to pay more than the unpaid balance of its capital subscription.(59)

b)- Borrowing by the Bank from the Capital Market.

This is, in reality, the most important source for the Bank. The Bank borrows about 70 percent of what it lends.(60) As a borrower, the Bank enjoys great popularity in the free market which enables it to acquire funds at extremely favourable rates because of the guarantee fund, referred to earlier. The Bank borrows either directly from government central banks such as the United States, Japan, West Germany and Switzerland, and recently from some OPEC countries namely Abu Dhabi, Saudi Arabia. Or it may borrow from private institutions such as the inter American Bank, the Asian Bank of Development, the Exim Bank or any other respectable financial institution. A survey of the Bank' s borrowing operations shows that the institution tends to favour the latter type of borrowing to the former. This may be explained by the Bank's traditional distrust for governments in general, and partly because the majority of the private lenders are American dominated agencies. As of June 1990, the amount of money subscribed by the members amounted to $ 0.09392549 billion (less the uncalled portion); whereas the total of loans approved by the Bank was 11,4 billion. It is clear that the members paid-in portion alone is far from covering the Bank's huge lending operations.(61)

The magnitude of the Bank' s involvement in the free market is reflected in the Articles which give the Bank ample powers to contract such borrowings (Art. IV sec. 1a (ii)). However, this capacity to borrow, although very high, is not unlimited. The amount of money the Bank can borrow may be assessed indirectly from the provisions of Article III section 3 which prohibit the Bank from lending more than its authorised capital. This 1 to 1 gearing ratio is, of course, highly conservative, and suggestions for change have been repeatedly made by LDCs. For, with a different and more flexible gearing ratio provision, the Bank's lending could be expanded greatly to the benefit of the borrowing members. This point will be discussed further when appropriate.(62)

Paradoxically, what is more important is the non paid capital that the Bank uses to back its borrowing from the free market. On the basis of such a limited subscription imposed upon the member states, it was possible for the Articles to make government intervention in the Bank impotent; as it can always argue that it is other's money which the institution is using, not the member's. So, in a sense, it is not the private market which makes the "strength" of the Bank, but governments in their capacity as states enjoying international legal personality. This distinction has to be made because quite often the Bank is unduly presented by its officials as an institution depending heavily on the free market, and, from there, they deduct a whole panoply of rules and principles which have a tremendous effect on the way the Bank shapes its policies and carries out its activities. As Mason et all remarked:

> The fact that the Bank was dependent on capital markets for the bulk of its funds was to the managment an asset rather than a liability... since this meant that the Bank was limited to the kind of lending that, because it had to be productive, would "build confidence in the Bank". Furthermore, dependence on the market meant independence from the political pressure of donor

governments. [63]

But this is not the whole truth. It may be right to say that by relying on the private market, the Bank reinforces its autonomy *vis-a-vis* its members, but, at the same time, it should be noted that this non reliance on government monies is self imposed. That is to say ,it was the founders of the Bank which wanted it to be so. Furthermore, most of the Bank's private lenders deal with the Bank mainly because it is an intergovernmental institution, backed, run, and managed by governments. Had it not had such strong support from governments, the Bank would certainly not enjoy such confidence and credibility in the market place. In sum, it is not the private bankers which make the Bank's strength, but the member governments in their capacity as shareholders

B- Shareholders.

The Bank is owned by 155 governments which may be compared, in many respects, to shareholders in a private financial institution. However, as the Secretary of the US State Treasury, Fred M. Vinson pointed out, "the Bank is not an ordinary institution with ordinary shareholders, It is a cooperative enterprise of governments and its chief business is with governments".[64] Unlike private shareholders, governments do not have unlimited share of participation. In the Bank' s regulations, the amount of shares allocated to individual members joining the institution is fixed by the Board of Governors, the highest authority in the Bank. Like shareholders in a private enterprise, governments do not interfere directly with the day to day running of the Bank. They invest their money and leave the daily business of the Bank to the Board of Management. Moreover, the distinction between big and small shareholders has not been without effect on the structure of the Bank which appears rather like an institution where the largest subscribers dominate the small ones; despite the formal equality which exists between all shareholders in their capacity as members of the international community.[65] This is a hierarchy which, it must be recalled, has been made possible and encouraged by the Articles of Agreement.

The Banks retained earnings have been accumulated from the net profits which the Bank has made every year since 1948. Unlike most other financial institutions, the Bank is not a profit making agency. Shareholders in the Bank do not receive dividends or interest on their paid in subscriptions. Instead, earnings have been used to build up the Bank's reserves to meet its own internal expenses. Under its present policy guidelines on liquidity, the Bank maintains "a pool of liquid holding", which at any given moment should be equal to a minimum of 40 to 45 percent of its estimated borrowings during the following three years. This policy is designed to protect the Bank from being forced to borrow under suddenly deteriorating market conditions to meet its own commitments. In recent years, part of the reserve surplus has also been directed to the financing of the Bank' s two affiliates, IFC and IDA.(66)

The Bank also increases its resources by cashing various remittances which are due to it as a result of its lending contracts. The institution is free to fix for itself the interest it charges on its loans as prescribed by the Articles.(67) Since the Bank borrows heavily from private lenders, its interest rates are accordingly closely linked to those available on the market place. Although the Bank is in principle allowed to borrow only in order to lend it can, however, invest its resources if they are not being used, and generate extra funds for its reserve. As a lending agency, the Bank has to develop a special relationship with both its lenders and borrowers.

To the lenders, the Bank must provide certain basic guarantees such as a return on the loan plus interest. The Bank must also build up a certain credibility and faith to attract private lenders. In recognition of such "Cooperation" the Articles provide the Bank with only a "partial" jurisdictional immunity.(68) In other words, in order to protect the lenders, the Articles have established provisions which enable them to have recourse to municipal courts in order to secure performance by the Bank of its obligations. Broches, who agrees with these rather unusual provisions, maintains that a complete jurisdictional immunity would only "discourage prospective investors in its securities."(69)

To the borrowers, the Bank must ensure that its money is spent efficiently within a healthy economy and get a return in order to pay back its lenders. For that purpose, the Bank is involved with its borrowers in practically all the stages of the project financed by its funds. Unlike a private banker, the Bank does not require from its client a repayment of the loan plus the interest only, but insists through its own method that the money should be spent on pre-agreed arrangements that are always transformed into law in a loan agreement and, as such, legally binding the borrower to the institution.(See infra at 77 et ss).

Since the beginning of its operations, the Bank has not had any losses on loans. It has never had to write off of a loan. It has never had a non accruing loan. It has, *per contra*, a firm policy against rescheduling its outstanding loans. Because of such financial discipline, the Bank claims that, so far, no member has defaulted, and that borrowers always meet their obligations to the institution in a timely fashion. However, in most situations, compliance with the loan agreement is not so much the borrower's faithfulness to its contractual obligations, but rather his fears of the implications of defaulting on the Bank's loan. A default to the Bank carries serious consequences that would affect the international credit of the country involved both with other countries and with commercial suppliers of resources.(70) Borrowers know that these resources will no longer be available to them should their relationship with the Bank deteriorate. As E. Rotberg clearly explained:

> There are substantial pragmatic reasons why borrowers do not default on World Bank loans. In the event of a default, no further disbursement would be made on that loan or any other loan outstanding but not yet disbursed to the country. And, no new loans would be committed until the default had been made up. Borrowers know our policies in this regard, and given the substantial amount

> of the Banks undisbursed loans, they would be extremely reluctant to take steps to jeopardize the transfer of future resources.(71)

C- Others Peripheral Functions.

Besides its financial functions *per se*, the Bank is also engaged in other parallel non financial activities which are rather unusual in conventional banking practice. In view of the importance of such extra activities and their implications on the overall functioning of the Bank, it is useful to describe some of these peripheral activities.

a)- Technical Assistance.

It is largely a futile exercise to scrutinise the Articles of Agreement of the Bank to discover even a single provision which suggests that technical assistance should become a part of the institution's functions.(72) The constitutional provisions upon which the Bank has justified its technical assistance is Article III section 4 (v) which directs the Bank to:

> ...pay due regard to the prospect that the borrower and the guarantor will be in a position to meet its obligations under the loan and the Bank shall act prudently in the interest both of the particular member in whose territories the project is located and of the members as a whole.

As the location of this Article suggests, the spirit of the provision is nothing more than a warning that the lending institution must exercise financial prudence when granting a loan. Stretched a little further, the Article may indicate that the lender has a right to investigate the borrower's capacity to carry out his prospective obligation under the terms of the loan.(73)

According to the Bank's own definition, technical assistance is any service provided by the Bank "unrelated to any immediate request for financing."[74] Initially, such services were limited to general development surveys of economic potentialities, and to specific programme surveys in order to assist a country formulating long term development programmes. Eventually, such a definition gave way to further expansion until it included activities such as the promotion of coordination among aid giving countries and training of officials of aid receiving countries. Barely a few months after the Bank began operations, it started giving technical assistance to some members. The policy was promptly endorsed by a committee of the Board of Governors which justified its decision on the ground that:

> The extent of the Bank's activities cannot be measured simply by the number or amount of its loans. Experience has shown that particularly in the development field, the Bank can act with full effectiveness only if in addition to passing upon the merits of loan applications presented to it, the Bank takes positive steps to assist its member countries in outlining the general pattern of their development programmes, in specifying the field of activities which would be given priority, and in formulating the specific projects within those fields.[75]

The third Annual Report of the Bank was even more precise, and indicated that: "successful development depends in most cases just as much upon the provision of technical assistance ...as upon the availability of capital."[76] Through the years the Bank has developed four main types of technical assistance. Briefly these are:

- Technical assistance incorporated in the loan agreement:

This kind of assistance is generally connected with a specific loan. The most frequent one is the inclusion in the loan agreement of special funds for the employment of foreign consultants to help launch the project. The loan may also include funds to help the borrower select appropriate equipment and prepare tenders for international bidding.

• Independent technical assistance:

This kind of technical assistance is normally related to any immediate development project. Examples of such assistance include extra funds for a ministry of a member country to improve its overall functioning, or expand its activities.

• Technical assistance related to preinvestment.

This type of assistance is provided for the purpose of preparing country development programmes, establishing development priorities,training nationals of the borrower to administer and prepare projects that are connected with external financing.

• UNDP financed preinvestment studies:

The Bank provides also a large amount of technical assistance by administering feasibility studies financed by the UN Development Programme (UNDP). By mid 1991, the Bank has acted as executing agent for 12 projects financed by various UN organisations.(77) In most cases, however, the Bank makes use of private consultancy firms or cooperates with governmental agencies when available in member countries. In sum, the speed at which the Bank developed and continuously improved these peripheral activities show, to some extent, the institution's intention to secure a much deeper and wider scope of intervention in the LDCs. For, by providing funds alone, the Bank's leverage will be somehow limited, in the sense that less access into the borrower's economy will be available. Yet, publicly, the Bank argues that its technical assistance is as essential as money for the institution to pursue its objectives as a development agency.

III- The Bank as a Development Agency.

The original drafters of the Bank refer to the institution as a Bank for Reconstruction and Development. This duality of function led to prolonged controversies between the participants in finding the proper balance between reconstruction and development. The issue divided the European delegates, who favoured the reconstruction of their war damaged countries, and the poor nations, who were more interested in enhancing their backward economies by development.(78) The issue of equilibrium was further complicated by the silent attitude of the Bank's Articles, as Mason et al remarked:

> The Articles of Agreement which would have normally statuated on the issues of priorities between reconstruction and development have left the question entirely to the discretion of the Bank. (79)

As a matter of interest, it may be worth looking at how the Bank in practice resolved the issue of the dichotomy by looking first into the early involvement of the institution into the field of reconstruction, and how it dealt with it, before considering the second and present function of the Bank in the field of development.

A- The Structure Produced at Bretton Woods:

It is the opinion of all writers that the delegates at Bretton Woods vastly underestimated the urgent need for a development agency.(80) Instead, they were more concerned by the recovery of war torn Europe. "From the outset", wrote Gerald, M. Meier, "it was apparent that issues of development were not to be on the Bretton Woods agenda."(81) Among the 44 delegates present, some less developing countries were invited but the real power lay with the United States and, to a lesser extent, the United Kingdom. The LDCs presence was felt unnecessary and somewhat cumbersome as Lord Keynes cynically observed:

> Twenty one countries have been invited, which clearly have nothing to contribute and will merely encumber the ground."(82)

The LDCs, whose preoccupations were different, naturally emphasised the need for development as the main task in terms of priority of the Bank's objectives. At the Bretton Woods conference, the Latin American nations insisted that the stated objectives of the Bank include an explicit commitment to development. They pointed out that " the task of reconstruction is only a temporary one and that most of the Bank's effort should be vested in the long term development."(83) The case for an accelerated role for development was vigorously defended by the Mexican delegation which called on the Bank to allocate a substantial portion of its funds for development purposes. The Mexican statement contended that:

> In the very short run, perhaps reconstruction will be more urgent for the world as a whole, but in the long run ... development must prevail. Without denying the initial importance of reconstruction, we ask you (the Chairman) not to relegate or postpone development.... If we tackle our own wide domestic problems, and for that we require sums of capital we do not dispose of at home, we will undoubtedly benefit not only ourselves, but the world as a whole, and particularly the industrial nations, in that we shall provide better markets for them and better customers. We submit therefore that capital for development purposes in our countries is as important for the world as is capital for reconstruction purposes."(84)

This was categorically rejected by the Chairman Lord Keynes as he said "we cannot accept the resources should be divided *equally* between reconstruction and development, but I am sure the word *equitably* would do."(85) (italics added). The result was the insertion of the phrase in an Article of the Bank's Charter that:

> The resources and the facilities of the Bank shall be used exclusively for the benefit of members with equitable consideration to projects for development and projects for reconstruction alike. (Art. III sec. 1)

But this was in blatant contradiction with the earlier Article 1 setting the purpose of the Bank in the following terms: "To assist in the *reconstruction* and *development* of territories members" (italics added). Article I clearly states the dual purpose but fails to indicate an order of priority. However, several authors have argued that as reconstruction is mentioned first, this may indicate that the drafters intentions were inclined more towards reconstruction than development. Thus, the provisions of Article I would have eventually settled the question of priorities had it not been the provisions of Article III, section 1. A brief comparison of Article I and Article III reveals profound contradictions that make the issue of priorities even more confusing.

First, there is a serious disparity in the actual phrasing of both Articles in relation to the exact position of the words reconstruction and development. In Article I, reconstruction comes first, followed by development. In Article III (1), it is development which is first mentioned with reconstruction relegated to the second position. Therefore, authors who have based the priority of the Bank's objectives on the premises of Article I, will have to look for further indications to support their assumptions. This is what Mason et all did when they took the view that it was the task of reconstruction that dominates the Bank's purpose.(86) The authors focus on the Bank's special duty to lighten the financial burden for countries that suffered great devastation from enemy occupation. This is particularly true when considering Article I which refers to "The restoration of economies destroyed or disrupted by war." Similarly, Article III shows the same affection and compassion for devastated Europe. It recalls in section 1 that the resources of the Bank shall be:

> for the purpose of facilitating the restoration and reconstruction of the economy of members whose metropolitan territories have suffered great devastation from enemy occupation or hostility.

The novelty brought by the inclusion of the word 'equitably' in Article III section

1, does not solve the problem of priority either. In a juridical sense, the term equitable comes from equity which means, amongst other things, impartiality, fair conduct. In the context of the Bank, it means that in its lending operations, the institution will give the same treatment to both projects for reconstruction and development. In other words, the Bank will not necessarily provide more finances for one type of project than to the other. This does not mean, however, providing an equal treatment for both types of projects as some LDCs have wished. Nor, and more importantly, does it indicate clearly the Bank's position in terms of priorities. For, to treat equitably is one thing, and to treat equally is another.

The question of priorities saw an end only when the Bank opened for business as the first loans found their way to Europe. Between 9th May and 21st August 1947, four European countries devastated by the war (France, the Netherlands, Denmark, and Luxemburg) received altogether the sum of $ 450 million. The four loans appear in the Bank's records as reconstruction projects.(87) The prevalence of reconstruction over development can only be explained by the international economic relations that prevailed at the end of World War II, and they should be evaluated in terms of economic recovery for Europe and also in terms of economic expansionism for the United States. As Secretary of the Treasury, H. Horgan explained :

> The reconstruction of the devastated countries of Europe and Asia is essential if normal trade relations are to be resumed promptly. The countries are vitally important to the export and import trade of the Western hemisphere.(88)

Economically, a revitalised Europe serves the American interests domestically as well as internationally. On the domestic front, the U.S. emerged as the major nation with the financial ability to engage in post war investment overseas with Europe as the ideal recipient market for most American products (machinery, equipment, and raw materials). Furthermore, a prosperous Europe was a *sine qua non* for the enhancement of the world economy, in which the United States would play a determinant role. As Bittermann remarked, "domestic and international (U.S.) objectives coincided." (89) Shortly after the Bank engaged in its scheduled programme for Europe, it appeared to the Americans that:

> The sources needed for the reconstruction costs were not likely to be obtainable neither in sufficient quantity nor in time to speed up the recovery of Europe.(90)

This motivated the American Secretary of State G.C. Marshall to step in and announce a major financial rescue operation (known as the Marshall Plan), for the European continent. (91) Beside the economic miracles of bringing Europe back on its feet,the Marshall Plan was also ideologically essential for the Americans which feared that "without it, the existing Western governments might have capitulated to local communist movements."(92) Besides, the Plan remains in the annals of financial aid, one of the best examples of transfer of resources without strings or pre-conditions attached to it. This partnership between the USA and Europe was first proposed by George Marshall himself in a speech at Harvard University in June 1947:

> It is logical that the USA should do whatever it is able to do to assist in the return of normal economic health in the world, without which there can be no political stability and no assured peace....It is already evident that before the US government can proceed much further in its efforts to alleviate the situation and help start the European World on the way to recovery, there must be some agreements among the countries of Europe as to the requirements of the situation, and the part those countries themselves will take in order to give proper effect to whatever action might be undertaken by this government. It would be neither fitting nor efficacious for this government to undertake to draw up unilaterally a program designed to place Europe on its feet

> economically. This is the business of Europeans. The initiative, I think must come from Europe. The role of this country should consist of friendly aid in the drafting of a European program and a later support for such a program so far as it may be practical for us to do. The program should be a joint one, agreed to by a number of, if not by all European nations.(93)

The huge amount of capital injected by the Marshall Plan into the Continent literally upset the chess board of the Bank's finance and ultimately led the institution to withdraw discreetly from the reconstruction field into development. It is to such a change of priorities that the next section will be devoted.

B- From Reconstruction to Development.

The passage from the field of reconstruction to that of development was officially acknowledged by outgoing President McCloy (1947) when he said: "The reconstruction phase of the Bank's activity is largely over and the development phase is underway."(94) As the Bank entered into the "new field" of development, it faced two problems: the structure of the Articles of Agreement and the insufficiency of funds. As to the first, G Meier wrote:

> When the Bank began the transition from reconstruction to development financing, it found that its operating guidelines were not as explicit as they had been regarding reconstruction and other activities.(95)

This is true and may be a relevant argument to back the point discussed earlier that the Bank was more concerned with reconstruction than development. In their original form, the Articles pay little attention to the issue of development. There is no comparable drive towards economically backward countries of the southern hemisphere. No appropriate terminology such as fighting poverty, eliminating endemic diseases or illiteracy existed, despite the fact that, as in war-damaged Europe, it was reality. On the moral side, the case for development was even more justified since Europe's destruction was man made whereas most of LDC misfortunes are due to natural calamities such as drought, flooding, earthquakes, in addition to colonialism. The vacuum thus created by the Articles was also admitted in a staff paper which said:

> Once the Bank moved from reconstruction into development lending, the guidelines of the Articles were only the beginning of the path in to new territories.(96)

Since the third Annual Report (1949), expressions such as " the World Bank is learning through experience" became common in the institution's language; a sign that the Articles were (and still are) not interested to regulate statutorily one of the Bank's legal objectives. More importantly, however, the imprecision and vagueness of the Bank's Articles helped greatly in the shaping of an institution which derives most of its work through a certain methodology developed in its most salient features outside the existing legal framework.(97)

As to the second issue relating to the insufficiency of the funds, the Bank seemingly had no other alternative but to content itself with what it could raise in the market with all the implications discussed earlier. The question of development was looked at in relation to the resources available, not as a human need motivated by other considerations than economic factors. Unlike in the reconstruction phase of the Bank, the idea of a second Marshall Plan -this time for development- seems never to have been envisaged.(98) This left the Bank entirely dependent on aleatory and limited resources to finance the development of more than half of the population of the globe. Under such conditions, it may be only legitimate to ask what kind of development -if any - the Bank has in mind.

a)- The Bank 's Conception of Development.

The lack of any clear commitment in the Articles of Agreement to development, coupled with the rapid change in the overall structure of the International community, explains to a large extent the uncertainties of the Bank in the field of development. Although it may be said that "the Bank has no fixed ideology for development", it is still possible, with some simplification to trace the evolution of the institution's conception of development.(99)

(i)- Early Period.

There are at least three levels at which the conception of the Bank on development can be asserted. The first level is the 'abstract' notion of the development phenomenon. In this context, development is conceived on merely economic grounds, as an economic overdue. According to this view, development can be cured basically by economic formulae such as the injection of financial aid or a reinforcement of private investment. As C. Payer remarked: "An emphasis on GNP growth was the primary if not the only definition of development."(100)

The second level is the general framework in which such a development is carried out, which even in the absence of a formal endorsement of a specific development theory contained the grand lines of a certain liberalism that is easy to foresee. When, for example, the Bank intervenes only as a lender of last resort, it is indirectly throwing the LDCs into the hands of private bankers of Europe and America. More importantly, however, are the underlying principles which are contained in the Articles of Agreement such as the Bank's promotion of private investment, the introduction of the rules of competition, the preference for the private sector. In other words, all the activities which constitute the very nature of the capitalist philosophy seem to have been espoused by the Bank within its conception of development. As J. Touscoz wrote:

> La Banque Mondiale est fondamentalement et par nature au service des principes de l'economie de marche quels que soient l'esprit inventif de ses dirigeants et la souplesse de ses statuts, elle ne saurait abandonner ses principes sans renier sa raison d'etre...Elle tend manifestement faire prevaloir une conception capitaliste du developpement.(101)

The third level is related to the so called 'neutrality' of the Bank in its development policy. The Bank, to some extent, does not investigate whom the development project is likely to benefit. For the Bank it seems to be a simple mathematical exercise. As long as the project is justified and financially sound, the loan is almost automatically granted. It was not the Bank's business to know what was happening in the African and Asian continents as a result of war and/or colonialism. As is known, the Bank is apolitical. And that was sufficient for the Bank to extend its lending operations to colonial powers for use in their respective colonies, as discussed earlier. Needless to say, most of the time these projects yield more benefit to the metropolis than to the indigenous populations. As Khadidja Haq remarked: "The Bank seems to have been more preoccupied by the development of Europe-at any cost- than the needy World."(102)

This brief sketch of the Bank's early conception of development may be summarised as follows: To begin with, the Bank has been considerably influenced by the capitalist approaches to development that prevailed at that time; from which the GNP growth theory was selected and applied. Furthermore, there is in the Bank's Articles certain statutory limitations which have unduly forced the Bank to consider almost exclusively only specific projects (Art.III,sec, 4 (vii)). That is to say, projects which were self supporting and would pay back the loans, e.g. infrastructure projects such as roads, highways, ports and airports and energy.

Last, but not least, the Bank has quite frequently neglected the social aspect of its projects. It was more preoccupied by the financial return of the loan than its impact on the welfare of individuals and society alike.

(ii)- Later Development:

The decolonisation era that followed the 1960's saw a massive influx of newly independent states into the Bank. The vast majority of these countries (except OPEC) were among the most financially deprived and the least able to sustain their own development.(103) This had a tremendous impact on every aspect of the Bank. Compared to the early period, the Bank underwent two major transformations in its attempt to shape its own development policy: one doctrinal, the other political (ideological).

By doctrinal change is meant the Bank's shift from the GNP theory to the adoption of a new theory more suitable and more responsive to the needs of its new member. Explaining the sudden shift in the Bank's developmental theory, Bettina S. Hurni wrote:

> Its [Bank's] development policy changed in the 1970's after the recognition that economic growth had failed to bring benefits to the majority of the poor.(104)

The Bank may have thus shifted from one type of development to another. However, in terms of law and legal explanations and references to the constitutional bases for action, its framework has remained largely unchanged. Among the noticeable changes made in the direction of its new members, the Bank has introduced major reorganisation plans to accommodate them.(105) These plans include:

- More geographical representation in the Bank.
- Diversification of staff nationalities.
- Increase in the lending programmes.

It has also extended its lending programme to new sectors such as agriculture, energy, health, education and even tourism.[106] In other words, many of the projects which were considered in the early period as non self-supporting projects, *viz.* which do not directly generate capital, became progressively integrated into the lending policy of the Bank. The style of the Bank as well as its language have also changed.[107] President McNamara speeches include slogans such as 'attacking poverty' leading 'the green revolution' (agriculture) and improving social conditions for the poor. The Bank's publications have carried out extensive research on specific remote areas where under-development is particularly severe such as in South East Asia and the Sub-Saharan countries in general. It appears, at least on the surface, that the Bank has become more aware of the social problems of the developing countries than in the past.[108] However, being aware of the problems may provide only a partial solution, if the instruments envisaged to carry out such changes do not exist, or, as in the case of the Bank, are inappropriate.

Of particular importance to the Bank's conception of development is its ideological stance which has remained unchanged ever since the institution was created. On the contrary, it may be safely said that the Bank has in effect worked even more towards the strengthening of its capitalist orientation with more emphasis on competition, liberalisation, privatisation and so forth. In pushing for such a radical policy, the Bank knows that it is moving safely in an area where neither the recent large scale influx of newly independent countries, nor their political vigilance will have any significant effect. As already discussed, the Bank depends on its fund-raising activities on the political principles, moods and prejudices of it investors who, by lending to the institution, engage both their money and their philosophy. This is an equation which is not always compatible with the borrowing LDCs. Broadly speaking, it seems that there is a serious time-lag between development in the Bank's conservative policy and the radical version (or vision) of the Third World notion of development.

b)- The LDCs Conception of Development.

Upon their accession to independence, the LDCs have, among other things, fashioned a certain idea of the concept of development. Such a view was not always compatible with the Bank's own interpretation of development, and clashes were inevitable.(109) One factor which contributed to the diversion between the Bank's and the LDCs' view of development is the existing legal framework; that is to say the Articles of Agreement. As already stated, the Articles did not foresee development as the most pressing or major priority of the Bank. For the drafters it was a new area in which the institution had no experience. Like self determination and co-existence, development is one of the new emerging concepts brought into contemporary society by the sudden and rapid changes that have occurred within the international community. Furthermore, states have, until now, been unable to agree on its definition, as well as its meaning and scope of application.(110)

For the developed world, the idea of development is first a matter of internal policy with little or no connection with the outside world and economic relations. It is up to individual states to carry out the burden of the welfare of their people. In the sphere of law, the DCs have raised doubts as to whether development should be included at all in the legal literature.(111)

For the Third World countries, the notion of development derives from two distinct and complementary factors. One is the historical responsibility for the DCs of the present state of underdevelopment of the LDCs. Thus, practically all the Third World demands formulated in various resolutions and other international documents take as a basis this historical element.(112) From this, the LDCs have developed the idea that in order to repair this past misfortune, the rich countries must assist in the recovery of the Third Word economies. In other words, the DCs have the moral duty, and this is the second element, to participate in the development of the LDC countries.

To this moral duty the Third World countries opposed for them a right to development and ask the DCs to recognise such a right.(113) It follows from that, that the concept of development has economic as well as legal and political connotations. In the Third World's view, development is not forcibly about economic welfare only. It cannot either be measured in terms of GNP growth, the number of schools, hospitals or rate of inflation. The concept of development goes beyond these purely materialistic considerations to cover a much wider area such as culture, democracy and political independence. As Brigitte Stern put it: "Developpement, c'est mettre l'homme debout."(114)

Furthermore, disagreement between the Bank and its less developed members in reaching a common approach to development is aggravated by the institution's structure which has been designed for a specific type of development, inspired by a capitalistic oriented ideology which is not compatible with the LDCs' view. In terms of law, this contradiction is reflected in the maintenance of rules of conduct in the Articles which do not always fit in with the emerging principles that the Third World countries strive to promote.

As far as the Bank is concerned, the LDCs would have preferred an institution which would have ideally lent funds to them without conditions; or at least on smoother conditions than the existing ones. They see in the present Bank's loans a kind of purely business like operation, whereas they expected the Bank to be a "humanitarian" agency which would not only provide unconditional but also unlimited funds to help them eradicate poverty and overcome their general state of economic backwardness.(115) For the Bank, on the contrary, its lending is a purely commercial enterprise which is guided by the principles of liberal philosophy which puts profit before morality or humanism. As E. Rotberg pointed out:

> We are not a social agency committed to making transfer
> payments to solve the problems of misery or poverty.

> We are a development bank using the most sophisticated techniques available to facilitate development while providing unmatched protection and strength for creditors and shareholders.(116)

It becomes clear from this statement that the Bank means business and that it remains to be seen how the institution can reconcile its business operations with the development needs and aspirations of its poor member countries.

Conclusion to Chapter One.

In this chapter, it was essential to state the conditions in which the Bank was set up, and the kind of relationship it has developed with its members. The first conclusion to be drawn from this concise overview, is that, although conceived initially as an international organisation, the Bank in reality belongs to a minority of industrialised countries, which because of their financial might, exercise a significant influence on the policy of the institution. Could it have been possible for the Bank to avoid such a situation? The answer is no, since the Articles of Agreement were laid down in such a manner as to make Western superiority inevitable. The same Articles were also responsible for the weakened position of the remaining majority of the members which come from the Third World countries. Their weakness was "legalised" through such provisions regarding subscriptions, management and above all voting powers.

The second conclusion to be drawn, is the difference in the interpretation of the objectives of the institution between the Bank and its members. For most LDCs, it appeared that, apart from the name, the Bank has no real connection with the real world of development. They expected and hoped for a genuine aid giving agency that would help them overcome their socio-economic problems in a different way than the one imposed on them. For the Bank, there seems to be no difference between development and business as far as the institution's functioning and operation are concerned.

McNamara's rhetorics in the early 1970's did not alter the course of the Bank's, which remained as ever, an agency committed to working on commercial basis. McNamara's view on "humanising" the Bank lacked the support of the international financial community, which is the main funds supplier and whose objectives do not coincide with the development objectives of the LDCs.

By possessing the money, the Western world extended *de facto* its authority on the structure, functioning and policy of the Bank. For the vast majority of non Western countries, this policy of *le fait accompli* was unacceptable since it amounted to an "highjacking" of the Bank by a minority of privileged states, and impeded the sacrosanct principle of state equality. In 1945, few countries refused to join the Bank because they did not agree with such a state of things; but for a large number of the Third World countries, they had no other alternative but to "surrender".

It is against this background of conflicting interest and objectives, that the Bank opened for business. How the institution will deal with its borrowing members, will be the purpose of the next chapter.

Notes to Chapter One

1 David E. Lilienthal, The Harvest Year`s 1959-1963 dated June 20,1963 Vol V of the Journals of David E. Lilienthal, 1971, at 480.

2 Eugene H. Rotberg, The World Bank: A Financial Appraisal, in 13, Fin & Dev, Sept.1976, at 14.

3 Bettina, S. Hurni, The Lending Policy of The World Bank in The 1970's: Analysis And Evaluation, Boulder, Colorado, (1980), at 99. Another definition of the Bank is given by John L. Taylor who sees the Bank as " a multilateral financial cooperative of its member countries". See, J. Taylor, "A Lawyer's View of Development in World Bank co-financing with private Banks", in David G. Pierce et all (eds.), Current Issues of International Financial Law. Butterworths, London (1985), at 415-48.

4 Two relatively old but still authoritative studies of the World Bank from a legal point of view are: H.T., Adam, "Les accords de prets de la Banque Internationale de Developpement et de Reconstruction",in 55 RGDIP, 1951, at 41-72; and A Broches, "International Legal Aspects of the Operations of the World Bank", RCADI 1959, at 300-408.

5 Edwards S. Mason and Robert E. Asher, The World Bank Since Bretton Woods, The Brookings Institution, Washington DC. (1973), at 457.

6 On the origins of the World Bank, Mason et all remains a leading authority. However, the editing department of the World Bank has announced recently a new history of the Bank which will be published by the Brookings Institution. The book is expected to be out in time for the 50th anniversary of the Bretton Woods conference (1944-1994). Equally valuable reading is J. Hopkins, The International Bank for Reconstruction and Development. 1946-1953, Washington DC. (1954); R.W. Oliver, Early Plans For a World Bank, Princeton's Studies in International Finance, No 29, (1971).

7 IBRD/IDA, Questions And Answers, Washington DC.,1976, at 4. For a comprehensive analysis, see J. Gold, Membership And Non Membership in The International Monetary Fund: A Study in International Law And Organisations, IMF, Washington DC, (1974).

8 Henry J. Bittermann, "Negotiations of the Articles of Agreement of the International Bank for Reconstruction and Development", in 5, International Lawyer, January 1971, at 72.

9 Supra note 5, at 19.

10 L., Perinbam, "The World Bank and the United Nations", in 4 Fin. & Dev., 1966, at 293.

11 For example, although South Korea was not a member of the UN until 1991, it joined the Bank in 1965. Its capital, Seoul, was the venue of the 1985 WB/IMF Annual meeting.

12 For an exclusive list, see the UN Treaty Series where all the Bank's loan agreements with the member countries are recorded.

13 UNGA Resolution 1514 (XV) 1960. Reproduced in P. Mathurika (ed), The International Law of Development, Basic Documents, Oceana Publications, New York (1978-), Vol. 1, at 517.

14 In UNCTAD, for example, members are divided into three distinct groupings: **A**: the Less Developing countries, **B**: the Developed countries and **C**: the Socialist countries. Almost the same division is found in FAO.

15 A. Bretaudeau, La Banque Mondiale., Collection. "Que sais-je?" PUF Paris, (1986), at 47-48; also, Questions and Answers, supra note 7, at 12.

16 For a discussion on country graduation, see F. Isaiah, "The Graduation Issue for the Developing Countries", in 13 JWTL, 1979, at 289-302.

17 This point is discussed in more detail in supra note 2, at 9-13.

18 The Economist, April, 1985, at 13.

19 Category **A** totals presently 22 members; **B:** 85 members and **C:** 44 members (compiled from The World Bank Annual Report, 1991).

20 From personal interview (Washington DC. April, 1987).

21 On the principle of implied powers, see C., Archer, International Organisations,

Allen & Unwin, London (1983), at 132. The principle is also discussed in The Reparations Case. ICJ Reports, 1949, at 174.

22 IBRD/IDA in Retrospective, IBRD Publications, Washington DC, 1974.

23 World Bank and International Finance Corporation, IBRD Publications, Washington DC., April, 1986, at 8.

24 Supra note 5, at 29.

25 Questions and Answers, supra note 7, at 7.

26 The Bank's stance on politics has been and still is fertile ground for the institution's critics. See especially A. Baldwin, "The International Bank in Political Perspective", in 18, World Politics Oct. 1965, at 68-87.

27 R. Gardner, Sterling Dollar Diplomacy, Mc Crawhill Books Cie. London (1969), at 257.

28 Supra note 5 at 35.
In the Bretton Woods Agreement Act, for example, it is specifically stated that the US governor (in the Bank) shall not vote any amendment of the Bank's Statutes without congressional authorisation. See A. Broches and P. Sella, "The International Bank for Reconstruction and Development", in Rubin, J. Seymour (ed), Foreign Development Lending: Legal Aspects. (Papers and proceedings of a conference of legal Advisers of national and international lending assistance agencies), Oceana Pub'l Inc. New York (1971), at 337 (hereinafter cited as Rubin).

29 *Cf.* Bretton Woods Agreement Act. (US Congress, 1945).

30 Questions and Answers, supra note 7, at 6.

31 In his memorandum, Lord Keynes relates his discussion with Secretary of the Treasury Fred, Vinson. He wrote:
"Vinson told me that the American delegation had decided that both institutions should be placed in Washington and that was a final decision the merits of which they were not prepared to discuss. The US Administration, he said, was entitled to decide for themselves what location within the US was to be preferred." (*emphasis added*). Reported in Mason et al, supra note 5, at 37.

32 Up to the present time, there has been an informal understanding among governments that the Bank's President should be an American and the Managing Director of the IMF a European. Supra note 7, at 6. Acording to the Italian newspaper, Il Sore 24-Ore, dated 08/04/1987, the election of the Fund's President is largely determined by US interests:

"It was thanks to the US influence that Michael Camdessus was elected to lead the Fund over Onno Ruding, who was known to disapprove of US fiscal policy. Thus, Camdessus will remain tied to the US strategy, following whatever James Baker leads."

33 In addition to the NAC, there is another equally important US institution called The Committee on Banking and Currency (CBC) which is also concerned with the Bank's business. Whereas the NAC is linked to the Congress, the CBC is linked to the Senate.

34 See supra note 29. A discussion of the Bretton Woods Agreement Act is in Rubin, supra note 28, at 333 et ss.

35 Supra note 29.

36 In his 1965 study, Escott Reid stressed the need to "internationalise" the Bank and pointed out that:

"While the professional staff is drawn from 45 countries, half of the top Officers of the Bank are citizens of the US and almost none comes from underdeveloped countries". E. Reid, Strengthening the World Bank. Adlai Stevenson Institute, Chicago, (1973). Although the situation may have changed, the Bank still remains Western dominated as far as the personnel is concerned. This is due to the fact that the staff is recruited by the Bank, and not on a government quota basis.

37 Supra note 8, at 83.

38 The non participation of the Soviet block is discussed at length in Escott Reid, supra note 36, at 171-192. He said:

"In consequence, the World Bank is not now a World Bank; it is a bank for two thirds of the world, mostly the non-communist two thirds of the world".

39 The question of the Bank's universality has been explored by some international lawyers like H. G. Petersmann who tried to cast some doubts on the real character of the Bank. For the author:

"were it not the absence of the Soviet Union and some of her client states, the Bank could be called a truly universal institution" see, H. G. Petersmann: The Operations of the World Bank and the Evolution of its Constitutional Functions since Bretton Woods 1944 - 1984, in 26, GYBIL. 1984 , at 15-17.

40 See, C. Hoon Mok, Decision-Making in the IBRD and the ILO: A Comparative Analysis of the Rules and Practices. Ph.D dissertation in International Relations presented to the Faculty of the Graduate School of Arts and Sciences of the University of Pennsylvania (USA), June 1970, at 257.

41 For a description of the internal structure of the Bank, see, A. Cairncross, The International Bank for Reconstruction and Development, Essays in International Finance No 3, Princeton University, New Jersey, (1970)

42 A detailed list of appointed and elected Executive Directors and their Alternates appears regularly in the World Bank Annual Report.

43 The records of the Bank are often linked to the competency of the President in office. See the Financial Times, (FT) 9/10/1985, at 7, FT. 26 /9/1986, at 5; and FT. 30 /3/1987, at 5.

44 J. Krantz, "La Prise de Decision dans les Organisations Internationales et le Nouvel Ordre Economic International", in 20 Archiv des Volkerrechts 1982, at 281-300. See also J. Kolasa, One State, One Vote Rule in International Universal Organisations, in 6, PYBIL, 1974, at 215-243.

45 Supra note 40, at 260.

46 On the issue of voting in international organisations, see particulary,C.W. Jenks, Unanimity, the Veto, Weighted Voting. in, Cambridge Essays in International Law Essays in Honour of Lord McNair, Stevens, London, (1965), at (48-63); J. Gold, "Weighted Voting", 68, AJIL ,1974, at 687-708, and S. Zamora, "Voting in International Economic Agencies", 74, AJIL, 1980, 566-608.

47 J. Gold, Legal and Institutional Aspects of the International Monetary System, Selected Essays, Washington, IMF, (1979-1984), Vol. II at 403. In Schewers' view," weighting voting has the important psychological disadvantage of making the persons operating within a particular organ unequal". Schwebel, *op. cit.*, at 683

48 See J. Kolasa, <u>supra</u> note 44, at 283.

49 The US has been outvoted in a few instances in 1971 and 1972 as they tried to block two loans to Bolivia and Guyana. The US voted against the loans because these two countries expropriated property in which US nationals held significant interests. See, <u>World Bank Annual Reports</u> 1971-72, at 76.

50 From personal interview with Sir J. Gold, Washington DC. April, 1987 According to J. Gold, "As a rule, votes are not taken unless members are fairly certain that the outcome of a vote will not create a severe confrontation".

51 A. Fatouros, <u>The Impact of International Organisations of Legal And Institutional Change of the Developing Countries,</u> International Legal Centre, New York (1977), at 14.

52 <u>Supra</u> note 5, at 11-13.

53 Extract from The Report of Commission II (International Bank for Reconstruction and Development) to the Executive Plenary Session (United Nations Monetary and Financial Conference), July 21, 1944.

54 R. Lavalle, <u>La Banque Mondiale et ses Filiales Aspects juridiques et Fontionnement,</u> LGDJ, Paris (1974), at 39

55 For a complete financial analysis of the World Bank, see E. H. Rotberg, The World Bank, a Financial Appraisal, <u>IBRD Pamphlets</u> Washington DC. January (1981).

56 Unlike the World Bank, the Fund has no subscribed but unpaid capital to guarantee its borrowings. The entire subscription of each member must be paid on admission. For a comparison between the Bank's and the Fund's capital structure, see Mason et all, <u>supra</u> note 5, especially in chapt. V.

57 Until 1959, the paid in capital was 20% This portion has been since diminished to 10% by a Board of Governors ' decision. For details, see H. G. Petersmann, <u>supra note</u> 39, at 31 et ss.

58 Questions and Answers, <u>supra</u> note 7, at 45.

59 Id.

60 Supra note 55, at 12

61 World Bank Annual Report 1991, at 189 and 74.

62 Supra note 51, at 12.

63 Supra note 5, at 460.

64 Reported in Mason et al supra note 5, at 38. The authors however sustain another view. For them,"The Fund and the Bank are not business institutions in the ordinary sense"

65 An interesting comparison between private lenders and the World Bank is in Baldwin, supra note 26, at 77.

66 Supra note, 55 at 13.

67 Article IV section 4.

68 Article VII in toto.

69 Quoted in Rubin, supra note 28, at 309.

70 Supra note 55, at 11.

71 See for example how the Sierra Leone government tried to avoid being in default with the Bank. The Guardian, 2 Feb,1986, at 22.

72 However, see, supra note 5, in chapter V.

73 For a discussion from a legal standpoint of the Bank's technical assistance activities, see R. Lavalle, supra note 54, at 240-247; also, World Bank Annual Report, 1971, at 61-67.

74 Quoted in C. Hoon Mok, supra note 40, at 92.

75 World Bank Annual Report, 1948, at 11.

76 World Bank Annual Report 1949, at 79.

77 See <u>supra</u> note 5, in Chapter XX.

78 The concept of development as understood in the Third World countries is better developed among the French and francophone lawyers than their Anglo-Saxon counterparts. See A. Pellet, <u>Le Droit International du Development,</u> Collection "Que-sais-je?" PUF, Paris (1986); A. Benachenhou, <u>Developpement et Cooperation,</u> OPU, Alger, (1984); Colloque d'Alger, <u>Droit international et developpement</u>, 0PU, Alger, (1976). In English, see R. B. Seidman, <u>The State, Law and Development</u>, Croom Helm, London (1978).

79 <u>Supra</u> note 5, at 12.

80 Opening the discussion on the Bank, Lord Keynes stated "It is likely my judgement that the field of reconstruction from the consequences of war will mainly occupy the proposed Bank in its early days. But.there is a <u>second primary duty</u> laid upon it, namely to develop the resources and productive capacity of the world with special attention to the less developed countries." Reported in Marvin G. Meier, <u>Emerging From Poverty. The Economics That Matters,</u> London, Oxford University Press, (1984), at 12.

81 Ibid, at 13.

82 Ibid., at 12.
In a completely opposite version, Mason et al, <u>supra</u> note 5, at 104. reported an opponent to the Bretton Woods Agreement as saying:
"We are told that 44 nations agreed [to the Bretton Woods Articles]. I think a more exact statement would be that 3 or 4 groups of very experts chaps got together and wrote a plan, and then took it up with 44 other technicians stating that " this is what the US and GB are willing to stand for with you".

83 This was later acknowledged in a letter from E. M. Bernstein, then the US Treasury, to the Chairman of the Bretton Woods conference:
"Reconstruction should be over in a few years and the Bank needed a more permanent function which should be development.", Reported in G. Meier, <u>supra</u> note 80, at 112.

84 <u>Supra</u> note 80, at 14. See also R. F. Meagher, W., Friedmann and G. Kalamalof, <u>International Financial Aid,</u> New York, Columbia University Press (1966), at 17.

85 <u>Supra</u> note 80, at 9.

86 Supra note 5, at 175 et ss.

87 On the first four loans made by the Bank to the European countries, see Mason et al, supra note 5, at17 - 21. This is how the authors relate the circumstances in which the loan to France was discussed by the Bank staff:
"...When the working party on the 1947 loan to France met, nobody really knew where to begin, what kinds of questions to ask, what sort of investigation to make. Neither the project approach, nor the elements in analysing creditworthiness had been developed. The economic report on France laid its stress not on financial resources or specific export prospects, but on the French "collective will to recover." supra note 5, at 153.

88 See supra note 8, at 24.

89 Supra note 8, at 60.

90 Ibid., at 63.

91 For a complete overview of the Marshall Plan, see J. Gimbez, The Origins of the Marshall Plan, Stanford University Press, California (1976).

92 R. Gardner, supra note 27, at 300.

93 Quoted in R. Fraser, The World Financial System, Longman, UK (1987) The initiative was followed by an European economic conference in Paris, on July, 12-15, 1947. A Franco-British plan for a special All European Organisation to work out and administer the European Recovery Plan (ERP) had been rejected by Vyacheslav Molotov, the USSR Foreign Minister as leading to "interference ...in the affairs of those countries with the greatest need for outside help.", See p.13.

94 Mason et al, supra note 5, at 60. See also R. Chaufournier, The Coming of Age, in 21 Fin. & Dev., 1984, at 7; For the author:
"The institution developed into a technically competent development institution, conservative but flexible, self assured and a trifle arrogant but with a strong *esprit de corps* and pride in its accomplishment."

95 Supra note 80, at 9.

96 Reported in C. Payer, The World Bank: A Critical Analysis, Monthly Review

Press, London, (1982), at 12.

97 To the question asked "do lawyers effectively participate in all stages leading to the conclusion of the loan agreement between the Bank and the borrower"? a senior official in the legal department said: "not really"! (Personal interview).

98 Cf. Late President H. Boumedienne of Algeria speech at the Special Session of the UN General Assembly- May 1974, as he said:
"The Marshall Plan was an excellent but most likely non-reproducible successful example (of economic assistance). Yet, compared to multinational development lending to the Third World, the conditions were radically different.", See also in the same line of thoughts, Barbara Ward, "For a Global Marshall Plan" in K. Haq (ed), Dialogue for a New Order, Pergamon, Oxford, (1980), at 230.

99 For a useful, though uncritical, discussion of the World Bank's conception of development, see John H. Adler, "The World Bank's Concept of Development, an in-house Dogmengeschichte", in J. N. Bhagwati and R. S. Eckaus (eds), Development and Planning, Essays in Honour of Paul Rosentein Rodan, Allen Unwin, London (1972).

100 Supra note 97, at 24.

101 J. Touscoz, "Le Groupe Mondiale face aux exigences du developpement", 6 RBDIP, 1970, at 25.

102 Supra note 98, at 119.

103 Many OPEC countries, namely Saudi Arabia and Kuwait, became major fund suppliers, but also large consumers of the Bank's technical assistance.

104 Bettina S. Hurni, supra note 3, at 104.

105 The latest 1987 Bank reorganisation plan did almost the opposite by cutting staff and reducing many of the Bank departments. See The Financial Times 27/4/1987, at 7.

106 Tourism was introduced in 1969 in the lending policy of the Bank but was withdrawn 10 years later. See, supra note 7, at 17.

107 B. Hurni, "The New Style" Lending Policy of the World Bank, 13, JWTL, 1979, at 522-534.

108 This period of shift in the Bank's lending policy from "hard" to "soft" projects is generally linked to Mc Namara's presidency and rhetoric in "attacking" poverty. See Robert, S. McNamara, Robert, S. McNamara's Years at the World Bank. Major Policy Adresses, 1968-1981, J. Hopkins University Press, Washington, (1981).

109 For two oposite views on the Bank's conception of development, see, A Bertrand, "Development Theory and the Bank Development Own Strategy", in 4 Fin. & Dev., 1977; and Raymond F. Mikesell "The World Bank as an agency for Development", in A. L. Keith Acheson (ed), Bretton Woods Revisited. Evaluation of the International Monetary Fund and the International Bank for Reconstruction and Development, Papers delivered at a conference at Queen's University, Kingston, Canada, Mc Millan. (1972).

110 See, The Hague Academy, Colloquium on "The Right to Development at the International Level", in XI, RCADI, 1978; also, G. Corm, L'Ideologie du Development ou le libre echange au XXeme siecle, Le Monde Diplomatique, Nov. 1979, at 9.

111 K. Ginter, and W. Benedek (eds), New Perspectives and Conceptions of International Law: an Africa-European Dialogue, Springer Wien, New York, (1983).

112 Actes du Colloque International d'Alger, Droit International et Developpement. Oct. 1976, OPU, Algiers (1976).

113 See K. Khan "International Right to Development, Legal Basis and Measures for its Development" in 7, Sciences, Technology and Development, Apr. 1984, at 1; also, M. Bencheikh, Droit International du Sous Developpement, Berger-Levrault/OPU, Paris (1983); M. Flory, Droit International du Developpement, PUF Themis, Paris (1977); and W. Friedman, The Changing Structure of International Law, Stevens, London (1978).

114 B. Stern, Un Nouvel Ordre Economic International ? Vol. I, Economica, Paris (1985), at LXI; also, C. Welch. and I. R. Meltzez (eds), Human Rights and Development in Africa, New York Press, Albany (1984). The book contains a series of articles showing Human Rights as an inherent part of the socio-economic welfare of African society.

115 See R. B. Seidmann, supra note 78, at 12-28.

116 Supra note 55, at 34. Answering an interview, Former Bank President A. W. Clausen echoed the same opinion. He said:
"Help (charity?) starts at home. We are a partner, we do not develop countries. They develop themselves. It's our job to help them". See Margaret, A. Novicki, "Interview with A. W. Clausen", in 30 Africa Report 1985, at 14-20.

CHAPTER TWO

THE CONTRACTUAL RELATIONSHIP BETWEEN THE BANK AND THE BORROWING COUNTRY.

Direct lending to member countries is the major instrument of Bank action. The loan agreement is the main document governing the contractual relationship between the state and the organisation. It lays down the conditions upon which the Bank has agreed to lend and the extent of its financial assistance. The basic legal rules governing the Bank's Loan and Guarantee Agreement, are laid down in Article III and IV of its Articles of Agreement.(1)

In their original form, however, the Articles envisaged a Bank that would act as a guarantee institution by guaranteeing, in whole or in part, loans made by private investors to fulfill the Bank's purpose as stated in Article IV sec. 2a (iii). In practice however, the Bank has used its constitutional capacity to extend guarantees only in a very limited cases, and in 1956 dropped out altogether from the guarantee field.(2) From a purely legal point of view, abandoning the guarantee field was not followed or consolidated by similar action on the legislative front. That is to say that since 1956, the Articles of Agreement have not been amended and the guarantee function remains in principle valid despite the Bank's acknowledgement of its inutility.(3) The Bank normally concludes two types of loan agreements and exceptionally a third type of loan agreement.

• A loan agreement directly with a government or one of its political subdivisions e.g. a ministry, for the construction of a particular project. This is by far the most common and most substantial transaction.

• A second type of agreement is the guarantee agreement which the Bank requests when the loan is made to another entity, whether public or private, situated within the territory of the member country. For example the Bank lends to the Tunisian Mining Corporation and asks for the Tunisian government to support the Corporation's loan by a government guarantee.(4) Compared to a loan agreement, a guarantee agreement is relatively less important and comes only in a second position to ensure that the state, as an international legal person, will give its full economic support in case the national entity is unable to comply with the undertakings laid down in the loan agreement. In terms of law, the guarantee agreement gives the loan agreement an international dimension which enables the Bank to transfer indirectly the national entity's responsibilities to the state which, as a subject of international law, is more conveniently "justiciable" for the Bank.(5)

Exceptionally, the Bank in "special circumstances" lends funds to governments for programme lending.(6) This third type of loan as opposed to project lending consists mainly in the Bank's relief operations in emergency situations such as flood or earthquake. Such loans generally bypass the ritual procedure of the Bank as they do not fall in its traditional lending operations, since they are provided for a non development project.(7) Broadly speaking, these loans are very small in size and number, and have no specific conditions attached to them; although it may be said that the Bank, in collaboration with the recipient country, monitors the use of such loans. Since these loans are the exception, they are not included in the present study.

The request for a loan is made formally either by writing or dispatching a government representative(s) to the Bank's Headquarters to explore the possibility for a loan. However, before a formal loan request is filed, the Bank considers whether the prospective borrower is eligible for Bank's financing, in accordance with the provisions of Article III section 4, which set up the criteria on which the Bank grants loans.

I-Criteria on which the Bank May Make Loans.

Although in theory all members are eligible for Bank assistance (Art III sec. 1a), it does not follow necessarily that membership in the institution gives automatic access to the Bank's funds, nor does it mean that loans may be granted on row or quota basis as is the case in some other agencies.(8) It is the borrowing country which requests the Bank for the financing of a particular project. On the basis of a certain number of criteria laid down in its Articles of Agreement, the Bank studies the borrower's application and decides whether or not the borrower is eligible for Bank's funds.

The main criteria upon which the Bank concludes loan agreements with its developing members are contained in Article III of the Bank's Statutes.(9) Broadly speaking, these criteria are couched in very general provisions and do not define precisely what the institution aims at, nor do they explain how to achieve such aims. Taken together, these criteria seek:

> to ensure that the Bank's loans are made in member countries for financially and economically sound purposes to which these countries have assigned high priority and that the funds lent are utilised as intended.(10)

On the basis of such principles, the Bank has created a whole methodology and lending procedure that has no comparison in any contemporary lending agency. One explanation advanced by the Bank in its early formative years was that these criteria and their further extensive interpretation was necessary:

> to prevent a recurrence of some of the unsound practices characterising international lending in the 19th and early 20th century which led to the great depression of the late 1920's.(11)

This argument provides, however, only a limited guidance for Third World governments which think that "the Bank invokes quite often these provisions in justifying some of its policies of omissions or commissions."(12) For them, the criteria serve as a mere facade for all sorts of actions that the Bank wants to undertake, but has no explicit constitutional power to do so. In such circumstances, they see the Bank's criteria as not only imposing on them constraints but also ensuring a large freedom of action for the Bank's management. As Fatouros remarked:

> In perceiving, defining, and proclaiming its criteria and judgments as technical and non political, the Bank perhaps mainly provides itself with certain defences and assurances of security in order to operate effectively.(13)

To avoid lengthy and repetitive discussions, three among the criteria set up in the Articles and which have been allegedly extended beyond their constitutional limits, will be singled out for more detailed analysis. These are: the creditworthiness requirement, the rule of last lender resort, and the specificity of the project.

A- Creditworthiness.

The requirement of creditworthiness finds its legal legitimacy in the vague and somewhat general language of section 4 of Article III which requires that the Bank:

> shall pay due regard to the prospects that the borrower or... the Guarantor will be in a position to meet its obligations under the loan [and that] it shall act prudently in the interest both of the particular member...and the members as a whole.

One way of being prudent, the Bank thought, was that it was necessary to assess whether or not the prospective borrower was in a position to meet its future financial obligations born out of the loan agreement, without undue strain.(14) In so doing, the Bank undertakes a thorough examination of the country's economic performance involving the study of a variety of indicators for the most part of an economic nature. This is how Eugene H. Rotberg, a Bank official describes what the Bank's financial analysts look at, in evaluating the creditworthiness of a potential borrower:

> The Bank staff examines the country's per capita income, and its potential for the future. It looks at the country's population growth, its savings rates and vehicles through which saving occurs. It examines the country's foreign position, its sources of borrowing, its tax base, and its terms of trade. The staff closely monitors the potential borrower's external debt- its interest and principal requirements for the immediate and forseeble future. It studies the country's reliance on export commodities, whether one or several and prepares the economic analysis required to show how the country's export could be affected by declines in international commodity prices. It examines the country's imports and whether imports could be curtailed in order to conserve the necessary foreign exchange to meet debt obligations. It examines the country's tariff structure, its reliance on food and energy imports, its overall economic health and the relative commitment of resources to productive and unproductive projects".(15)

Despite several efforts to keep creditworthiness within the ambit of economics, the Bank could not in practice avoid overlapping on extraneous factors, mainly political. The impossibility of remaining guided solely by economic considerations was first demonstrated as early as 1949, when the Bank was looking into a loan application from the Chilean government. At that time Chile was heavily indebted and, in many cases, in a defaulting position towards its western creditors. In a statement, the Bank made it clear that Chile had to clear its previous commitments prior to consideration of any Bank's assistance.(16)

The involvement of the Bank in politics became even more visible with the accession of many Third World countries to independence, some of whom engaged in vast programmes of expropriation of local and foreign assets.(17) As most of these assets belonged to western interests, the Bank stood openly against such acts and, on the basis of its "prudent policy", made them a bar to the institution's funds. Thus, expropriations, without arrangements for adequate compensation, was a bar to much Bank lending than otherwise might have been made to Algeria (1964-1973), Indonesia (under Sukarno) and Iraq (mid-60's), to cite only these few examples.(18) Explaining the official attitude of the Bank, Broches wrote in the Egyptian case:

> In the UAR [United Arab Republic], when wholesale expropriations and sequestrations had taken place, and no moves appeared to be made towards a solution, and the governments which felt their nationals had not been fairly dealt with, were some of the major members of the Bank, we considered that for a combination of reasons, we could not proceed with financing in the UAR.(19)

This led the Bank to admit that "creditworthiness is not determined by economic factors alone."(20) And Baldwin to remark: "The Bank has.greatly.diverged from that provision in the Articles of Agreement which specifically forbids consideration of political factors."(21) Despite their economic impact, default and nationalisation are in the first place political acts carried out by sovereign governments. Their insertion in a loan agreement, in addition to being unconstitutional, is inconsistent with the purpose of the loan which adresses issues of development assistance. Furthermore, national, as well as international, law provides various means for states to resolve these and other kinds of disputes which go beyond the scope of this study.(22) The main concern here is whether an international organisation, in the exercise of its functions, may actually be called upon to act on behalf of a portion of its members for the achievement of their "private business interests." This led some of the Bank's critics to qualify the institution as a "debt-collector".[23] Defending the Bank's attitude, Mason et al wrote:

> In order to lend, the Bank itself had to borrow in the market, and how could it borrow on behalf of prospective clients who had failed to pay back existing debts including indemnisation.(24)

Without indulging into a polemic with the noted authors, their logic would have remained unchallenged, had it not been overshadowed by the subsequent and somewhat inconsistent practice of the Bank. For as it appears from a general survey of the Bank's loans, that there are a multitude of countries which have been recognised by the institution as economically bankrupt, therefore uncreditworthy, but nonetheless were granted loans on the ground that these countries have accepted that they would implement the Bank's advice.[25] If the borrower has passed the first test of creditworthiness, then the Bank moves on to consider the second criterion.

B- The Rule of Last Resort Lender

When considering a loan application, the Articles explicitly forbid the Bank to lend to any member unless it is satisfied that the borrower is not able to obtain funds elsewhere under conditions which, in the opinion of the Bank, are reasonable for the borrower. The official interpretation often advanced by the Bank is that it acts only as a last resort lender.[26] That is to say, that the institution must be convinced that the applicant has exhausted all existing sources of finance possible, whether public or private, before soliciting its assistance. One extreme application of such an interpretation may well be that the borrower "should be turned down by every banking house in the world" before going to the Bank.[27] The rationale underlying the last resort clause is that it is a restrictive clause. In the particular case of the Bank, the last lender rule finds a more logical and meaningful interpretation in the context of the Bank's relationship with the private investment market which the institution endeavors to promote. This promotion appears first in Article I section 3 stating in part the purpose of the Bank as follows:

> ... when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital.

Article III. sec.4(ii) is even more explicit in the sense that it makes loan agreements subject to the condition that:

> the Bank is satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions, which in the opinion of the Bank are reasonable for the borrower.

The interesting point which has raised so many questions in the writings of lawyers such as Baldwin, Fatouros, Broches and many others, is the "reasonableness" element. That is to say, the determination of whether reasonable interest could be obtained is determined by the opinion of the Bank alone. In Baldwin's view:

> [S]ince the Articles leave to the Bank's officials to define "reasonable terms"in each specific case, one can hardly accept the proposition that Bank officials are inhibited in this respect.(28)

This is what prompted the Bank's critics to react and establish a link between the Bank and the private financial market.(29) From a political point of view, the core of the debate is the commitment by the Bank not to compete with the private (foreign) market. A commitment which, in the eyes of Third World countries, denotes a certain "complicity" between the Bank and the business community at large. As one Bank official reported:

> [T]he Bank is intended to promote private investment not to compete with it, and does not undertake business which private investors are willing to transact on a reasonable basis.(30)

As a consequence, the Bank has been accused of being prepared to finance only limited branches of the economy of its borrowers, while leaving the others to private capital.(31) This remark leads to the consideration of the third criteria in respect of this chapter.

C- The Specificity of the Project.

The legal basis of this requirement lies in the provision of Article III section 4 (vii), which reads as follows:

> Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of <u>specific projects</u> for reconstruction or development.(emphasis added)

What is meant by specific project has never met a general consensus among either lawyers or politicians.(32) In the Bank's understanding,(33)

> A specific project is the only safeguard by which the Bank can assure that its resources are in fact used to meet [essential] needs is to require, before granting a loan, that an agreement be reached with the borrower on the precise purpose of the loan. This is essentially all what the specific provision implies.(33)

To be even more specific, the Annual Report of the Bank added:

> If the Bank were to make loans for unspecified purposes or for vague development programs ...there would be danger that the Bank's resources would be used either for projects which are economically or technically unsound or are of a low priority nature... (34)

It follows from this description of a specific project that the project must be of quite an important size, have a remarkable development impact and generates a reasonable rate of return. According to the Bank, without such specifications, it would be impossible for it to judge whether, or to what extent, a loan would be effective in contributing to the general economic development of the borrower.

One immediate conclusion to be drawn from the Bank's interpretation is that the specific project approach tends to limit the scope of lending of the institution. Although such limitation has been rejected by Baldwin and others, the Bank sees such an action as only "natural", considering the limited amount of money that the Bank is allowed to raise, and the amount which it can actually lend. (Art. III sec. 3) Furthermore, the limitation imposed may be, according to the Bank, beneficial to both lenders and borrowers. Through the specific project, the Bank monitors the use of its money in such a way that it is not invested in uneconomic projects or "white elephant" projects as they are sometimes called. The issue has been often raised by the Bank that a great deal of U.N. money and some of that of the specialised agencies as well goes into items which are not high priority items. Supporting the Bank's view, J. Williamson wrote:

> The Bank wants to ensure that projects are carried out, and the money does not just get fluttered away into building monuments or luxurious airports or in the pockets of certain individuals. It is healthy to get outside organisations to give assistance on a project basis, rather than just handing over money, assuming that the terms are reasonable.(35)

Despite the Bank's concern over the use of its monies, and its declared *bona fide* intention towards the LDCs, the specific approach as it is interpreted by its officials, draws a cutting line between "doing good" and "doing business".

The initial reaction to the Bank's specific approach was that the institution would be looking for projects which could generate a rate of return, make profits and accumulate capital. There has been considerable criticism from the LDCs of the specific project approach. It was alleged that such an approach was based on the assumption that the Bank examines the merits of particular projects in isolation , regardless of the overall economic situation of the borrower.(36) This practice seems to have prevailed in the early lending operations of the Bank but was soon overturned, and the institution now claims that it does "exactly the reverse":

> It is a cardinal requirement, that financing any given [specific] project depends not only upon its technical and financial viability but also upon the suitability of the project within the economic conditions of the country as a whole.(37)

For, in the Bank's economic logic, it serves no purpose to finance one sector of the economy if the whole economy is impotent. For no matter how viable or profitable the particular project proposed may sound, it is not worthy of support if its economic return is "swallowed" by loopholes in other sectors of the economy. In this case, the Bank does not want to be seen by its major creditors as supporting ailing economies. Nor does it want to give the impression that the projects it finances subsidise other inefficient or uneconomic (e.g. military), sectors of the borrower's economy.(38)

From a purely business point of view, the specific project is strategically important for the Bank in many respects.1) The financing of the construction of a hardware (ie. specific) project, a port for instance, not only generates revenues for the country's economy (imports/exports of goods, taxes), but it also offers guarantees that the loan will be paid back. Otherwise the Bank would have never allocated the funds for the project to be built. 2) Taking the same example as above, a port construction is a grandiose undertaking, involving advanced technology in marine building, highly skilled expertise and sophisticated equipment, which can be provided only by the western industrialised world. In other words, the project has a high foreign exchange component and, as such, is likely to bring business to the creditors. 3) Financing a specific project, such as a port, may also find its justification in the long term ambition that the Bank has always nourished in laying the ground for the private sector be it local or foreign:

> A primary concern in the Bank's financing hard projects, has been to provide the framework needed for the expansion of private enterprise, the real motive behind economic development.(39)

Despite earlier remarks that the Bank has varied its lending policy, the specific project is an integral part of the rules of the game. As such, the institution has to cling onto it because, as a constitutional requirement, the Bank is not in a position to depart from it as it did with the guarantee function. To do so may prompt some suppliers to cease financing the institution.(40) This is at least in appearance. On more "sensitive" ground, the specific project option, because of its impact on the borrower's economy, may prove a useful facade behind which the Bank is in a better position to "advise", or perhaps better to influence, governments on policies affecting all parts of their economy. For Baldwin, for instance, the Bank is more interested in influencing the behaviour of governments than in making loans. Said the author:

> Many of the Bank's actions in promoting economic development are clearly of an actor of international politics; that is the Bank often tries to induce governments to behave in ways in which they would not otherwise behave.(41)

In its second Annual Report, the Bank refers to the goal of exerting a "helpful influence" on member governments in order to persuade them to remove trade barriers and adopt sound financial programmes.[42] The third Annual Report clarifies even further the objective of the Bank as seen by its administrators:

> It seems clear that the real measure of the Bank's effectiveness will be, not so much the number of its loans and guarantees, significant as they may be, but rather its success in influencing attitudes. In promoting a realistic constructive approach to development problems on the part of its members and in fostering a greater degree of confidence among investors.[43]

As will be seen shortly, the Bank's "helpful influence" starts the very moment the Bank dispatches its fact finding mission to the borrower's country. The actual process of investigation usually falls into two general stages, although in some cases both may proceed more or less concurrently. Whereas the first stage is concerned with the overall investigation of the economy of the borrower, the second stage is rather limited to the examination of the project(s) selected for financing.

II- The Various Stages Leading to the Conclusion of the Loan Agreement.

A mere application for a loan does not necessarily imply acceptance by the Bank to finance the project. Wherever possible, the Bank prefers to hold informal exploratory discussions with prospective borrowers before any formal loan request is filled. These discussions enable the Bank to determine whether the economic conditions of the borrower are favourable for Bank financing; if not, to indicate to the prospective borrower what kind of information the Bank will wish to have concerning the project to be financed. This is the beginning of the first stage.

A- The Study of the Economy of the Borrower.

When considering a loan application from a member borrower the Bank starts by sending representatives and experts (known as a Bank mission) to the applicant country for a preliminary investigation on the state of the economy of that country.(44) Although as already stated, the Articles did not say anything about technical assistance, the Bank soon "discovered" that, in applying for loans, its less developed members were not likely to present well prepared project proposals without the Bank's intervention.

The Bank's decision to undertake investigations of economic conditions in its LDC members is followed by a series of missions. The aim of these missions is to obtain for each member country an inventory of development problems and progress, which could later be updated and expanded. As they were lacking the explicit support of legislative enactment, these missions were, quite surprisingly, justified on moral grounds. This was made clear in the Fifth IBRD Annual Meeting:

> It is a combination of technical and financial aid which is the new aspect of the Bank's program and the one which gives the most promise that the program may be effective. The Bank recognizes that when it sends out such a mission, it assumes a moral obligation to help, with its financial resources, in the development of the country concerned... (45) (emphasis added)

As stated earlier, the Bank's intrusion into the borrower's economy started as earlier as 1949 when the first loan to an LDC, Chile, was being discussed. Despite strong pressure from the Chilean government, the Bank management insisted that before it could proceed with the loan, it had to know more about the Chilean economy, and about the project. An economic mission was later dispatched, and from that time onwards feasibility studies were required before any financing was undertaken.(46)

From the legal standpoint, The Bank's Statutes are silent on the establishment of country economic missions. At the begining of the Bank's operations, there is no formal provision or any clear indication in the Articles of Agreement which empowers the Bank to carry out such an investigation.[47] The main reason advanced by the Bank's own repeated statements is that it wants its resources to be spent with prudence, soundness, effectiveness and similar vague and imprecise terminology. On the basis of such a vocabulary, the Bank has developed one of its most exceptional techniques which is the right to set foot inside the borrower's economy.

There is, however, no certainty about the uniformity of such practice in the Bank's subsequent lending because of the lack of legislative reference. According to the Bank's critics these missions were selective and sent only when the institution had doubts about the economic performance of the borrower.[48] It was not until the seventies, a decade which coincides with the emergence of the Third World in the international arena, that the Bank formally enacted the country study mission as a legal requirement prior to any lending assistance.[49] The description of the work of such missions may be briefly related here as it plays an important role in the whole process of the Bank's lending operations.

Before a country study gets underway, the Bank and the borrower set up various objectives and agree upon various commitments. One of the most important of these commitments is that the borrower government agrees to open its books and provide all the necessary information that the Bank's staff may deem relevant to the completion of their study. In principle the purpose of these missions is technical in nature, since the Bank is required by its Statutes to "pay due attention to consideration of economic efficiency, without due regard to political or other non economic considerations. (Art. III sec. 5 (c)) The task is enormous and time consuming, as is formally acknowledged by the Bank's officials:

> The amount of time it took to process loan proposals, the interrogations involved and the elaborate documentation required by the Bank at all stages of lending gave rise to understandable impatience among borrowers.(50)

Information gathered is varied and covers practically all aspects of the borrower's economy, education, transport, health, energy, employment and defence spending. In the light of this overall analysis, the Bank produces a report upon which it makes its own judgement and defines its lending policy *vis a vis* the prospective borrower. The Report usually opens with a debt table and a data sheet that scrutinises in minute detail the external financial position of the borrower. (This is in fact the outcome of the creditworthiness test discussed earlier). Then the report moves on to a broader analysis of the economic conditions of the borrower. Under the heading "The Economy Of The Country", a host of information is brought into light, compiled, analysed and commented on.(51)

The reasons underlying the necessity of such in-depth investigation are manifold. The Bank needs that kind of overall view in order to assess the economic performance of the borrower and decide whether or not to start the loan proceedings. Another reason the Bank is interested in such findings is to pinpoint the deficient parts or sectors of the economy and situate the project to be financed within the general framework of the borrower's development programme.

Country economic studies carried out by the Bank's missions are in theory confidential and their use in principle restricted only to the Bank management and the borrowing government.(52) This latter may take advantage of the Bank's professionalism and expertise and use the report's findings for its own purposes. The borrower can, for instance, introduce changes in its economic policy, restructure some parts of it or review its entire economic strategy. He may also, in the light of such reports, request the Bank's financial assistance to carry out such programmes. There are also occasions where the reports may be used by other governments and/or international organisations which happen to be engaged in the economic development and aid assistance to the borrower.(53) In these cases, known as aid consortia, the Bank's reports are said to contribute more efficiently to the ventilation of these collective efforts. Critics of the Bank, however, allege that such confidential reports are quite often made available to private bankers willing to invest in a particular country.(54) For the Bank, the most immediate effect of the country economic study is to determine the priority sector in the country for lending. It is only then that the Bank considers whether the project submitted to it is worth funding. As in the country study, the Bank also needs an in-depth analysis of the sector it finances. This is the second stage of the loan project.

B- The Sectoral Identification.

Once a decision is reached in principle on the appropriateness of the loan, the Bank proceeds to a second investigation directed mainly to the particular project(s) selected for financing. The procedure is commonly known as the Project Cycle and aims at a thorough examination of the project proposal from conception to completion and operation.(55) Projects submitted to the Bank may take two different forms; a) The project may be limited to a particular sector of the economy such as telecommunications, or b) the project may be only a portion of a large sector such as the construction of a railway which is itself part of the transportation network. Both forms of projects present different approaches, but in general they undergo the same itinerary.(56)

When considering a particular project, the Bank always insists that it must be well prepared. In principle it is the applicant candidate who is responsible for such preparation. He must provide to the Bank, together with the loan application, a complete description, technical, financial economic and so forth of the project to be financed. In most cases, however, a candidate which is a less developed country may be unable to satisfy the Bank's high requirements and eventually may fail in his application.(57)

According to the Bank's own testimony, loan refusals have been quite frequent, especially in the early lending operations of the institution. The Bank has always complained that it does not receive a significant number of well prepared high priority projects to use all the funds that could be made available. In his statement before the UN ECOSOC in 1950, President Eugene Black emphasised that the reasons why the Bank has made so few loans to LDCs:

> had not been so much the lack of money, but the lack of well prepared and well planned projects ready for immediate execution.(58)

The obstacles in the L.D.Cs to the making of well conceived "bankable" projects include, among other things, the shortage of skill and expertise in various areas, the low level of education, and the lack of well formulated development plans. There are, however, limited ways for the L.D.Cs to get their projects appraised. They can obtain expert assistance from some international organisations for projects in which these institutions are specialised; namely, UNDP for industrial projects, FAO for agricultural projects, and UNESCO for educational projects. These international organisations may either undertake the feasibility studies themselves, through their own expertise; or hire consultants to do the job for them for the benefit of the LDCs.(59) In this context, the Bank remains by far the most active institution in feasibility study work because of the high professionalism which it possesses in almost all fields. Since the 1960's, the Bank has become increasingly involved in helping the poor countries to organise and finance a series of projects and sector studies according to the Bank's norms.(60) In 1976, the feasibility study was institutionalised through the creation within the Bank of a Project Preparation Facility (PPF) which has since expanded remarkably. The Bank, however, undertakes feasibility studies only when it is convinced that such studies are likely to clear a direct channel for Bank investment. PPF then, became the second "legalised" window through which the Bank penetrates, once again, the borrower's national economy. For many Third World lawyers and politicians, the institutionalisation and the use of PPF signals that the Bank's staff will be actively involved from the first phase of identification, to the completion of the last operation of the project. As a result, the participation of the developing countries in the preparation of projects has become even more problematical. On one hand, the Bank's officials claim that:

> Each project is based on close collaboration at all stages between the Bank and the government.(61)

On the other hand, the Third World countries maintain that the Bank's role in project appraisal is carried out in such a manner that:

> The role of the borrower is overwhelmingly nil, reduced to a passive attitude [and that], it is the Bank which decides what is good for the Less Developing Countries.(62)

This latter view is supported by the Bank's critics who argue that the poor countries are so weak that they have no say in project preparation except to provide information.(63) The Bank might, for a number of possible reasons, refuse a specific loan request. It might refuse the loan on the ground that the project is not sufficiently high priority for the potential borrower's development. Or that the project is unsound, too ambitious, or badly prepared. The Bank might also consider that the candidate could obtain finance on the proposed project from other sources on reasonable terms. Another reason for the Bank not to lend might be that the project is in a sector in which the Bank does not operate (e.g. oil exploration). It might also consider the prospect of repayment too uncertain, and refuse to lend on the ground of common prudence, which its Articles enjoin it to observe. This excess of prudence reassures more the fund's suppliers but suits less the LDC borrowers, which, incidentally, have no defined rules (or rights) to challenge the Bank's decisions.

During the appraisal of a project several aspects, technical, institutional and organisational, economic and financial, are reviewed in order to determine whether the project has a reasonable chance of achieving its objectives, and whether these objectives constitute the best set of alternatives available for the project at that time. Despite the fact that the study of the various aspects of a project is within the domain of a multitude of different disciplines, (economics, engineering, architecture, etc...) a brief description of their work would illustrate in non technical language the scope and area of the origins of the so called "Bank's interference" in the domestic affairs of the borrower. For whatever the Bank does, it has always maintained that it does it on a purely technical basis, taking into account the sole success of the project.

a)- Economic and Financial Aspects.

It is known that the Bank supports only projects that are financially viable and economically sound. On the financial side, the Bank's analysis consists mainly in evaluating the cost of the project during the construction period and the resources expected to be available. This means, essentially, estimating the cost of goods and services required, engineering services, allowances for escalation and contingencies, interest and so forth. Of prime importance, too, is the precise identification of the origin of the other part of the financial resources i.e.from where the money comes to meet the project's requirement. Bearing in mind that the Bank provides only a small portion of the loan, the remaining, (usually the biggest), portion has to be clearly identified at this stage.(64) Here, the borrower is faced with several options. He may provide the rest from another lender who might be a government, a private bank, or an international organisation.

As a prudent institution, the Bank gives equal importance and care to new loans from the other co-lenders. The nature of loans, whether long or short term borrowings, the debt service, and the capability of the borrower to repay are all discussed in this phase of the project. The economic analysis, however, focuses on a wide range of parameters that the Bank considers, among which, the rate of return is particularly controversial.(65)

In order to keep a project economically sound, the Bank's economists have instituted a 10 percent rate of return that the project must generate after completion. Below such a figure, the loan might not be granted. The calculation of such a rate is worked out in such a manner that it will ensure that the project will be both self-liquidating (i.e.bring back the money spent for its construction) and self-sustaining (i.e. bring a reasonable return on the capital invested).

Broadly speaking, in making a project economically productive, most of the time the Bank asks the borrower to intervene in a multitude of "highly sensitive" areas such as tariffs, pricing, wages, foreign exchanges, investment law and interest rates.(66) Quite often, it is only by carrying an adjustment in these peripheral areas that a rate of return may be calculated, and the project made profitable. From the legal point of view, to carry out these adjustments often involves among other things, legislative enactment, parliamentary procedure or even constitutional amendment. Furthermore, these changes have rarely occurred without social unrest which has frequently threatened the very (political) existence of many LDCs governments.(67)

b)-Technical and Commercial Aspects.

This part of the project appraisal looks at all the technicalities involved in the project such as engineering, design and maintenance. Questions may arise here about

about the location of the site where the project is to be implemented, the choice for the best route for a highway, or any particular issue relating to the physical aspect of the project. For example, industrial projects must be planned with reference to the sources of raw materials, power, skilled and unskilled labour, the infrastructure in place, (roads, railways, ports). More concretely, technical appraisal is concerned with questions of physical scale, layout and location of facilities. As such, the findings of the experts can hardly be said to bring the Bank and the borrower into direct conflict as this occurred in the study of other aspects of the project. However, the few problems which might arise in the technical appraisal are of a completely different nature but, when they occur, may have a far-reaching impact on the whole country and possibly the whole planet. The Polonoroeste Project in the northern Brazilian state of Rondonia provides an illustration of the kind of "technical error" that the Bank's technical staff may commit. In 1982, to ease the migration process, the Bank lent to the Brazilian government $ 250 million to pave the road to the state of Rondonia. The Bank's technical experts prepared the project and recommended the financing of the project. Four years later, the project turned out to be "one of the fastest and most avoidable case of environmental destruction ever achieved."(68)

During the technical appraisal, particular attention is also attached to the proposed arrangements for the financing operations of the goods and services needed to construct the project, or procurement as it is known.(69) This aspect touches upon the commercial edges of the project, as the main objective is to obtain the best value for the money spent. This aspect is also particularly "sensitive" for the Bank because it concerns directly the use of its own resources. For, as stated in the institution's lending criteria (Art,III), the Bank finances only the foreign components of the project. Since this part deals mainly with the use of the Bank's money, a great deal of work has been done by the institution in order to ensure that its money is spent within its members and without discrimination between them.(70) In other words, the Bank is required by its own Statutes to restrict its money solely for the purchase of goods and services acquired in hard currency in the developed world. As will be seen later these provisions do not always fit with the borrower's wishes to shop freely and, here too, disagreement with the Bank often emerges.[71]

C-Institutional and Organisational Aspects.

The Bank always insists that, before a project gets underway, it must be satisfied that there should be a favourable environment for its construction, implementation and operation. There is a general consensus among insiders as well outsiders of the Bank, that it is not the financial, but the managerial and institutional difficulties that are most serious:

> Experience suggests that it is a good deal easier to identify and provide the tangible elements of the project- the civil works,the equipment and the funds needed to pay for them- than the less tangible project elements such as the adoption of policy changes or the creation of an operating entity with a well trained staff and a competent management.[72]

If such an organisational environment does not exist, and in the case of many LDCs it does not, the Bank insists that it should be created. The creation of such an adequate milieu, however, has not been always an easy task. In the words of the Bank:

> An accurate evaluation of the institutional capability of each borrower is essential to the successful implementation of lending operations. But it is time consuming and difficult.[73]

From the Bank's loans surveyed, it seems that the difficulties stem from the broad vision that the Bank gives to the project, and what the LDCs consider as going beyond the actual limit of a loan. Broadly speaking, there are two main types of institutional arrangements that the Bank usually presses for.

(i)- The Creation of (semi) Autonomous Agencies.

The Bank regards ownership and operation of the project as important as the finance of the project itself. Sometimes,when such an authority does not exist, the Bank insists that a separate entity be created which would be permitted to conduct its day to day operations and handle its own affairs. As one Bank official remarked:

> In our institution, we strongly prefer to deal with the entities carrying out the projects and we like to see them enjoy a certain amount of autonomy, believing that there is a better way of running things.(74)

The rationale underlying such a policy is the Bank's willingness to keep the authority for the project as far as possible outside the framework of government regulation and, above all, control. In a general manner, the requirements that the Bank seeks, when evaluating the institutional and organisational aspects of a project, may take one of two forms and sometimes both; **a)** the borrower may be required to take positive action in ensuring the Bank that he is ready to comply with the Bank's advice, and adopt certain policies for the organisation and management of the entity running the project, **b)** alternatively, the borrower may be induced to take a negative attitude and refrain from taking certain measures possibly detrimental to its own as well as the lenders' interests. If the borrower wishes to act, he must then request and obtain the Bank's agreement. Problems arise when, for various reasons, the government does not yield to the Bank's requirements, and in response the Bank witholds the loan, or makes the creation of such an entity with proper powers, a condition of effectiveness.

(ii)-The Approval by the Bank of the Professional Qualities of Key Personnel.

To ensure that a project is properly managed, the Bank has also shown a particular interest in the human aspect of a project. The quality and experience of the borrower's personnel comes under close scrutiny by the Bank's officials. When the Bank is not satisfied with the quality of the staff, it asks for additional assurances in the form of provisions which have to be eventually inserted in the loan agreement.(75) The provisions usually call for changes in the management and/or improvements in all key posts responsible for the running of the entity to be made. Depending on the circumstances of each project, the Bank's concern over the staffing is sometimes pushed "to the point of insisting on representatives [of the Bank] on the controlling body [of the borrower's new entity]".(76) It is not usual for the Bank to appoint or recommend a particular person to fill a specific post. What it does, is to advise on a certain degree of professionalism to be observed in recruiting the staff for the project as well as the right to have a say on the people recruited. This extract from a relatively recent grey report, confirms the Bank's worries over the issue of management of the project it finances. In this loan, the Bank opposes the presence of a Minister of the borrowing country at the head of the institution.

> The general issue of the composition of the Boards of public enterprises in {...} is being reviewed by the Bank in the context of a proposed Public Enterprise Restructuring Loan; the aim is to make these boards more professional and effective by including in their membership people with technical and managerial experience. The Minister of {...} is serving as acting director General of {...}. During the current transition period and until new organisational and management systems are in place.... A permanent Directory General is expected to be appointed by 1988. (77)

The question which arises here is that such expertise advised by the Bank is most of the time available only in the developed countries; and the requirement to their employment is made compulsory in the loan agreement. From an LDCs point of view, the use of foreign expatriates presents too many drawbacks, economic, social and even political. The LDCs are dismayed at the extent to which the Bank loan involves the use of foreign expertise. They believe that the use of such expertise is very expensive and, as such , it begs the very purpose of the project, which is a development assistance. This is how, for example, the point of foreign expertise was brought up, in a discussion on development lending by an African official banker:

> I know of one project in which a country was involved and the lender (the Bank), insisted as a condition for approving the loan that a particular person be recruited as advisor... It was suggested that the advisor be taken on at a salary of about 9,500 pounds (prior to 1977 value); the government considered this salary excessive, because the President of that country earned less than half this sum. And here was a person who was supposed to come as advisor and to be paid from the proceeds of the loan. But it was a question of taking it or leaving it. It was finally agreed to because there was no choice. I repeat this is not actually perhaps interference but it is something close to it, especially in a poor country, which has to pay out of the loan for something whose value is not clear...(78)

Furthermore, such expertise may do more harm than good to the project, in the sense that it may demoralise the borrower's own civil service, by preventing it from developing its own intellectual capabilities. Moreover, the danger here is that too much reliance on foreign expatriates may well make the developing countries too much dependent on foreign expertise with all the consequences that such dependence may imply. For the Bank, such foreign expertise is necessary to strengthen the capacity of the civil service and that the expense is unavoidable. Once all major obstacles have been cleared "in the field", the Bank invites the borrower to its headquarters to discuss the details of the loan.

C- The Negotiation of the Loan.

At this stage, the Bank and the borrower meet to reach an agreement on the proposed project.(79) It is a meeting dominated by the Bank which unveils to the prospective borrower the different measures to be taken, if he is to benefit from the loan. All issues that have been raised prior to and during appraisal to ensure the success of the project are thus cleared. For example, if the Bank has suggested price increases, or the use of consultants or any change to be introduced, this is formally agreed upon during the negotiations. At this stage the borrower may still object to the Bank's requirements, but he will inevitably lose the loan. In practice this never happens, as most of the obstacles are cleared well in advance and the borrower, at this stage, is generally ready to agree to implement the Bank's conditions.

At this stage also, the Bank does not insist that all remedial measures which may appear necessary in the case of any given country may be completed before that country may qualify for a loan. On the other hand, the Bank is not normally willing to rely simply on a representation by the government that such remedial measures will in due course be taken. The Bank's position is midway between these two extremes. It requires concrete evidence that the government is actually taking appropriate steps to establish stability but, once given such evidence, it is usually willing to make a loan concurrently with the execution of the measures adopted.(80) Once both parties have agreed on all the details of the loan, the agreement thus reached is converted into legal obligations binding on both the Bank as a debtor and the borrower as a creditor. A final report is submitted to the the President of the Bank, who in turn submits the loan to the Executive Directors (Administrators), for final approval.

a)- The Adoption of the Loan.

Once negotiations are complete, and the contract technically formulated, the President of the Bank submits a report to the Administrators where he recommends the adoption of the loan. The report, along with other legal documents (covenants), is then studied by the Executive Directors, and eventually submitted to voting. The loan must be approved by a *quorum* of a majority of the Executive Directors who must possess between them at least half of the total votes. The loan is adopted through a resolution. The resolution may be reached through a vote according to the majority of voices expressed, or through a consensus. As already discussed, it is very rare that a loan is rejected at this stage through a negative vote. For, if there is any opposition to the loan, it is generally manifested in the very beginning of the loan procedure, since the Executive Directors are usually aware of all the lending programmes of the institution. Nevertheless, it may happen that some opposition to the loan appears at this terminal stage from some members.(81) These objections appear in the form of abstention to the voting or by a negative vote. The reason behind these objections may or may not be directly linked to the loan agreement. But in most cases, the objections have their sources in bilateral dispute between the borrowing country and the voting Executive Director of another country, dispute of a completely different nature and which have nothing to do with the loan proposal.(82)

b)- Applicable Law.

The question arises whether the loan and guarantee agreements concluded between the Bank and its members are international agreements, and as such they are governed by International Law.(83) The question arises because of the mixed nature of the loan agreements which contain elements from both municipal and international law in such a confusing way that it is difficult to ascertain whether the contract is governed by one or the other, or both, laws.

One view is that Bank agreements lack the explicit support of international law and, therefore, should be considered as falling within the jurisdiction of the borrowing state. This view is based on the premise that neither the Articles nor the General Conditions make direct reference to the application of international law.(84) In these documents, as well as in the loan agreements, however, there are several express and implied references to municipal law. For example, Article IV, section 4.10 (General Conditions) states that :

> Any payment required under the loan agreement ... to be made to the Bank in the currency of a country shall be made in such a manner ... as shall be permitted by the laws of such country...

The second and predominant view is that the Bank's loan and guarantee agreements with its members are basically international agreements governed by international law.(85) This view is reinforced by the insertion in the General Conditions of certain standard clauses such as Article X, section 10 (1) which provides:

> The rights and obligations of the Bank, the Borrower and the Guarantor under the loan agreement, the guarantee agreement and the bonds shall be valid and enforceable in accordance with their terms notwithstanding the law of any state or political subdivision thereof, to the contrary.

The first declared objectives of this section is that the law of a country on whose territory the project is carried out cannot prevail over the provisions of the loan agreement. In other words, member states, or their entities, which are the signatories of the loan agreement, cannot invoke their national laws to repeal one or several clauses of the loan. This precaution is especially valid for the period after the implementation of the loan. It makes redundant any legislation passed by a state on its territory which is not compatible with the Bank's contractual obligations. For this reason, the Bank has always demanded and indeed received, a legal certificate stating that the loan agreement is in full compliance with the prevailing laws in the borrowing country. Such a letter is considered as much part of the contract as any other obligation in the loan agreement. Infringement of its content is treated as infringement of any of the initial clauses in the original loan agreement.(86)

This is a particularly sensitive point for the Legal Department of the Bank. Lawyers in the Bank fear that since they are dealing with sovereign states, there is always the possibility for governments to overrule unilaterally existing laws, or repeal international engagements. So the very purpose of section 10 (1) is precisely to recall the principle of the inopposability of internal law to international agreements. Indirectly therefore, the Bank has excluded the application of the borrower's domestic laws and has underlined its preference for international law. Broches, who has discussed this question in a lecture given at the Hague Academy, concluded after a thorough investigation into some legal aspects of the Bank, that the Bank's agreements are governed by international law. He justifies his findings by saying that:

> The steps by which I reached this conclusion were that the Bank is a subject of international law, that it has treaty-making capacity, that that capacity extends to the conclusion of loan and guarantee agreements and, finally, that the Bank's loan and guarantee agreements with its members are concluded in the exercise of that capacity and are intended to be, and are, governed by International Law."(87)

Broches cited as evidence of his findings:

- The Loan Regulations of the Bank (referred to as the General Conditions)

- The registration by the Bank of its loan agreements with the Secretariat of the United Nations in accordance with the provisions of Article 102 of the U N Charter.

In practice, the Bank has always avoided entering into conflict with its members, and cases to support which law applies to the Bank's litigation do not exist in the absence of precedent in the lending history of the institution. Although the lack of an express provision in the Bank's Statutes of a particular applicable law may be of some doctrinal significance, in practice, the question has never been raised. Commenting on this precise point, A. Fatouros remarked:

> As in so many other instances, it is the actual practice of the Bank rather than the doctrinal debate that appears to provide the answers.(88)

The question is unlikely to arise in view of the lengthy procedure followed in each loan as described earlier. Furthermore, it is not in the member's interest to come into conflict with the Bank by, for instance, cancelling unilaterally its contractual obligations with the institution, or altering previously agreed arrangements. For, as in the case of default discussed earlier, cancellation, or non respect of the loan agreement provisions carries serious consequences on the reputation of the borrower and may put at risk its future lending from both the Bank and other suppliers of resources.

Last, but not least, it is equally important for the Bank not to get involved in repeated and endless legal disputes with its borrower members. This would only impede the course of its operations and, more importantly, damage its reputation and credibility vis a vis its creditors upon which it is so dependent.

Conclusion to Chapter Two.

Between the request and the granting of a loan, the Bank has developed a policy which enables it to maintain direct relationship with the borrower through the life of each loan. In developing such a relationship, the Bank appears to be not only interested in supplying money, but it was equally anxious to know in minute detail, how such money should be spent by participating directly in the realisation of the project(s) it finances.

Under the umbrella of technical assistance, the Bank undertakes a thorough examination of the borrower's economy, before going on finally to agree to finance a modest fertilizer plant. By qualifying its criteria and actions as technical and non political, the Bank aims at several objectives. In the first place, the Bank claims that it wants to establish a certain financial discipline, which, it alleges is missing in most LDCs and which is imposed on it by its limited resources.

Secondly, by resorting to technicalities, the Bank's management tries to fill a legal vacuum left by the Articles of Agreement concerning the agency's intervention in the field of development. Thirdly, and perhaps more importantly, by emphasising on the technical aspect of its action, the Bank wants to free itself from the common constraints on non intervention that the international order imposes on public organisations.

The Bank technical and financial superiority gives the loan agreement between the institution and the borrower a particular taint, that makes the contract looks more like *un marriage de raison que d' amour.* In theory, borrowers are associated in all stages leading to the conclusion of the contract. But in the absence of a real bargaining power, the LDCs appear more like executing agents than authentic partners. This second class position in contract making makes the borrowing LDCs more vulnerable to the Bank's demands. It also explains to a large extent, the impact of the Bank's policy on the laws and institutions of the borrowers, as will be discussed in the following Chapter.

Notes to Chapter Two

1 An interesting legal analysis of the Bank's loan agreements is found in A. Broches, International Legal Aspects of the Operations of the World Bank, in RCADI, 1959, at 316-321; also, D. Zavala, Les prets de la Banque Mondiale aux services publiques industriels et commerciaux. Une etude des contrats, LGDJ, Paris, (1981)

2 H. G. Petersmann, "The Operations of the World Bank and the Evolution of its Constitutional Functions since Bretton Woods 1944-1984", in 26 GYBIL1984, at 11. In the author's view, the Bank withdrew from the guarantee field because such activity:
"would not widen its financial leverage since under the Bank's Articles of Agreement, the total amount outstanding of its loans and participation in loan and guarantee agreement cannot exceed 100% of its unimpaired subscribed capital, reserve and surplus".

3 D. Zavala, supra note 1, at 38.

4 A distinction must be made here between: **1)**-Project loan, which is a loan between the the Bank and the state corporation, and **2)**- Guarantee loan, which is a loan between the Bank and the government responsible for the corporation. Both loans are concluded simultaneously.

5 A. Fatouros, The World Bank Impact on International Law. A Case-Study in the International Law of Cooperation, in Jus et Societas. Essays in Tribute to Wolfgang Friedmann., Martinus Nijhoff, New York, (1979), at 64-66.

6 The interpretation of the expression "special circumstances" has been cardinal in the shaping of many aspects of the Bank's lending operations in the early 1960's and 1970's. See John A. King, Jr., Economic Development Projects and their Appraisal, John Hopkins Press, Baltimore (1967), at 3-4.

7 For a discussion on this point, see A. Broches and P. Sella, "The International Bank for Reconstruction and Development", in Rubin, J. Seymour (ed), Foreign Development Lending: Legal Aspects. Papers and proceedings of a conference of legal advisers of national and international lending assistance agencies, in Oceana Pub'l. Inc., New York (1971), at 337.

8 *Cf.* FAO and UNCTAD Statutes.

9 Article III of the Bank's Statutes refers to conditions instead of criteria. In the present chapter the term condition has been temporarily substituted by the word criteria, in order to distinguish between conditions which are normally imposed on borrowers from criteria which lack the obligatory force.

10 G. Delaume, Legal Aspects of International Lending and Economic Development Financing. Oceana Publications Inc., New York (1967), at 36.

11 World Bank Annual Report 1949, at 11.

12 Supra note 5, at 13.

13 Ibid., at 24.

14 For a discussion on the requirement of creditworthiness, see Edwards S. Mason and Robert E. Asher: The World Bank Since Bretton Woods, The Brookings Institution, Washington DC. (1973), at 154, 180 - 183, 470 - 471, 305 and 557.

15 Eugene H. Rotberg, "The World Bank. A Financial Appraisal", in 13, Fin. & Dev., Sept. 1976, at 8 - 9.

16 T. Hayter and C Watson: Aid Rhetoric and Reality, Pluto Press London (1985), at 78.

17 Formally, the Bank is not against expropriation of foreign assets if the dispossessed is fairly compensated:
"Expropriation is the right of any country. The Bank is concerned however, that the country involved makes serious efforts with the former owners to reach agreement on the payment of fair compensation and it may refuse to lend to members who fail to make reasonable efforts to settle expropriation claims, or similar disputes". in Questions and Answers, IBRD, Washington 1976 at 13.

18 Mason et al supra note 14, at 338.
The main instance where the Bank's use of non political criteria was publicly at issue, was in the case of the loans to South Africa and Portugal (1967), contrary to UN General Assembly resolutions and suggestions.

19 Supra note 10, at 107.

20 IBRD: Policies and Operations, Washington DC., 1971, at 32.

21 D. Baldwin, The International Bank in Political Perspective, 18 World Politics, 1965, at 79.

22 On the position of international law on the issue of expropriation, see, D., Sornarajah, The Pursuit of Nationalized Property. Martinus Nijhoff, Lancaster (1986); also, F.R., Ryder, Legal Problems of International Banking, Sweet & Maxwell, London (1987), esp. Ch. IV.

23 C. Payer, The World Bank. A Critical Analysis, Monthly Review Press, London (1982), at 34.
For example, Greece was kept out of business for twenty years, because of unsettled foreign debts. See supra note 10, at 303.

24 Mason et al supra note 14, at 316.

25 eg. Chile, see supra note 23, at 113.

26 R.B.J., Richards, "The Role of the World Bank and its Affiliates", ICLQ, Suppl. No. 3, 1962, at 38. An interesting analysis of the last lender resort principle is found in J. Guttentag and R. Herring, "The Lender of Last Resort Function", in Essays in Int'l Finance, Princeton, New Jersey, (1983).

27 In the past the Bank has refused to finance the Indian Bokaro Steel Mill Plant, despite the declaration of the Indian Chamber of Commerce that no private capital would be available in India to finance the project. See, R.F., Meagher, W., Friedmann, G. Kalamalof, International Financial Aid, New York, Columbia University Press (1966), at 465.

28 Supra note 21, at

29 Supra note 5, at 37.

30 Mason et al, supra note 14, at 562.

31 T. Hayter, Aid as Imperialism, Penguin Books, London (1971), at 16.

32 Mason et al reported that: "During the time when the Bank lending was being developed, the terms specific projects for reconstruction and development

frequently demanded interpretation. In the US discussions of the Bank proposal before Bretton Woods, the argument in favour of lending for specific projects was based on the need to avoid such ill considered loans as the balance of payments loans of the 1920's, when the use of the proceeds was unspecified.", See supra note 14, at 25

33 World Bank Annual Report 1951, at 8.

34 Id.

35 J. Williamson, (ed) IMF Conditionality, Washington DC. (1983), at 124; see also supra note 10, at 201.

36 J. Talor,"A Lawyer's View of Development in World Bank Cofinancing with Private Banks", in David G. Pierce et al (eds.), Current Issues of International Financial Law. Butterworths, London (1985), at 419.

37 World Bank Annual Report 1949-50, at 11.

38 This is Paul Mosley's "fungibility problem", which means that:
If aid finances a project which the recipient government would have undertaken anyway -aid or no aid- then the aid money is actually financing some other, unidentified project which the aid agency does not known about, and might not like. P. Mosley et al, Aid and Power, The World Bank and Policy Based Lending. Analysis and Policy Proposals. Vol. I London (1991), at 29.

39 Mason et al, supra note 14, at 465.

40 Supra note 5, at 23.

41 Supra note 21, at 65.

42 World Bank Annual Report 1948, at 16.

43 World Bank Annual Report 1949, at 14.

44 On the work of the Bank's missions, see: Mason et al, supra note 14, at 32-33, 73-74, 85, 185-186, 297, 302-307 and all Chapter X. A different view on the Bank's economic missions is held by F.T., Moore, The World Bank and its missions, in 42 Review of Economics and Statistics, 1960, at 89. He wrote: "Their reports are replete with data in almost every conceivable aspect of

economic activity; and the reader feels inundated with statistics. And for what purpose ? Most of the statistics are never used again. They are obviously meant to be purely illustrative and descriptive. For the most part they do not contribute to an understanding of the critical development problems in the economy, and they are not used in setting up a program or in checking its internal consistency sector by sector, and finally specifying the implications of alternative programs."

45 See, IBRD 5th Annual Meeting of the Board of Governors, Sept.6-14 Summary Proceedings, Statement on Technical Assistance, 1952, at 49.

46 Mason et al, supra note 14, at 305.

47 By contrast, the IMF Articles of Agreement specify in considerable detail what kind of data its members are required to supply. This is due to the Fund's function as a regulatory agency of the world monetary system.

48 In its 5th Annual Report, the Bank acknowledged that there were no Bank missions sent to the European countries in 1947:
"There are special cases, of course, where detailed project investigation are neither necessary, nor feasible. The early construction loans to France, Denmark and the Netherlands...were designed to meet emergency needs... Because those needs affected so many different sectors of the economy, because it was so urgent to assist in meeting the needs in order to prevent a disastrous decline in production, and because the Bank had satisfied itself that the goods financed by the loans were to be used for essential and productive purposes, the Bank was willing to make the necessary financing available without detailed examination of the specific projects in connection with which the goods were to be employed."

49 The provisions relating to the country study mission have been enacted in 1974 in a document called General Conditions Applicable to Loans and Guarantee Agreement. See notably Article II, section 4.

50 Mason et al, supra note 14, at 190. Depending on individual countries, it may take between 1 to 3 years for a loan to be effective.

51 For a sample of the Bank's mission, see J. King, supra note 6, at 45.

52 These Reports are called Grey Reports (because of the colour of their covers),

and bear the mention "For Official Use Only".

53 Question and Answers, supra note 17, at 19.

54 Supra note 16, at 165.

55 W. C. Baum, The Cycle Project, IBRD, Washington (1981).

56 Ibid, at 31.

57 This is how Simon Aldewereld reported the first encounter of the Chilean government with the Bank's officials.
"The Chilean proposal had arrived in a book handsomely bound in black Morocco leather, and I remember that one of the senior people in the Bank... expressed a belief that we would be able to make a loan for the project in about a week. But when we opened the book, we found that what we had was really more of an idea about a project, not a project sufficiently prepared that it needs for finance, equipment and manpower resources could be accurately forecast." S. Alderwereld, The Challenge of Development Aid, Address to the Swedish International Development Authority, Stockholm, 6/5/1966, at 5.

58 Mason et al, supra note 14, at 358.

59 Ibid, Chapter XX.

60 See, Van M. A. G. Meerhaeghe, International Economic Institutions, (5th rev. edition), Kluwer, Lancaster (1985), at 73-89.

61 Bettina S. Hurni, The Lending Policy of the World Bank in the1970's: Analysis and Evaluation. Boulder, Colorado, (1980), at 81.

62 Id.

63 Supra note 31, at 43.

64 The Bank does not finance a whole project. Depending on the objectives and circumstances, the Bank loan may finance a minor or a major part of the project. See supra note 1, at 158.

65 A technical discussion of the factors involved in the calculation of the rate of

return is neither possible nor appropriate here. See supra note 5, at 62.

66 Despite all the precautions, the Bank does not always get the results expected. Emery M. Roy wrote:
In a project appraisal made to Kenya, the rate of return was estimated at around 35% by the Bank's mission. 8 years later, after the completion of the project, the rate was close to zero. Emery M. Roe, Project Appraisal: A Venture Capitalistic Approach, 2, Development Policy Review, 1985, at 208.

67 This aspect will be considered in the course of the following two chapters III and IV.

68 CBS 60 Minutes Programme on "The World Bank's Role in the Amazon", Washington DC. April 23, 1987, at 7-8pm.

69 See the Bank's Guidelines Procurement Under IBRD Loans and IDA credits, IBRD Pamphlets, Washington DC, 1985.

70 Id. However, the Guidelines exclude non members of the Bank from bidding.

71 Supra note 6, at 69.

72 B. Chardenet, and A.J. King , "What is a Bank Project", 3 Fin & Dev. Sept. 1972, at 6.

73 See, World Bank News Letter, Issue No 2, April 1986, at 2.

74 Supra note 21, at 269.

75 Mason et al supra note 14, at 253.

76 Supra note 5, at 48; also Mason et al, supra note 14, at 163.

77 The document quoted is an official paper, it has a restricted distribution. Its content may not otherwise be disclosed without the Bank's consent. See, supra note 52.

78 Supra note 5, at 47. See e.g. the Bank's view on foreign expatriates:
"The requirement of advisors, temporary managers, is frequently put in term of expatriate or foreign staff. This term foreign has been eradicated, because it is a

completely wrong specification. They are not wanted because they are foreign, but because they are experienced.", supra note 7, at 314.

79 Supra note 1, at 34-35.

80 World Bank Annual Report 1950, at 12.

81 See for example, the US attempt to block an agricultural loan to Brazil on the ground that the Brazilian government was following a wrong environmental policy. The Financial Times 24/6/1987, at 11.

82 See supra note 5, at 34.

83 Supra note 7, at 79-81; also D. Zavala, supra note 1, at 63;

84 D. Zavala, supra note 1, at 142-143.

85 A. Broches, supra note 7, at 127; also, H.T., Adam, "Les Accords de Prets de la Banque Internationale de Developpement et de Reconstruction", in 55 RGDIP 1951, at 85.

86 Supra note 2, at 39.

87 See supra note 7, at 132, and R. Lavalle, La Banque Mondiale et ses Filiales Aspects juridiques et Fonctionnement. LGDJ, Paris (1974), at 221-227.

88 Supra note 5, at 19.

CHAPTER THREE.

THE MODALITIES OF THE LEGAL IMPACT: A STUDY OF THE BANK'S CONDITIONS.

The loan agreement does not come into force by the mere signatures of the Bank and the borrower. Before granting any loan, the Bank subjects its borrowers to a set of conditions which range from the most common conditions contained in all loan agreements, down to the very specific obligations tailored to the nature of the project.(1) Although these conditions may be inspired from objective as well as operational reasons, they nevertheless serve to guarantee to the institution a predominant role in the transaction. Depending on their place and importance in the loan agreement, these conditions may be classified by order of importance into three categories. These are, **(1)** conditions of a general character which are found in all loan agreements and, as such, are applicable to any potential borrowers without discrimination. Governments which solicit financial assistance from the Bank are usually supposed to be aware of these conditions. Once the Bank has agreed in principle to lend to the applicant, it may, **(2)** either before or during the negotiations of the loan, require additional particular conditions to a specific loan which, in the Bank's thinking, would enhance the effectiveness of the loan. The Bank may finally **(3)** resort to other implicit conditions to force the borrower to act outside the proper context of the project being financed from the institution's fund.

I- General Conditions Applicable to Loan and Guarantee Agreements

These represent the first type of conditions the Bank requires from any borrower seeking its financial aid. The General Conditions Applicable to Loan and Guarantee agreements (hereinafter BGC), deal with a particular aspect of the Bank's conduct of its business. They define the relationship between the Bank and the borrower in many areas, such as the way the financing of the project should be conducted, the reimbursement method, the payment of interest, and matters of the like that concern the administration of the loan directly.(2) Because the Bank has always relied on very precisely formulated loan agreements, it was therefore indispensable for it to lay down from the very beginning "a standard framework" for the formulation of its contracts to be followed by all borrowers. In view of the important role that the BGC play in the formation of the contract, it may be useful to consider: **a)** under what circumstances did these conditions come into being; and **b)** the delimitation of their field of application.

A)- Background.

Historically speaking, the BGC were not part of the original talks that led to the creation of the Bank. Nor were they included subsequently in the Articles of Agreement. They were "instantaneously" developed by the Bank's Administrators as they ventured into the lending business. Anxious to impose their own methodology in contract making, the Administrators decided to set up pre-conditional clauses that would apply *de facto* to every potential borrower.(3) The first clauses appeared as early as 1947 and were known under the official heading of "Loan Regulations". Each Loan Regulation contained a certain number of clauses which were more or less common to all loans that the Bank granted to its borrowers.

Loan Regulations were identified by a code number. For example, Loan Regulation No 1, published in May 5th, 1947, deals with the procedure of arbitration applicable to litigation between the Bank and the borrower. Loan Regulation No 2 established the US Dollar as the main currency in the Bank's transactions. These loan regulations were not static. They changed and evolved in accordance with the Bank's experience and evolution. Thus, Loan Regulation No 1 was later fused with Loan Regulations No 3 and 4 (published in 1950), whereas the Loan Regulation No 2 was dropped as it became obsolete. However, it was only in 1967 that the Loan Regulations underwent their most significant change when they were consolidated into one single document known as the "BGC Applicable to Loan and Guarantee Agreements."(4)

In the opinion of many authors, such as R., Lavalle and D., Żavala, the substitution of the term Conditions to Regulations was appropriate and reflects better the legal nature of the clauses.(5) Like their predecessors, the BGC have undergone, since 1967, revisions, namely in 1974 and 1980 (twice, July and October), and more recently in 1985. The purpose of these changes has been to update the clauses.

B)- The Context of Application

Perhaps the major and immediate concern of the Bank in any loan agreement is to have a clear idea as to how its money is going to be used by the borrower. It is a practical concern which implicitly invites the Bank to intervene massively in the loan agreement by laying down procedural rules to be followed by all borrowers in any loan agreement. To give the BGC a legal nature, therefore a binding force, the Bank has made them an inherent part of the loan agreement. A glance at any loan agreement reveals the existence of a standard clause which reads as follows:

> The parties to the agreement accept all the provisions of the BGC Applicable to Loan and Guarantee Agreements dated [______] with the same effect as if they were fully set forth herein.

A variation of this clause which may be found in more recent contracts, reads:

> The BGC Applicable to Loan and Guarantee Agreements of the Bank dated [______] (the BGC) constitute an integral part of this agreement.

As may be noticed, there is no difference in meaning between the two quotes above. In both clauses, the objective of the Bank is to make the borrower aware of the obligatory character of the BGC, hence their strict observance in the execution of the loan agreement. As they stand presently, the BGC dating from January 1985 deal with four main areas:

• A set of clauses giving definitions of the various terms and expressions used in connection with any loan agreement (Arts. I and II BGC). The terminology used by the Bank is rich and extensive and it appears constantly in the various loans made to different countries with different concepts and terminology. One way of avoiding misinterpretation between the Bank and the borrower is to provide a kind of common language used and understood by all parties. For example, since most of the Bank's loans are designated in Dollars, there is in the BGC a definition of what is meant by such a currency: "Dollars and the sign $ means dollars of the United States of America" (Art. II, sect. 2.(1) (a)). Another example would be the definition of the term taxes, which includes "imports, levies, fees and duties of any nature (Art.II sec. 2.(1) (18) BGC).

These are roughly the kind of questions the BGC try to settle before going into the details of the loan. As elementary as this exercise may be, it does, nevertheless, help the Bank to maintain a certain uniformity in its lending style; and by the same token, avoid futile repetitions, which would only overload the formulation of the contract. These definitions are compulsory and every borrower must comply with them in accordance with Article II section 2.(1) BGC which reads:

> The following terms have the following meanings whenever used in the BGC.

Since the BGC are an integral part of the loan agreement, it follows that all the terms defined would obligatorily retain that particular definition whenever used in future contracts. Thus, if China borrows money from the Bank, and there are some taxes involved in the loan, the Chinese government would, or should, know what this term covers in the Bank's view, and not in its own national legislation. Moreover, these compulsory definitions are constantly reiterated in all loan agreements under the following clause:

> Whenever used in this agreement, unless the context otherwise requires, the several terms defined in the BGC have the respective meanings therein set forth.

Despite their "universal" character, these definitions are by no means exhaustive and they are quite frequently supplemented by additional definitions and terminology proper to each loan as the above clause provides:

> ...and the following additional terms have the following meanings.

For example, in a loan made to Nigeria, one additional clause reads: " Naira or N means the currency of the borrower. "[(6)] Additional clauses may also be brought in to clarify or explain local abbreviations used in connection to a particular loan. Thus, in a loan made to Algeria, one additional clause goes:

M.H.E.F. means the "Ministere de l'Hydraulique, de l'Environnement et des

Forets", then follows the English translation or its equivalent " the borrower's Ministry of Hydraulics, Environment and Forestry."(7) Additional clauses may also help to specify certain events or dates which are peculiar to the borrower and related to the loan such as the following clause:

> Fiscal year means the borrower's fiscal year commencing January 1st and ending December 31st.

This is to distinguish this particular borrower from other borrowers whose fiscal years may be set at different dates.(8)

• The second set of clauses deals mainly with financial matters such as the Loan Account, the withdrawal of funds, interests or reimbursement (Arts. III to VIII BGC). Perhaps the subject which is discussed most in this part of the BGC is the issue of withdrawal of the proceeds of the loan, as it appears from Article V, which is entirely devoted to that particular issue. In the Article in question, the Bank imposes the maximum safeguards by laying down various and extremely detailed procedures to be followed by borrowers whenever they want to make use of the Bank's funds. Thus, section 5.(3) of the above Article states:

> Applications for withdrawal, including the documentation required... shall be made promptly in relation to expenditures for the project. (emphasis added)

Another strict requirement from the Bank is the borrower's obligation to produce supporting evidence:

> The borrower shall furnish to the Bank such documents and other evidence in support of the application as the Bank shall reasonably request, whether before or after the Bank shall have permitted any withdrawal requested in the application. (Art. V, sect. 5.05 BGC)

It follows that, in the absence of a formal application or insufficient documents in form or substance, the Bank will deny the borrower the right to use the money, which in principle he is entitled to by the mere signature of the loan agreement (Art.V , sect. 5.(7). Another area of special interest for the Bank in this part of the BCG is the question of repayment of both the principal and interest. Here too, the Bank has put into place quite a rigid procedure by setting deadlines for reimbursement, locating the locus for repayment, defining the currency of repayment and the calculation of interest.

• The third set of clauses calls for the Bank and the borrower to co-operate for the success of the project by providing an exchange of information on all matters related to the loan agreement.(9) Thus, Article. IX, section 9.(1) BGC, states:

> The Bank, the borrower, and the guarantor shall... from time to time, at the request of any one of them, exchange views whith regard to the progress of the loan and the performance of their respective obligations under the loan agreement and furnish to the other party all such information....

That the Bank requests information is not a novelty in the Institution's practice. As has already been discussed earlier, this kind of request, although uncomfortable to the borrower, is typical of the Bank which has ceaselessly shown a particular interest in the follow up of the projects it finances until their completion, and even once they have been completed. The argument here is that the exchange of information is not always a two-way business as the Bank claims. Although the Article uses the expressions "exchange" and "co-operation", thus denoting a certain reciprocity, in practice, however, most of the information is one way; *viz* from the borrower to the Bank.(10) This superiority is underlined in the provisions of Art. IX, section 9.(1) (c) BGC:

> The member of the Bank, which is the borrower or the Guarantor shall afford all reasonable opportunity for representatives of the Bank to visit any part of its territory for purposes related to the loan.

The above privilege has no sense nor any counterpart from the borrowers side, since, even in the event of a borrower visiting the headquarters of the Bank for the purpose of the loan, the information he may get is less important than that which the Bank receives when visiting the borrower's territory. Moreover, in several countries, especially the economically weak ones, it may be hard to conceive that officials from such countries would challenge a "Giant" such as the Bank. As Mason et al notice:

> the information requested by the Bank is more and is usually less than required by the borrower itself for the efficient control of its own operations.(11)

This can only be logical for a borrower, no matter how strong he is, may be constantly called upon to make concessions as long as he remains a debtor. Security over the repayment of its principal and interest is another area of concern for the Bank. To that effect, the BGC have introduced what is called the "negative pledge." The purpose of this clause is "to ensure that no other external debt should have priority over the [Bank's] loans." (Art. IX,sect. 9.03 (a) BGC). The inclusion of such a clause in the loan agreement acts as a security found in private law whose effect is to limit, if not forbid, the borrower to create any lien on any of his assets as a security for debt incurred by him. The purpose is to enable the lender to recover his money from such assets, should the borrower fail to repay the loan. In the context of the Bank, there is no security as such, but the borrower undertakes in writing that he will not secure any of his public assets for any external debt which will result in a priority for the benefit of the creditor of such an external debt.(12)

Finally, there are other administrative clauses which aim at keeping the Bank and the Borrower in close contact over the day-to-day life of the loan. Among these clauses, section 9(7) of Article IX BGC summarises in a succinct manner the Bank's intentions:

> The borrower shall maintain records and procedures adequate to record and monitor the progress of the project to identify the goods and services financed out of the proceeds of the loan... to enable the Bank's representatives to visit any facility and construction sites included in the project... and to furnish to the Bank at regular intervals all such information concerning the project.

• The fourth and last set of clauses relates to some legal matters such as enforceability of the loan agreement, failure to exercise rights, arbitration, entry into force and termination. The two main areas in this respect are the clauses dealing with Enforceability (Art. IX, section 10.01 BGC) and Arbitration (Art. IX, section 10.04 BGC).

As far as Enforceability is concerned, the issue has already been discussed in another context, namely in Chapter Two. Therefore there is no need for elaboration on this point again. The other and no less important part dealt with in the BGC is the way the Bank and the borrower settle their differences. Article XI, section 10.(4), provides that:

> Any controversy between the parties to the loan agreement... which has not been settled by agreement of the parties shall be submitted to arbitration.

Thus, there are two ways of settling disputes. The first one is amicably; that is to say, through negotiations and mutual understanding. The second is arbitration, through a tribunal, of which the BGC define the composition in advance. The Arbitration Tribunal consists of three arbitrators appointed as follows: one arbitrator by the Bank, a second by the borrower and / or Guarantor, the third (called the Umpire) by agreement of the parties. If they do not agree, then he is appointed by the President of the ICJ; in case of failure, then by the UN General Secretary. The procedure is simple and similar to that found in any conventional Arbitration Tribunal. The award is final and binding upon the parties to the loan agreement.(13) According to the Bank's own records, it does not seem, till now, that such a procedure has ever taken place. The Bank has either settled its differences with the borrower amicably or has applied its own legal sanctions (namely suspension or cancellation of loans).

From a legal point of view, the immediate effect of the BGC is to subject the borrower to a set of pre-established or "ready-made" clauses. As such, the BGC are somewhat comparable to the clauses found in the *contrat d'adhesion* in French private law, where one party has to abide by conditions set in advance by the other party.(14) In the case of the Bank, this practice has both its advantages and drawbacks. The advantage is that the BGC, by their universality, contribute to the uniformity of the rules and procedures, although partially, giving thus all the Bank's users the feeling of equal treatment. The disadvantage is that, like in the *contract d'adhesion*, the borrower is completely dissociated from the process of the formulation of the final contract.

The borrower is thus presented with a set of clauses which he has no choice or chance to discuss, only to accept or give up the loan. The acceptance must be total and without any reservation. Moreover, the unilateralism in law making, makes the BGC extremely rigid from the borrower's side, but too flexible from the Bank's side, and the Institution has always used this flexibility to its advantage. In principle, all loan agreements make it compulsory that the contracting parties must accept the clauses as if they were an inherent part of the loan. However, most of the agreements do carry some modifications on the clauses of the BGC, or sometimes explicitly stipulate the inapplicability of some of them.(15) A good illustration may be to compare the standard clause of Article 1 relating to the status of the BGC in a few loan agreements:

• Example One: In a loan made to Algeria, Article 1 reads as follows:

> The parties to this agreement accept all the provisions of the BGC applicable to the Loan and Guarantee Agreements, dated October, 1980 with the same force and effect as if they were fully set forth herein.(16)

• Example Two: In a loan made to Hungary, Article 1 reads:

> The BGC applicable ....dated October, 1980, with the last sentence of section 3.02 deleted (The BGC), constitute an integral part of this agreement.(17)

Unlike in the first example, in the case of Hungary, the Bank has exempted the borrower from the provisions contained in section 3.2. of the BGC. A glance at the said section reveals that under normal circumstances, the borrowers are subject to a payment of a commitment charge on the amount of money unwithdrawn. In this particular loan, the Bank has, for specific reasons, exempted the Hungarian Government from such a payment.

• Example Three: In a loan made to a Yugoslavian bank, Article 1 reads:

> The parties to this Agreement accept all the provisions of the BGC... dated October, 1980 with the same force and effect... subject however to the following modification thereof... namely that the following sub paragraph (d) is added to section 3.04 of the BGC.(18)

The said section deals with the method of repayment, and the Bank thought it necessary to add, in this particular loan, specific provisions for its repayment by the Yugoslavian Bank.

• Example Four: Sometimes, the modifications entered by the Bank into the BGC are long and numerous, and it may not be convenient to insert them in Article 1. This is the case of a loan made to Morocco where Article 1 reads normally (as it does, e.g. in example one), then follows a reference to a schedule at the end of the loan agreement listing the modifications introduced.(19)

It seems that the BGC, as they stand, have fallen short in this particular loan, to provide all the necessary assurances for the Bank to grant the loan. Therefore, new additional clauses have to be found to fill the gap in the existing legal framework provided by the BGC. The legal nature of these additional clauses seems to have been resolved simultaneously as the Bank always attaches the mention that the additional provisions have become part of the BGC, i.e. that they are legally binding like any clause contained in the original BGC.(20) However, the deletion or addition of any particular section(s) is valid only for a specific borrower for whose benefit the changes were made. It cannot be extended ex-officio to other loans, nor can it be used as a precedent by other borrowers to claim similar treatment. Despite their general character, the BGC remain from the legal point of view part of the contractual and obligatory package. As Zavala pointed out,

> [T]hey , (the BGC) flow from the loan agreement itself, and as such are nothing else but a mere continuation of the loan like any contractual clause in the agreement."(21)

Such a binding character is also recalled, although implicitly in Article II section 2.01 (BGC) in the following terms:

> [T]he loan agreement includes these BGC as applied thereto and all schedules and agreements supplemental to the loan agreement.

It follows that non-compliance with any clause in the BGC would, at least in theory, amount to a breach in the form of the contract, and eventually lead to the application of the appropriate legal sanction, (suspension / cancellation of the loan).(22) From the point of view of this study, it may be worth recalling that the BGC *per se* are neither a substitute, nor a replacement for the conditions that the Bank lays down in the Articles of Agreement, or the specific conditions it may attach to individual loans. Despite their binding force, the BGC by their content may be said to stand at the bottom of the ladder of the various conditions which the Bank imposes on its borrowers. The coercive element that the term conditions generally implies is almost non existent in the BCG clauses. In addition, the BGC do not contain any "sensitive" clause which may "hurt" the borrower. For example, they do not deal with the nature of projects to be financed by the Bank, nor do they set a limit to the money to be lent. They do not fix the limit of reimbursement or the rate of interest. They were initially set up mainly for practical reasons, i.e. to unburden the text of the loan agreements in order to facilitate their negotiations. Broadly speaking, most of the clauses set in the BGC are more bureaucratic guidelines, a kind of routine rather than serious stringent rules. As such, the BGC do not pose any real threat or constraints on borrowers, who usually tend to accept them without too much reticence, since most of them are clauses directly attached to the formal aspect of the loan, rather than its substance. The BGC have no legal effect on their own. As mentioned below, they draw their legal force basically from the loan agreement in which they are inserted.(23) Consequently, it is the loan which governs the contractual relationship between the parties according to the old established rule *Pacta Sunt Servanda*, as it is faithfully recalled in Article 1, section 1.02 (BGC):

> If any provision of a loan agreement or Guarantee Agreement is inconsistent with a provision of these BGC, the provisions of the loan agreement or Guarantee Agreement as the case may be shall govern.

From the Third World point of view, the BGC help the Bank to fulfill certain hidden objectives. One of them is to use the BGC as a way to add or delete whatever the Bank wants. This gives the Institution a large margin of manoeuvre in meeting any kind of changes that may occur in its lending policy. It is especially a clever legal technique to introduce conditions without having to change its main Statutes, the Articles of Agreement.(24) This means in legal terms avoiding amendment, a procedure that the Institution has always rejected. And if the Bank has so far successfully resisted such amendments, it owes this resistance mainly to the BGC. For, as stated earlier, it is the Administrators who are the architects of the BGC. They shape the clauses as they think would suit the Institution's functioning. Their work is not supervised, or submitted to discussion to any external authority such as, for example, an inter governmental group, or a special independent body of experts.(25)

II- Conditions of Effectiveness.

In the Bank's parlance, the conditions of effectiveness are those conditions which the institution deems indispensable for the success of the project. In other words, without such conditions there is no guarantee that the loan will achieve the purpose for which it is made.(26) The nature and scope of these conditions is still a mater of controversy between the Bank and its developing country members. Although, in principle, the conditions of effectiveness are the subject of bargaining between the Bank and the borrower, it is generally agreed that it is always the Bank's ultimate decision which prevails.(27) By making the conditions of effectiveness a *sine qua non* for the success of the loan project, the Bank has implicitly reduced the borrower's bargaining capacity. Since the Bank considers such conditions as indispensable, it follows automatically that their content cannot be challenged or disapproved by the other contracting party. Henceforth, the Third World claim that these conditions are set unilaterally, and, as such, imposed on them.(28)

In the Bank's belief, conditions of effectiveness are introduced for the purpose of the sole benefit of the borrower. By imposing these kinds of conditions, the Bank wants -at least in appearance- to focus its concern on its borrower's success. It is precisely that concern which led the Bank to consider the conditions of effectiveness as of paramount importance. This assumption reinforces the previous argument put forward by the Bank, that it does not lend for investment purposes only:

> What is at stake here, is the concern...that the borrowers have done whatever has to be done at the domestic level to make the agreement binding. The pre-eminent concern of [the Bank], is to get [its] money back... But since we [in the Bank], do not lend money just to invest it and get return on it, we are concerned as well with all matters to be taken into account of to permit the proper execution of the project. That concern can lead to the imposition of conditions to be fulfilled before the first disbursement is made.(29)

Thus, effectiveness became just another key word to which the Bank has attached a great deal of importance, and given a wide interpretation in the process of its lending policy.(30) Unlike the BGC, conditions of effectiveness are available in no other separate legal covenant (eg. in the letter of intent). They are neither general nor universal, and their application is strictly limited to individual loans. Each borrower has his own conditions of effectiveness attached to his loan. Some loans may carry more conditions than others, while some others may have none at all. The nature and content of these conditions depend not on the borrower's status, but on the complexity of every loan. Thus, the same borrower may be subject to different sets of conditions of effectiveness, at different times of borrowing. This optional characteristic may give the impression that these conditions are negotiable when they are not.(31) Studies of Bank operations have cited several instances where acute conflicts developed between a member country and the institution over the extent of imposing the conditions of effectiveness.(32)

From the legal point of view, the conditions of effectiveness do not enjoy the same legal status as the BGC, in the sense that they are not agreed upon, *ex-officio*, by the borrowing state. The sole common denominator between the two sets of conditions is that they are both referred to in the loan agreement. This insertion is sufficient to give the conditions of effectiveness a binding force in accordance with Art. II, section 2.01(BGC.)(33) As a consequence, the proper execution of the loan will depend on the compliance with these conditions. As Broches wrote:

> if conditions established for effectiveness are not fulfilled by a specific date, the agreement shall be cancelled automatically.(34)

However, unlike the BGC, conditions of effectiveness are not pre-established clauses, "fittable" to any borrower. They start taking shape from the early stages of the Bank's appraisal mission. They are thus part of the operational aspect which distinguishes the Bank from other international organisations such as ILO, WHO or FAO, which are rather functional institutions.(35) In practice, not all borrowers are subject to the same degree of conditions of effectiveness. The string of conditions depends largely on the economic and financial capabilities of each borrower; the less fortunate he is, the more stringent the conditions are. In reality, it is the weakest countries of the LDCs which have the most to fear from the conditions of effectiveness, because of the hard constraints imposed on them.

From the point of view of International Law of Development, the conflict between the Bank and its borrowers has its roots in the very nature and opportunity of these conditions.(36) On one hand, the LDCs argue, that the Bank unduly requires conditions attached to the effectiveness of the loan, as an obligation for the borrower to carry out some specific measures. Seen from this angle, the conditions of effectiveness would: **a)** grant the Bank an authority which it does not have in reality, and **b)** raise the corollary question of whether it is appropriate for the Bank to impose on borrowing governments policy choices concerning the use of their economic resources, which differ from those they would otherwise prefer. On the other hand, the Bank defends its position by arguing that the conditions it requires for the effectiveness of the loan are part of its prerogatives as an International Institution. As one of the Bank's officials put it, in these rather simplistic terms:

> The Bank does not obligate the borrower to carry out any kind of measures. It has neither the ability nor the power to do it. What the Bank does is to subject the disbursement of its funds on the existing of certain preconditions necessary to the effectiveness of the loan. These measures rest entirely with the power of the borrowing state or entity.(37)

The conditions that the Bank imposes for effectiveness are numerous and varied, and cannot possibly be listed here. Among these conditions, institution building, the rate clause and procurement seem to be common in almost all loan agreements surveyed. An attempt will be made to look, through concrete examples, in some depth at the reasons why the Bank asks for such conditions and what are the legal implications of these conditions on the institutional arrangements of the borrowers.

A)- Institution Building.

As discussed previously, a major concern for the Bank when negotiating a loan is the borrower's entity which will be responsible for the materialisation of the project.(38) In the following loan made to Ageria no such entity existed and the Bank insisted that before it agreed to finance the project it made the creation of an autonomous entity a condition of effectiveness for the financing of the project.(39)

a) The Algerian Case of EPEOR(40)

The EPEOR loan, approved on March 13, 1986, is among a series of loan agreements made by the Bank to supply drinking water to Oran, the second largest city in western Algeria. According to schedule II of the loan, the objectives of the project are:

(1) To increase water production for the area of Oran to meet the present demand and future requirements.

(2) To expand the distribution network and improve the efficiency of the production system.

(3) To improve the organisation and operations of the Regional Water Companies.

(i) The Water Situation in Oran before 1986.

Before the Bank stepped in Oran, like any major city in Algeria, suffered immensely from an acute shortage of drinking water. Institutionally, the water supply depended on two separate entities: SONADE, which is a state controlled firm under the auspices of the Ministry of Hydraulics, with the main task of prospecting for water resources. The second entity was the APC, the equivalent of the French Commune or the UK District Council, with the main task of selling water to the consumer. The lack of clearly defined roles and prerogatives, coupled with bad management between the two entities led to chaos in the water supply industry, the result being that a lot of water was unaccounted for; no strict list of consumers was available; and there was no real effective control on consumers, with some having huge arrears, while others have never paid at all. In some instances, people did not even have a meter, and illegal connections were quite a common practice. Others were astonished that they should pay for water at all, on the religious grounds that it is a natural resource and therefore exempt from tarrification. When paid by a minority of consumers, the prices of water were insignificant as water was subsidised by the Central Government.

For many years, there was no fixed rate, and people were paying only a nominal charge for a given period of time, no matter how much water they consumed. There was no rigid control over the use of drinking water, and some people did not hesitate to use it for their own gardening or small factories. There existed by laws to penalise bad users or illegal consumers, but they were hardly enforced by the local authorities. As a result, less money was getting into the APC funds and no maintenance or repair work was carried out in time. Damaged pipes and flooding streets were regular scenes. To these man made degradations, the severe drought that had affected the country for the previous eleven years or so made the water situation even worse.(41) It was in these conditions that the new institution recommended by the Bank to take charge of the project came into being.

(ii) The Creation of EPEOR.

As a result of the negotiations between the Algerian Government and the Bank's officials, it was agreed, on the insistence of the Bank, that the water supply and sewerage be taken charge of by an autonomous enterprise called EPEOR. In legal terms, and in the specific case of the Bank, this meant that as a condition of effectiveness the Algerian Government had to provide to the Bank a satisfactory entity which would be responsible for the project. In other words, the loan would not be granted, unless EPEOR was set up.(42) Following the recommendations of a Bank sector study in 1982, EPEOR was created by governmental Decree No 83-340, dated May 14, 1983.(43) The Decree states that:

- EPEOR is an autonomous entity.
- EPEOR is guided in its organisation and functioning by the principles of the "Socialist Management of Enterprises" code.
- Tariffs are set by the Government.

- The State has the control over EPEOR's budget.

From this brief outline of the Decree, it may be interesting to trace back the Bank's influence on the creation of EPEOR, and see from a concrete case how, and to what extent, the Bank's action can affect the borrowers laws and institutions.

(iii) The Role of the Bank in the Creation of EPEOR.

At first glance, there is no noticeable or direct involvement of the Bank which may mark the Decree with some of the Bank's own specifications. On the contrary, the Decree reflects a great deal of the Algerian socio-economic and ideological realities. Among such purely Algerian characteristics, Article 2 (Decree) refers the creation of EPEOR to the code of the "Gestion Socialiste des Entreprises" (GSE) thus denoting the Government's intention to keep EPEOR in conformity with the national ideological framework.(44) This may sound paradoxical in comparison with the Bank's traditional dislike of socialist management and state-owned enterprises. One hypothesis may be that this was deliberately done to prevent EPEOR from falling into private hands, although the Bank may have hoped for this to happen.

However, an intensive study of the Decree reveals that the government authority is less important than it appears on the surface, and that the real author of the Decree is not the Algerian government, but the World Bank. To support this argument, two misleading but nonetheless most important provisions of the Decree will be discussed. The first misleading provision in the Decree is that referring to the Code of Socialist Managment of Enterprises. In the present case of EPEOR such reference is absolutely irrelevant. The salient feature of the named code, its very *raison d'etre*, is precisely to subject all state enterprises to socialist laws.(45) This does not seem to be the case for EPEOR where reference to socialist management has been inserted more for political reasons than as a matter of principle. For such a reference is in blatant contradiction to the provision of Article III section. 3. 02(a) of the loan ,which seeks purposely to distance EPEOR from the state:

> The Borrower [ie. the government] shall (i) transfer to EPEOR upon the completion of the project, all facilities provided under Part A of the project ...and (ii) assign to EPEOR the responsibility for the operations, management and maintenance of the facilities transferred to EPEOR.

Had the Code of Socialist Managment been applied, as it was in other public undertakings, EPEOR would have never acquired such autonomy.

As a consequence of Article II, the state has lost the most important aspect of any economic enterprise, which is the right to control and dispose of EPEOR's revenues. Before the loan, the money collected from water consumption was aimed primarily at generating as much cash to the government's Treasury as possible. With the establishment of EPEOR, it became the enterprise's ability to take over the whole water industry. This involves water exploration (drilling), collecting bills regularly, penalising bad and illegal consumers, making compulsory connections, supervising maintenance work, building reservoirs and so on.

Though the money collected belongs to the enterprise it must, however, be spent according to the Bank's own conventional directives, which set up spending priorities in similar loans.(46) The first of such priorities is that the money must service the loan, ie. pay back the principal plus interest of the loan to the lender which is the Bank. This may sound natural since the prime objective of any banker is to recuperate his monies and build his business on the interest that is attached to the loan. The second priority is that money collected should be used to finance EPEOR investment programmes, without relying on government subsidies. This commitment is part of the general policy of the Bank of keeping the government away from the enterprise. The third priority is that any money left should be used as a contingency for any unpredictable expenses that the enterprise may incur. Here again the purpose is to prevent EPEOR from falling under government authority under any pretext. The second misleading provision of the Decree creating EPEOR relates to the tariff issue, and should be handled carefully. For if the Decree states that it is the government which fixes water prices, this is not always correct. What the Decree does not say is that the price issue has been raised, discussed and agreed upon conjointly by the Bank and the government during the negotiation phase; that is to say, before the loan was formally granted. In other words, any final price that the Algerian authorities may have come up with at the end is a price which had satisfied the Bank, and on which the government had given its accord. So, it is essentially the Bank's tariff, not the government's own decision.(47) Accordingly, there too, reference in the Decree to the government as the responsible person for the tariffs issue was rather motivated by political considerations than being an act of a sovereignty. Mainly that it is government officials who decide on such important matters as the price issue.

Furthermore, the influence of the Bank on EPEOR can also be inferred, not from particular aspects of the Decree, but from the circumstances which led to the promulgation of the Decree. It has been said earlier that EPEOR was created at the insistence of the Bank. Since the Bank can approve EPEOR only on some sort of legal basis, it follows that the Decree creating EPEOR was also submitted to, and approved, by the Bank. In other words, the Bank's satisfaction with EPEOR comes from its satisfaction with the Decree creating EPEOR. The Bank's right to examine the Institution is not argued here, since such a right is guaranteed by Art. IX, section 9.(1) BGC, discussed earlier (infra poge 117). The argument can also be explained the other way round, i.e. had the Bank not been satisfied with EPEOR, or more precisely with the Decree creating EPEOR, it would have never granted the loan.

Perhaps it is outside the Decree, ie. in the loan agreement that the Bank's participation in the creation of EPEOR may be best inferred. Under a series of warning clauses which actually protect the Decree, the Bank indirectly admits its involvement by acting as a "behind the scene" member in the legislative process. Thus, in Article V, section 5. (1) (c) of the loan agreement, the Bank threatens to suspend its funds if:

> Decree No 83-340 of May 14, 1983 ...shall have been amended, suspended, abrogated, repealed or waived, so as to affect materially and adversely the ability of EPEOR ... to perform any of [its] obligations.

The same warning is given in the subsequent paragraph which unequivocally states that the loan may be suspended if:

> The borrower or any other authority having jurisdiction, shall have taken any action for the dissolution, disestablishment of EPEOR (or for the suspension of [its] ... operations.

These two clauses demonstrate in a clear manner the Bank's tacit approval of the Decree and its commitment to seeing its provisions implemented. For it would be inconceivable that the Bank would have surrounded EPEOR with such a protection if it were not convinced by its overall structure, and above all its ability to execute the project successfully.(48) There are other further protective measures in the loan agreement to ensure that during the execution of the project, and even after its completion, EPEOR shall be immune from governmental influence, whatever form it may take. In some instances, the government is specifically called upon to refrain from taking actions as those stipulated in Article III, section 3.01 (6) of the loan agreement which reads:

> The Borrower (III) shall not take or permit to be taken any action which would prevent or interfere with [EPEOR's] performance.

The second and equally important area where the Bank's influence is most felt, is the rate clause, but seen from a different angle than previously.[49]

B)- The Rate Covenant.

In the Bank's understanding, the rate clause is "a clause which imposes as a condition that the borrower undertakes certain obligations to sell (water / electricity) at a certain rate.[50] The issue of rate has been one of the most controversial issues which is frequently raised in loan agreements dealing with public utility projects such as water electricity, and more recently, telecommunication and transport. Part of the controversy is that, in some cases, the making of arrangements for the establishment of rates acceptable to the Bank is made into a condition of effectiveness. In other words, unless the borrower raises its tariff he will not qualify for the loan. The following example is an illustration of a loan where the rate clause is at stake.[51]

a) The Case of A2BZ.[52]

In 1987, the Bank made a loan to {......}, to finance a telecommunication project. In its finding, the Bank's mission personnel reported that the borrower's tariff structure was particularly defective, and that it needed to be reviewed. It was revealed in the report that the connection fee ($ 24. 75) was too low to ration some of the large excess demand.[53] The service charge ($ 1. 68), while not including telephone maintenance, was still low. Call units were charged at ($ 0.37) and local calls were not metered. There was no peak/off peak pricing. Numerous miscellaneous charges were too small to have any meaningful effect on user behaviour (eg., a $ 1.87 reconnection penalty) and generated more administrative costs than revenues. In the Bank's opinion such a tariff policy sends the wrong signals to subscribers, which may result in sub-optimal utilisation of an already inadequate network. Therefore concluded the Bank's report, "A2BZ should carry out, as part of the project, a study of its telephone tariff focussing on costs of service..." Then follows the relevant clause:

> As a condition of effectiveness, A2BZ should have furnished to the Bank a program satisfactory to the Bank (including action plans, tariff review and time schedule), to improve its overall organization, management and operations.

In the Bank's view, the insistence on the rate clause, is to provide sufficient revenues for the institution responsible for the project. This would permit the institution to operate economically, and to ensure its independence from government subsidised support. In several instances, however, where such a rate was unbearable by the majority of the people, there was social unrest and political upheavals. Examples in this area are abundant and include Tunisia in 1984, Morocco in 1985, Sudan and Egypt in 1986. In some cases, governments have simply withdrawn the rate clause and accordingly they pulled out from the loan altogether, because they could not afford to ask their people to pay such high rates. The Third World complaint about the rates is that they are deliberately meant to be high so as to ensure enough revenues for the project and to prevent it from failure, so that the borrower can eventually pay the loan back to the Bank. This argument is categorically rejected by Broches for whom the rate increase recommended by the Bank is for the borrower's benefit. He wrote:

> We require [rate covenant] not so much to ensure service of the loans as to ensure a healthy financial condition for the borrower; and a healthy financial condition may mean accumulating sufficient income to be able to finance expansion out of its own resources.(54)

Broadly speaking, the Third World leaders do not understand the necessity for the Bank to impose on their own people prices calculated in the sumptuous offices of Washington, and which do not take into account the socio-economic realities of the borrower. They feel that the price policy is a matter of domestic determination, and that any interference by the Bank is tantamount to an infringement of their sovereignty.(55)

c)- Procurement Requirements.

The third area where conditions of effectiveness are common in loan agreements to LDCs is procurement.(56) It was stated earlier that one of the particularities of the Bank's contracts was that they linked the loan to the procurement (ie. purchase) of goods, from certain member countries known before the loan becomes effective. The procurement clause as it stands is not found in the Articles of Agreement. It derives from a general principle in the Bank's Statutes which directs the institution to use its money with "due diligence" This concept, which is borrowed from the Anglo-Saxon tradition, means that the Bank should take all precautions to ensure that its money is well spent. Translated into law, this principle gave birth to a set of rules known as "Guidelines for Procurement under IBRD Loans and IDA Credits" (hereinafter the Guidelines).(57) Explaining the reason for the establishment of the Guidelines a former legal adviser in the Bank said:

> [W]e have a provision in our Charter that the Bank should make arrangements that ensure that the proceeds are used only for the purpose for which the loan was granted with due attention to consideration of efficiency and without regard to political or other non economic considerations. Based on that, we have evolved the idea of requiring international competitive bidding.(58)

Briefly the purpose of the Guidelines is to give all eligible prospective bidders an equal opportunity to bid for the necessary goods and works related to the project financed by the Bank. What is particularly relevant to this study is that in some cases the procurement of goods under the Bank's Guidelines is made a condition of effectiveness, as will be seen in the following loan made to Morocco.[59]

a) The Case of ONPT.[60]

The project is an integral but self contained part of ONPT's investment programme to be implemented during 1987-1994. It aims at expansion, improvement and modernisation of the telecommunication network. The project comprises:(i) providing and installing about 290.000 lines, (ii) connection of 300.000 new subscriber lines, (iii) long distance transmission systems, (iv) equipment to expand domestic and international telex service by about 7000 lines, (v) equipment to upgrade and automate services in 89 distant rural districts, (vi) technical support equipment and vehicles, (vii) specialised transport, tools data processing and training equipment. The relevant clause in the loan agreement states that:

> Except as the Bank shall otherwise agree, procurement of the goods, works and consultant's services required for the project and to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 4 (the Guidelines) of this agreement.[61]

In the Bank's interpretation, this means that the loan will not be awarded, unless ONPT follows the Bank's Guidelines on procurement and construction works. The reason for the lodging of such a clause in this particular loan is explained by the fact that the project is heavily capital intensive, requiring sophisticated and expensive equipment produced mostly by the developed world. Schedule 4 section 1 of the loan agreement, is even more explicit in its wording:

> Goods and works shall be procured under contracts awarded in accordance with procedures consistent with those set forth in sections I and II of the "Guidelines for procurement under IBRD Loans and IDA Credits" published by the Bank in May 1985.

For the purpose of the above mentioned clause, and in order to comply with the Bank's Guidelines, the Moroccan government must prepare under the Bank's supervision a General Procurement Notice, (GPN), outlining briefly the works and goods to be acquired through ICB. The GPN is then published in business reviews of world wide diffusion, including the Bank's "International Business Opportunities Series" (IBOS), and the UN publication "Development Business", to cite only these two major sources.(62) In terms of law, this procedure has the disadvantage of reducing the borrower's participation in the formulation of the contract, while giving the Bank the key function.

(i) The Role of the Bank in the Procurement Contract.

In the procurement business, the role of the Bank is rather controversial. Despite the Bank's numerous statements that the conclusion of the procurement contract is a matter between the borrowing country and the supplier of goods and services, it is a fact that the buyer's freedom is severely restricted. Not only is the borrower limited to buy from certain countries, but he must also get the Bank's approval on any final deal he concludes with a supplying party.(63)

The Bank's officials insist that the role of the Bank is not the conclusion of the contract, but the interest of the borrowing buyer. That is to say, to help the borrower to obtain the adequate goods and services for the best price for the execution of the project. In so doing, the Bank says that it is only fulfilling one of its statutory obligations which requires it to use its loans with economic consideration and efficiency.(64) No matter how plausible this argument may sound, for the vast majority of the LDCs, it is not a convincing argument, since the boundaries between not interfering in the conclusion of the contract and deciding over who is going to win the contract, the line is fictitious.

(ii) The Legal Implications of the Procurement Clause.

Since the Guidelines have been incorporated into the loan agreement, it follows that they have become an inherent part of the obligatory package, like any other clause in the contract. Therefore, non compliance with the ICB clause gives the Bank the right to refuse to lend to any borrower who does not comply with the Guidelines.(65) The first implication of such a clause is that, indirectly, the Bank makes its contracts tied to the purchase of specific goods from specific countries, some of which are not even members of the institution, such as Switzerland and Taiwan.(66) In C. Payer's view, there is a complicity between the Bank and the western multinationals which provide the goods and services for the Third World borrowing countries. As the author says:

> Loans and credits disbursed by the World Bank are for most part project-tied, which means the money is paid directly to the corporation that wins contracts for constructing or supplying projects financed by the Bank...This is a multibillion Dollar market.(67)

Although the Bank tries to minimise the importance of such allegations, the arguments so far advanced are not convincing and the question whether the Bank's loans are untied remains, as far as LDCs are concerned, still unanswered. The second implication of the procurement clause, is that it makes the LDC borrowers a big shopping forum for the DCs goods and services. In this context,the World Bank is regarded by most of its critics as a bridge across which the money lent earlier from the DCs is being re-injected in the economies of these same countries, perhaps with better and larger long term profits.

The third implication, which is a logical continuation of the second, is the feeling amongst the LDCs that by forcing them to buy foreign goods, the Bank is implicitly discouraging the development of Third World infant industries. To justify its stand, the

Bank argues that:

> There has been a feeling that by insisting on international competitive bidding, we do a disservice to the borrower in special cases. On the other hand, we have to take into account that the providers of our capital are very interested and we have to strike a balance between the interest of exporters of equipment and goods and recipients of loans.(68)

This statement confirms the view described earlier, namely that the procurement contracts are no more no less than a Bank reward for the DCs financial contribution in the institution's capital. They also see the Bank's action in a much wider context, as an instrument to maintain the industrial dependency of the South on the North. It was not until the late sixties that, the Bank under the pressure of some Third World "advanced" countries, such as Brazil, Mexico and India, responded by allowing a certain margin to the LDC goods (7%), and civil work (15%).(69) The figures have not been changed since, despite the capability of some LDCs to participate in the procurement operations on a much larger scale than those imposed by the Bank.

III- Conditionality.

Amongst the different conditions that the Bank imposes on its borrowers, conditionality is undoubtedly the most stringent set of measures that is most feared by the Third World borrowers.(70) Generally speaking, conditionality requirements are found in the grey reports which summarise the different stages of the negotiations leading to the conclusion of contracts. Since these reports are confidential, it is not always easy for an outsider to evaluate the degree of conditionality that accompany such agreements.(71) Therefore, one possible and feasible approach to evaluate the Bank conditionality programmes may be to look at current policies of certain LDCs that have been receiving Bank assistance for the past decade. However,since Bank funds have been made available to a large number of LDCs, no attempt will be made in this section to select any particular country except to cite examples when appropriate. The purpose here is rather to try to trace the origin and nature of the concept of conditionality; to examine its application in the context of the World Bank; and to evaluate its legal and social impact on Third World borrowers.

A-Origins, Meaning and Scope.

There is no single definition of the concept of conditionality.(72) For Mason et al, for instance, conditionality is synonymous with leverage, which they define as:

> The existence and degree of influence exercised by a lender on the behaviour of a borrower.(73)

This definition is incomplete in the sense that it does not limit the scope of influence of the lender. In other words, Mason et al do not specify the sphere of influence of the lender ie. whether the Bank's influence is limited to the loan, or whether it extends beyond the loan.(74) This lacuna seems to have been filled by T. Hayter's definition which is probably nearest to reality:

> By conditionality..., is meant the Bank's ability through offer of rewards or threat of withholding benefits to induce action on the part of a state concerning economic policies and institutional reforms not related to the particular project.(75)

This definition can, to a large extent, be verified from the study of recent cases, where it appears that the World Bank is no longer satisfied with the traditional measures it has customarily imposed on its borrowers. These latter are not asked to limit themselves to implement conditions surrounding the loan project only, but are also required to intervene in several other areas. This is what economists in the Bank call policy based lending.[76]

From the Bank's point of view, conditionality is regarded as a safeguard that borrowers will eventually repay their debts. One method for the Bank to ensure being repaid is to get directly involved in the economic process of the borrowing countries. But this formula does not always fit in with the borrower's aspirations and objectives which he intends to achieve when he applies for the loan. Hence the dilemma for the developing countries: on the one hand, they know that they must get the money which they need for their economic development; on the other hand, they realise that they cannot get the money unless they bow to external pressure and behave in a manner not always chosen by them.[77]

On the origins of the word conditionality, there is also the same state of confusion.[78] So far, there is no general consensus between writers as to the origins of the term conditionality. For some authors such as Frances Stewart and Paul Mosley, "Conditionality is probably as old as loans to governments."[79] The authors base their arguments on the missions sent to Latin America in the 1920's by Montague and others, which already required a certain financial orthodoxy from the countries which were asking for credit.

In modern international financial relations, the same pattern of conduct may be found. Any creditor, be it private or public may, for "safety reasons", impose certain measures, often referred to, in the case of the Bank or official (ie. governmental) assistance, as a conditionality package.[80] The difference with the past however, is that the lender is more involved in the borrower's internal economic affairs. The degree of involvement is sometimes disproportionate to the value of the loan in terms of economic interference and political cost for the borrower. The conditionality packages, as it will be seen later, vary in degree and nature from one borrower to another. From the cases studied, it appears, paradoxically, that the poorer the country, the harder is conditionality. The concept of conditionality, thus understood, covers a much wider area and implies, *inter-alia*, a direct intrusion of the creditor in almost every aspect of the debtor's economy. It is generally agreed that its use in modern times is closely associated with IMF operations. It is therefore essential to look, albeit briefly, into the Fund's practice, before considering in more detail the Bank's attitude.

a)- IMF Conditionality.

The international Monetary Fund was established at the close of World War II, along with the Bank, though for a different purpose. Rather than finance specific development projects and reconstruction, the purpose of the Fund is to assist member countries, developed and less developed, to finance temporary balance of payment problems and foreign exchange shortages.(81) Fund Officials argue that this can be done in two ways. First, by providing money and, secondly, by making its provisions conditional on governments carrying out programmes which will improve their balance of payments situation. Initially, the Fund's Statutes did not provide for arrangements to tie borrowers with specific conditions.(82) According to C Payer, the need for conditionality appeared as late as 1950 under the US influence, then the sole creditor of Fund resources.(83) The American view was that the IMF should not, as its Articles state, merely provide more or less automatic access to its resources to help members to deal with balance of payment difficulties. For the Americans, the Fund should exercise, in parallel, some kind of control and security over all drawings and should have discretion to promote what it considered "appropriate domestic policies in member countries"(84) The industrialised governments which were the biggest Fund users at that time did not subscribe to the idea of having to bend their knees to U.S. interference in the management of their economies. But as F. Stewart reported, the attitude of the same Europeans changed completely when the less developed countries became the chief borrowers.(85) However, it was not until 1960 that the word conditionality appeared for the first time following an amendment of the Fund's Articles of Agreement.[86] Thus Article III refers to conditionality as:

> the policies the Fund expect a member to follow in order to be able to use the general resources.

From the legal point of view, the aim behind the use of conditionality on potential borrowers was seen largely in terms of the need to ensure prompt repayment of drawings so as to safeguard "the revolving character of the Fund"; a technique which means, in the Fund's jargon, reviewing the Fund's finance in a short time.[87] It has constantly been maintained that the Fund is entirely concerned with providing financial support for packages of policy reforms. In this respect, the role of the Fund is to commit, and make available, its resources purely and simply against the willingness of a government to formulate and subsequently to implement, within a period of time, the agreed programme. As Gold wrote:

> The word [conditionality] is applied to the practice according to which under most policies,the Fund makes its resources available only if it receives satisfactory assurances from a member that it will follow policies likely to solve its balance of payments problems within a temporary period and enable it to terminate its outstanding use of the Fund's resources not later than a prescribed date [88]

But, as LDCs engaged in the Fund's programmes soon came to realise, quite often the "stringency of conditionality has sometimes seemed disproportionate to the need to safeguard the repayment of Fund credit."[89] The stumbling point is that the Articles did not give any express guidance as to what policy the Fund should encourage its members to follow under its policies of conditionality. There is, thus, no absolute standard of conditionality. However, it appears from the current practice that some of the conditions frequently incorporated into IMF loans to LDCs include:

- Changes in public investment programmes.
- Reform of Public enterprises (autonomy, privatisation).
- Raising interest rates.
- Reduction/elimination of consumer price subsidies.
- Wage and salary control.
- Improved management of external debt.
- Devaluation of local currency.
- Liberalising imports.
- Encouraging exports.

Whilst no single loan contains all the foregoing conditions the list, nonetheless, is representative of the policies the IMF regularly imposes upon LDC borrowers.[90] This relentless insistence on such conditions has given the Fund an odious image in the vast majority of Third World countries. For, in most countries where Fund medicine was prescribed, no country was able to swallow it properly.[91] "Certainly", wrote Robert S. Brown,

> no government leader is going to take the medicine, no matter how miraculous it may be, if it believes that the likely result will be the overthrow of his regime.(92)

B- The Basis of the Bank's Conditionality.

Although the Bank has always been influenced, and to some extent attracted, by IMF conditionality, this influence is not the only decisive factor which is at the origin of the institution's decision to adopt a similar concept in its lending operations.[93] There are other totally different reasons which go back to the early 1970's. During that period, LDC. governments had been able to avoid going to the Bank because they could get almost unlimited and, more importantly, unconditional loans from western commercial banks which were then busy in recycling OPEC petrodollars.(94) Wrote Williamson:

> With that money going around, the vast majority of LDCs carried out expansionist policies which the IMF and the Bank could not have agreed to.(95)

By the end of the seventies, the newly private lending system established previously became uncontrollable and eventually collapsed. The world economy entered its second deep recession of the decade.(96) The consequences on Third World economies were disastrous: heavy debts and less funds, from either private or public resources, were available. It was eventually to the World Bank that most of the LDCs turned for assistance.(97) From the Bank's side, the situation was not enviable either.

Faced with a private source of funds lending in total disarray and a huge demand from the developing countries, it became clear that the World Bank had to take special measures to deal with the situation. It was in the circumstances of these global economic conditions that the Bank introduced in 1980, a new lending instrument called the Structural Adjustment Loan (SAL).(98) The most striking novelty in SAL is that many observers associate its content with IMF conditionality.(99) To understand the concept of conditionality it is, therefore, essential to look briefly at this new type of lending arrangement, before assessing its impact on Third World borrowing countries.

a)- Structural Adjustment Lending.

SAL was unveiled for the first time at the Annual Meeting of the Bank and the Fund in Belgrade, in September 1979; and the first SAL was made to Turkey in June of the following year.(100) The Bank Operational Manual defines SAL as:

> Non project lending to support programs of policy and institutional change necessary to modify the structure of

> an economy so that it can maintain both its growth rate and the viability of its balance of payments in the medium term.(101)

SAL is thus supposed to respond to the economic crisis of the Third World countries, brought about by maintaining high levels of external debts combined with international recession, which together have a negative effect on their balance of payments and, at the same time hinder their economic development.(102) From the above Bank's own definition, it appears that SAL is:

• A non-project lending, that is to say a loan to finance a programmne of policy rather than a traditional specific project. The immediate consequence is a change in the lending policy of the Bank. Thus, instead of requesting a loan for a specific project, the borrower is required to formulate and present a programme of economic reforms, which encompasses a particular sector(s), or the entire economy. For example, a $ 300 million SAL made to Algeria in 1990 was described by the Bank Annual report as:

> A non-project loan to support the ongoing reform program, designated to turn the economy from a centrally planned system to one that is more decentralized and market-oriented.(103)

From this description, it appears that the Bank has indeed moved a long way from the traditional approach, under which the Bank used to refuse to lend if the loan were not tied to a specific purpose. What is more interesting in the SAL is the areas which it covers. In this context, the SAL made to Algeria is quite significant:

> Constraints will be addressed in macro-economic management, the incentive structure, the financial and productive sector and the environmental, population and social sectors.(104)

Most critics see this new form of lending as a sharp departure by the Bank from its original purpose, and argue that the Bank is deviating from its initial Statutes which instruct it to lend only for specific projects.(105)

• The second feature of SAL is that its purpose is to modify the structure of an economy, namely its growth rate and balance of payments viability. This is a totally new function for the Bank which is neither envisaged by the Articles of Agreement nor is derived from any past practice or Board decision or executive interpretation. Moreover, such a function falls traditionally within the strict competency of the Fund. This has prompted an avalanche of criticism of both the Fund and the Bank. The latter being accused of unconstitutionally interfering in the business of the former.

• The third feature of the Bank' s SAL, is that SALs are never disbursed totally at the outset, but always in two tranches; the second tranche being conditional on the completion of the objectives agreed upon by the Bank and the borrowers, as stated in the letter of intent which is usually annexed to the loan agreement. However, borrowers quite often consume the funds before the completion of the objectives agreed upon with the Bank. This is what happened to Yugoslavia in 1983, when the Bank refused to disburse the second structural adjustment tranche until the government complied fully with its previous commitments.(106) The specific measures the Bank demanded included:

- The introduction of positive real interest rates.
- Relaxation of price control.
- A more liberal import policy.

• The fourth feature of SAL, is the time limit imposed on borrowers which is relatively short as it varies between three and five years, (compared with a traditional loan where the time limit is between fifteen and thirty years). This is another stumbling block, as most LDC governments are generally hostile to deadlines, because they do not leave them enough room for manoeuvre in implementing their reforms. Thus, in the previous Yugoslavian loan, the government agreed to implement the remaining conditions referred to earlier; but not immediately. Government negotiators emphasised that any such measures should be implemented only gradually in order to minimise social and political tensions.(107)

Originally planned to be exceptions, the Bank's SALs are increasingly becoming the rule in the institution's lending policy. This is implicitly recognised by the Bank's officials in various statements where it justifies its shift in policy lending by the scarcity of the resources in the financial market:

> Because of the decline since 1982 in resources available for investment...,the number of traditional projects that are suitable for external financing has declined. In addition, the need for quick disbursing loans has increased, the bank therefore has increased considerably its commitments for adjustment lending.(108)

The real problems for the the LDCs start however, when it comes to putting SALs into effect.(109) As the vast majority of them discovered, SAL implementation is not an easy process and quite often it involves painful decision making on the part of the borrower. This in turn requires a strong political commitment, courage, and, as it will be seen later, social risk taking.

The common practice in SAL implementation is for the borrower to spell out in detail in a letter of intention, which is explicitly referred to in the loan agreement, a precise set of measures to be taken over a given period of time. (See infra Annexe I)

However, in most cases, such commitments fall into desuetude because of the Bank's conditionality that accompany these loans. Examples of disillusioned governments are numerous and, quite often, conditionality is at the centre of frictions between the Bank and the borrower.(110) According to a highly placed Bank Official (who wished to be unnamed), a SAL discussed and negotiated with the Senegalese authorities was cancelled at the last minute, because of the Senegalese government's failure to agree on a particular point of the whole loan. In other cases, governments start effectively implementing a SAL but never finish them. In the opinion of the same Bank Official, in nearly all the Bank's SALs half of the second loan disbursement has been delayed for an average period of six months. The explanation given is that these delays reflect disputes between the Bank and the government as to whether agreements agreed upon previously have been fulfilled. According to the unnamed Official, some governments simply did not want to request the release of the second tranche as originally scheduled. This meant that conditions were not met, and that governments were reluctant to press for their implementation. In many instances, a member country has broken off relations with the Bank on the grounds that the requests or demands of the Bank amounted to an infringement of its sovereignty; and on other occasions, the Bank has taken the initiative and stopped the loan on the ground that its advice was being ignored.(111)

For the LDC governments, there is no doubt that the SAL represents a sharp departure from lending for traditional projects such as infrastructure, agriculture or power plant. The reality underlying such a change in policy is that SAL provides the Bank with a sharper tool to penetrate the borrowers economy than the specific project method does

> Indeed heightened concern about the policy framework can and does substantially affect the context and focus of project lending operations . Bank's structural adjustment lending enables the Bank to address basic issues of economic arrangement more directly and more urgently then before.(112)

The sudden shift towards balance of payments difficultes means for most LDCs more pain and less money. Unlike project lending, conditions attached to a SAL are extremely hard for LDCs borrowers because they encompass almost every aspect of their economy, in addition to the short term lending period which adds an extra burden to them. Moreover, the continued pressure exercised by the Bank on its borrowers through SALs made the Bank move even closer to its sister, the Fund, in term of cooperation on policy based lending. Ironically, just as growing discontent and real doubts have been raised by many LDCs as to the continued existence of IMF conditionality, the Bank has moved in exactly the same direction in its recent lending policy of SAL. In fact, such a collaboration existed in the past, but became more accentuated in recent years, with the emergence of SALs, as will be seen below.

b)- Bank-Fund Collaboration.

Historically, the principle of collaboration between the Bank and the Fund has never been challenged. For, since their inception, the two institutions have been working closely through various established means.(113) At the basis of such collaboration are the Articles of Agreement of each institution which call on them to work closely -not just between themselves- but with any UN international organisation.(114) This collaboration was expressly reinforced in a 1966 dual memorandum which confirmed "the necessity for close and continuous contact between the two staffs at all levels."(115) However, it was in the area of responsibility that the emphasis on close collaboration was more pronounced. Two relevant paragraphs from the 1966 memorandum illustrate the scope of such collaboration. Adressing the Bank, the first paragraph of the memorandum reads:

> As between the two institutions, the Bank is recognized as having primary responsibility for the composition and appropriateness of development programs and project evaluation, including development priority on those matters..., the field missions of the Fund should inform themselves of the established views and positions of the Bank and adopt those views as a working basis for their own work.(116)

In almost identical language, the second paragraph of the memorandum reads:

> As between the two institutions, the Fund is recognized as having primary responsibility for exchange rates and restrictive systems for adjustment of temporary balance of payments desiquilibria. ...On these matters, the field mission of the Bank should inform themselves of the established views and positions of the Fund and adopt those views as a working basis for their own work.(117)

In 1966, at the time this memorandum was issued, the subject of debate was to coordinate the work of the two institutions, while keeping each in its own field, in order to achieve a better result. This close cooperation was summed up neatly by J. Gold in one word: synergism; that is to say:

> Cooperative action by discrete agencies such as the total effect is greater than the sum of the two effects taken independently.(118)

Recent case studies show that some of the policies which the Bank actually recommends to its borrowers, fall within IMF competence, with the result of an overlapping in role and function between the two institutions. Such an overlap does not seem to worry the Bank's leadership for which:

> As soon as the IMF enters the realm of supply side policies, it is inevitably treading on the "development" turf of the World Bank. Similarly, as the World Bank began its program of "structural adjustment lending", its activities began to overlap with those of the IMF.(119)

In some cases, the Bank is no more no less than applying SAL conditionality to a specific project. This means that a country requesting Bank assistance in, for example, the construction of a cement plant, is likely to find itself modifying its tax laws, increasing public transport fares, reforming its educational system, devaluing its currency, and cutting subsidies in staple food. In other words, taking action in areas and sectors of the economy which have no direct link with the purpose of the loan for which finance has been requested. For J. Williamson, there is no difference between the Bank's SALs and IMF stabilisation programmes; they are both complementary and mutually enforceable:

> Both institutions now provide funds that are available to finance a broad range of imports and both impose conditionality that requires the development of action programmes focussed on policy and management issues.(120)

Thus, when the IMF imposes price incentives, it is in fact pointing to the redirection of resources towards the private sector, an area of particular interest for the Bank. Again when the Fund presses governments to reduce subsidies, it is partly preparing the ground for the Bank's privatisation programme. Conversely, when the Bank requires from the borrowers tariff increases in water or electricity, it is, in fact, indirectly helping fight inflation. What is more disturbing is that as a result of this so called modern collaboration between the two institutions, countries securing a Bank's SAL were also required to negotiate a stabilisation programme with the IMF.(121) This means that before a borrower is granted a loan for a particular project, he must undertake a preliminary SAL. In practice, the combination of an IMF programme and a Bank SAL has not been an easy task. Since most borrowers had, in the past, enormous difficulties in reaching a satisfactory agreement with each institution, how could it be possible to ask them now to satisfy both institutions simultaneously ? The results reached so far are mixed. In Turkey, for example, the Bank imposed a series of SALs during 1980-84 before agreeing to finance a traditional project in agriculture in 1985.(122) An example where such a difficult loan combination did not work is the Tanzanian experience. In 1983, Tanzania was negotiating an IMF agreement and at the same a Bank loan. After lengthy negotiations, the Tanzanian government succeeded in getting an agreement with the IMF, but had not been able to reach an agreement with the Bank.(123) The reason for such a "linkage" between the Bank's traditional specific project method and its new SAL's policy based lending is explained by a Bank official, in the following terms:

> It is likely that given the current deterioration of the worlds economic situation, the scarcity of resources and the debt crisis that the World Bank will shift from project lending to SAL, or ask for SAL to get lending. This is the situation now, and there is a tendency that the World Bank is trying to secure anywhere a SAL before negotiating a traditional project lending.(124)

In other cases, the Bank requires a SAL before agreeing to lend for a project. In so doing, as senior officials in the Bank believe, SAL has the merit of cleaning up the countries economic mess, and preparing the ground for the implementation of project lending.(125) In the Bank's thinking, it would be absurd to run an economy on a sectoral basis, ie. providing project lending solely. As J. Williamson put it:

> The Bank has come to the conclusion that there is no reason to think that a sector of activity can be completely reorganised, if the macro-economic context remains in a profound state of imbalance.(126)

Such a curious "liaison" prompted some authors to call the Bank, the Fund and vice versa.(127) Others like Van Meerhaegh have simply called for a merger of the two institutions. For the author noted:

> Close cooperation with the Fund is imperative... In fact, a merger of Fund and Bank would seem to be the best solution, since the same work is often done in both agencies.(128)

Bank officials tend to insist that joint intervention of the Fund and the Bank is possible only with the consent of the borrowing country. In practice, however, both institutions have been implicitly forcing their customers to be bound by each of the other institution's policy (This is what economists call exercising cross conditionality).(129) In the Philippines, for instance, the Marcos regime obtained a SAL only after the IMF approved two loans totalling $ 654 millions.(130) The conjunction of the three loans was commented on in a US Treasury Department Report in the following terms:

> Thus, structural adjustment loans are usually approved only when the borrower has negotiated an extended Fund Facility Agreement with the Fund, a factor which is producing increasingly close Bank/Fund collaboration. Without the added weight and broader focus achieved through collaboration..., the Bank's leverage over macro-level policy is limited.(131)

From an economist's point of view, the Bank-Fund collaboration cannot be refuted. It may be indeed an initiative which should be encouraged, if there are good reasons to believe that it will yield satisfactory results. What is arguable, however, is that economists use such an argument to justify the imposition of a conditionality package by both institutions. If the logic of economics dictates that sound development cannot be achieved except by a combination of macro and micro economic policies, from the legal point of view there is no obligation for the two institutions to impose necessarily similar packages of conditions on borrowers.

Moreover, there is no legal obligation whatsoever in the Articles of Agreement of the two institutions, nor in the interpretation of their respective Executive Boards, that a Bank loan is a precondition for an IMF agreement or vice versa. This is even recognised by one of the most eminent senior officers of the two institutions, Sir J. Gold, as he wrote:

> A stabilisation program supported by the Fund is not a legal condition of a SAL by the Bank. Nor is it necessary that a member must qualify for assistance under the Bank's criteria before the Fund will make its resources available.(132)

Thus, if the conditionality packages that accompany SAL are not foreseen by the Articles of Agreement of the Bank, it may be only legitimate to raise the relevant question as to whether conditionality is a legal concept.

C)- The Legal Nature of Conditionality.

One issue frequently discussed is whether conditionality as applied by the Bank (or the Fund), is appropriate (ie. lawful). As Gold pointed out, "the desirability of a concept of conditionality is not usually accepted and the legal necessity for it has been constantly questioned."(133) From the legal point of view, this remark presupposes an identification of the nature of the term conditionality, ie. whether conditionality is a legal term or has any legal connotation. J. Gold does not think so:

> The word conditionality, although attached to what is regarded as a fundamental and distinctive aspect of the Fund's activities, is not a legal term of art.(134)

In the Fund, the issue of the legality of conditionality was resolved in the late 1950's. As discussed earlier, it was under US pressure that Fund officials were urged to observe a policy of conditionality. At that time, the Americans argued that the necessity for such a concept was implicit in the Fund's Articles. As Gold reported:

> When the US urged the Fund to observe a policy of conditionality, [they] argued that the necessity for conditionality was implicit in the Articles of Agreement.(135)

In the context of the Bank, the evolution of the concept of conditionality and its recognition as a statutory requirement, is less clear and poses some difficulties in tracing it. In the first place, there is nothing convincing in the history of the institution which suggests imposing conditionality packages on borrowers. As noted earlier, one of the cardinal rules governing access to the Bank's resources, is that such assistance must be used efficiently and that the loan must be repaid within a limited period of time. The wide interpretation that was subsequently attached to these provisions enabled the Bank to develop a set of constraints known as leverage, which the institution exercised on its borrowers. As Mason et al explained:

> The Bank is predominantly a project lender and the leverage it has used has taken the form mainly of conditions attached to particular projects or of threats or promises either to withhold or to grant project loans or to reduce or raise the level of such lending.[136]

Leverage in this sense is synonymous with conditions but not conditionality, even if some authors see no difference between the two concepts.[137] It follows from Mason et al's statement that leverage was confined only to conditions which were directly attached to the loan and which would influence in one way or another the life of a specific project. In other words, there is a link between the conditions imposed, and the materialisation of a particular project. In that respect, the scope of leverage was limited. In 1971, for example, when Jamaica wanted to expand a previous forestry loan, the Bank report stated that Jamaican income tax law and regulations did not provide incentives for investment in forestry. Therefore, if the government wanted a loan extension, it must seriously think of a new investment law in forestry.[138]

Another distinctive feature of leverage is its relative application. A brief survey of a few loan agreements shows that the Bank's leverage is strong and persistent whenever projects financed are of great importance to the power (western states) controlling the Bank such as an open door policy to multinationals. However, leverage is weak or even non existent on economically and financially less important projects, such as environment or consumer rights projects. It appears, therefore, from the above examination that leverage is not, and cannot be, associated with conditionality because, unlike leverage, conditionality implies a much wider field of application. As already discussed, conditionality focuses primarily on policy and institutional reforms that cover the whole structure of the borrower's economy.

If the concept of conditionality has been to some extent justified economically, from the legal point of view, its foundation remains unclear. To fill this lacuna, officials in the Bank tend to insert SAL and its corollary, the conditionality packages, under the broad, and somewhat vague provisions of Article III sec.4(vii). This Article refers to the Bank's ability to provide non project lending "in special circumstances". However, what special circumstances are, have never been clearly defined by the Bank's Executive Board, whose tasks include interpretation of the institution's Articles.(139) It seems that it is this exception that the Bank has exploited to give SAL, and accordingly conditionality, a legal recognition. As a former Bank economist Stanley Please wrote:

> It was these special circumstances which the Bank's Articles of Agreement required, if non project lending in the form of SAL operations was to be legally justified.(140)

However this is not the first time the Bank has used this open window to justify some of its activities which are not specifically called for by its Statutes. It has been formally acknowledged by the Bank's Officials that, in addition to SAL, non project lending has been so far used in at least three types of loans where special circumstances were invoked:

- A need for the reconstruction or rehabilitation of an economy after a natural disaster (earthquakes, flood, famine), where urgent transfer of resources were needed to restore normal development activities.
- The need to import supplies or equipment so that existing production capacity can be used more fully.
- In cases of a sudden fall in export earnings in an economy that is critically dependent on a single item of export.

Since the Bank's Statutes did not delimit cases of "special circumstances", it remains difficult to question the legal nature of both SAL and conditionality. As long as such a clause remains open, the Bank can, at any time, introduce changes in its lending policy without being accused of acting outside its legal prerogatives.

In the meantime, even if it were accepted that Bank (or Fund) conditionality has emerged from statutory interpretation, this is still a weak argument to most LDCs, which think unanimously that "conditionality has gone well beyond even what was implied in the Articles of both institutions."(141) The scale of criticism from LDCs that followed the implementation of the first SALs, denote to a large extent their discontent and sometimes their rejection of the Bank's conditionality.

a)- Criticism of the Concept of Conditionality

There is considerable hostility amongst LDCs to the use of SALs by the Bank as most of them find the Bank's analysis inadequate and the imposition of a conditionality package untenable.(142) One decisive factor that contributed to worsen the Bank's image, was undoubtedly its close collaboration with the Fund which is well known by the LDCs for its severity due precisely to its conditionality requirement. Major opposition to the Bank's conditionality may be also explained in large part by LDC leaders who tend to give such a conditionality a political colour. That is to say, that they associate a request for a SAL as an invitation to trade their sovereignty.(143) To many LDC leaders, the conditionality requirements imposed on them by the Bank are (i) legally unfounded, (ii) economically inefficient and (iii) socially mistargeted.

(i) Legal Criticism of Conditionality.

There is a common agreement between writers that conditionality has never been an intrinsic feature of either the Bank or the Fund in their early lending operations.(144) The absence of well-defined rules on conditionality led many pro-conditionality authors to use different subterfuges to legitimise the Bank's and Fund's actions. On the one hand, the concept of conditionality, has never ben codified in the Bank's Statutes. On the other hand, the use of Article III sec. 4(vii) referring to special circumstances cannot on its own justify the use of conditionality. The Bank needs a more convincing legal argument to persuade the LDCs for the necessity of such a concept.

But this legal recognition in itself is regarded by many authors as unsatisfactory, because it is extremely vague. Conditionality thus conceived was ambiguous and conceptually ill defined. As a result, the Fund's conditionality was looked upon by some critics as a loose concept, a sort of "mixed-bag" where anything could be legitimised.(145) This lacuna was remarked upon by J. Gold as he wrote on the Fund:

> The content of conditionality has never been defined by the Articles or codified beyond a few broad principles by decisions of the Fund. The absence of a detached code, has enabled the Fund to develop and modify conditionality so as to accord with changes in the world economy and the special circumstances of individual members or classes of members.(146)

In the same line of thought, Williamson admits that conditionality, has no legal basis per se, but what the Fund or the Bank does, is to achieve the purpose set forth in their respective Articles of Agreement. For the author, as long as conditionality is not in contradiction with the purposes of both institutions, it is not illegal, according to the old saying "what is not forbidden, is permissible" He wrote:

> Conditionality arises when the Fund (or the Bank) adds requirements for access to its resources that are legally compatible with the Articles of Agreements but are not called for by the Articles.(147)

From the legal point of view, Gold's and Williamson's analyses are unconvincing. Their explanation to justify conditionality is simplistic in comparison with the effect which the conditionality package inflicts upon its borrowers as will be seen shortly.

(ii) The Economic Inefficiency of Conditionality .

Although it may be not possible in the context of this thesis to attempt a full economic evaluation of the conditionality concept, It may be said that the introduction of a conditionality package as a mean to improve the economic development of the LDCs, has not been a success.(148) There are external signs which indicate that SALs and the conditionality packages they carry have not met so far, either the Bank's or the borrower's expectations. There is in the first place, a large and constantly expanding anti-conditionality literature by economists such as J Spraos, for whom:

> Conditionality as practiced is conceptually flawed at its core. By targeting policy instruments such as the volume of credit and the public sector deficit, instead of genuine policy targets, conditionality reverses the natural priorities and leads to inefficiencies.(149)

The second, and probably the best, argument to support this statement, is the insignificant number of SALs granted annually by the Bank. From the Adjustment loans surveyed during 1980-1990, not many countries were enthusiastic about SALs.

The number of SALs granted during that decade is not stable. In some years (e.g.1983), it has even decreased sharply. Furthermore there is no established evidence that those countries which have implemented the Bank's conditionality package have succeeded in their economic development. Despite the setting up of an independent Operation Evaluation Department (OED), there is no clear data available to confirm, or refute SALs' success.(150)

Finally, there are cases where the Bank recognised the difficulties in implementing the SALs conditionality packages, implicitly thus, admitting its own failure:

> In the early years, little attention was given to the possible adverse impact of adjustment programs on the poor. This was to a large extent justified by the expectation that adjustment programs could facilitate growth, and in the process reduce poverty. With the passing of time, however, it became evident that the economic problems were more severe then expected, that adjustment was slower than anticipated, and that many countries..., were experiencing prolonged periods of economic stagnation and deteriorating social conditions for some groups.(151)

Perhaps more relevant to the economic failure of SALs is the creation of a new facility fund within the Bank called Social Dimension Adjustment.(SDA)(152) The aim of SDA is to assist countries undergoing a SAL to alleviate the social effects brought upon them by the adjustment. For, it is in the social area that SAL effects are the most felt by the LDCs.

(**iii**) The Social Effects of Conditionality.

Third World criticism becomes more accentuated when it comes to evaluating the social effects or dimensions of the Bank's conditionality programme.(153) The question often asked about SAL is what social impact do the reforms carried through SALs, have on the borrowing countries? A major criticism in this regard is the Bank's overemphasis on policy reforms, while paying inadequate attention to the social repercussions on the masses. This is how the Prime Minister of Jamaica described a SAL at an IBRD/IMF meeting. He said:

> It is as if prevailing wisdom dictates that since there is no path of painless change, it matters not how painful the process may be. But it does matter. We do not adjust economic systems, we adjust the lives of our people who make these systems work. It is short-sighted, in the least to ignore the human element.(154)

The problem is so acute, that the social cost of SAL is becoming part of the agenda of many regional as well as international organisations, including the Bank itself. As Ismail Serageldin, the head of the IBRD's Eastern and Central Africa Department confessed:

> The Bank is increasingly aware of the social costs of adjustment and the need to make them bearable... The situation has got worst, in spite of twenty five years of cooperation.(155)

In the mean time, Third World leaders have come to realise that wherever the Bank's SAL and/or Fund's programmes have been implemented, the results were often the opposite of those promised to them. Says an ILO report:

> Each month during the first half of the present decade, close to one million persons across the world have been pushed below the poverty line as a result of measures aimed at fighting inflation, recession and the debt crisis.(156)

In spite of numerous analytical complexities, the available data indicate that the poor are extremely vulnerable during periods of adjustment. Rising unemployment is one facet of the general deterioration of the living standards of Third Word populations since the beginning of the 1980's. In Sudan for example, the adoption of a Bank's SAL led within a few days to the lay off of some 9000 employees of the National Railways companies.(157) In Mexico, after the negotiations of a SAL, 4 million people lost their jobs.(158) In Senegal, the implementation of a Bank's SAL in 1984-85 of a new industrial policy aimed at increasing productivity and competitiveness led to the loss of 5000 jobs.(159)

The decline in real wages is another aspect of the worsening situation of a large section of the working class. In numerous cases, the fall in minimum real wages led to an increasing impoverishment of the population. In Kenya, the average wage was 3.5 times higher than the minimum wage in 1983, compared with only 2.7 times in 1980.(160) Various reports indicate that workers at the lower end of the wage scale are the worst hit. In Brazil, the IMF and the Bank demanded an annual reduction of 20 percent in wages. (161) In Zaire, after a SAL took effect in 1983, it was followed by a massive 400 percent devaluation of the national currency which led to the wholesale removal of so called fictitious and unqualified employees in the public sector.(162)

Furthermore, the rise in food prices during the period of adjustment had also a severe negative effect on the poorest households who have been "forced" to restrain their food consumption in quantity and quality. The consequences on the welfare of the population are sometimes indescribable. In some countries such as Ghana, child mortality has even risen from 100 to 115 per thousand during 1980-84; and in neighbouring Ethiopia, from 155 to 175 over the same period.(163)

The social effect of SAL has become so crucial that the European Council adopted in May 1988 a Resolution on the Particular Concept of Structural Adjustment for the ACP which was presented by the Commission. In its preamble, the resolution recalls that:

> The Commission's approach does not seek to compete with that of the IMF and the World Bank. It tries to direct the Bretton Woods institutions towards greater realism by adding to their concern, that politically and socially, as well the process of adjustment be acceptable.(164)

The resolution calls for a more pragmatic approach that would take into account the social dimensions of structural adjustment policies as well as certain important objectives (eg. food security) which were in danger of being neglected in the structural adjustment approach as implemented so far. In that sense, the Commission's approach differed substantially from the stereotyped, often dogmatic and too exclusively economic and financially based view of the Washington institutions. Among other things, the resolution calls for:

- The participation of the governments concerned to the greatest extent in analysing the difficulties to be resolved and in preparing reform programmes.
- The integration into SAL of other non economic imperatives such as cultural matters or environmental protection.
- Taking into account the social dimension of the implementation of SALs, particularly in order to reduce any negative effect they may have on the most vulnerable segments of the population and to simultaneously promote the objectives of economic growth and social justice.
- To ensure that the rate at which reforms are implemented are compatible with

the capacities and resources of each country and its development objectives, and must be bearable for its people.

- The need for effective coordination between the EEC on the one hand, and the World Bank and IMF which play a leading role in the dialogue on structural adjustment, on the other.

It was finally agreed in the resolution that "the Council hope that the Commission and the member states will impress on (the Bank and the Fund), the Community approach defined above.(165) As may be seen, this statement is more political than practical. Its inclusion in the resolution reflects the EEC's intention to work closely with the Bretton Woods institutions. It only emphasised that the Community does not intend to compete or to depart from the Bank and Fund's approach to structural adjustment.

The resolution was followed later by an EEC-ACP seminar on structural adjustment, debt and commodities.(166) No formal recommendations or conclusions were adopted. Broadly speaking, the seminar's conclusions support to a large extent the LDCs criticism that, socially, SALs have been disappointing. There was a general feeling within the industrial countries of Europe, that the size of Bank loans and the conditionality packages attached to them were not commensurate with the costs and risks of the adjustment that they proposed. More importantly, the participants agreed that in most cases, SALs have failed to have the anticipated effects and have instead produced unexpected detrimental effects as already discussed. After a lengthy debate, most of the participants seemed rather sympathetic to Third World grievances; and one of them reacted emotionally when he talked about "adjustment with a human face"; something, it should be noted in passing, very rare in the merciless world of finance.(167)

The solutions proposed by the participants may be classified in two diametrically opposite solutions. The first one represents what could be called, in political terms, the radical view. Its proponents suggest that in a period of adjustment someone has to pay the price:

> ...Experience to date has shown that some groups have to accept losses, at least temporary. This is true , for example, in case of public sector workers who have their wages cut or even lose their jobs because of austerity measures.(168)

According to this view, those living at subsistence levels such as unemployed households, peasants, small farmers, all have to be patient in the hope of better -but unguaranteed- days. This point of view reflects the official position of the World Bank for which:

> Such results generally do not occur immediately. However, frequently...policies designed to bring about long term structural transformations may entail painful adjustment in the short term.(169)

The second solution proposed by other participants during the seminar is perhaps softer and more humane in many respects. They suggest that, in order to avoid jeopardising programmes aimed at structural adjustment, accompanying measures must be provided for in good time. To meet such a proposal, there are two kinds of measures that the developed world can take in favour of the LDCs. Firstly, the DC must accompany any structural adjustment by an additional financial support to help the LDCs carry out their purposes successfully. This view is held by the Germans who have already embarked on such a path by providing substantial amount of funds from their development budget to many LDCs already carrying out SAL programmes.(170)

The ambiguity of the German proposal is that there is apparently no patent recipe for how these funds are to be spent. In practice, however, this is only a lure, since the very purpose of that additional contribution, is precisely to help the LDCs implement

SAL programmes. Apart from its generous aspect, this solution presents a double danger for the Third World countries. On the one hand, SAL itself is a loan, therefore a debt which by definition has to be repaid at a given time. On the other hand, the additional resources, whatever form they may take, (soft loan, loan without interest, or simply a grant), may also create some kind of extra financial obligations *vis a vis* the donor country. This brings to the fore front the well known story of tied aid, a story which the vast majority of the Third World does not want to hear about.(171)

Secondly, the developed world can indirectly help the LDCs to achieve their SAL programmes by taking at its own level a series of internal measures that may have a beneficial effect on the LDC economies. Such measures will be discussed in a more appropriate context (see infra Chapter Five). It may suffice here to say at this stage, that it would help a great deal if the DCs put their house in order before telling the LDCs to clean up theirs.

Conclusion to Chapter Three.

Traditionally, the flow of the Bank's finance has been dependent primarily on identification and development of those projects which the Bank believed would generate an adequate rate of return. To that end, the economic mission surveys permitted discussion about broad economic policies, but the central point remained the project to be financed. It must be recalled, project financing was never conditional in the past on general policy advice (ie. conditionality) being taken. The conditions (or leverage), were generally confined to policies in the particular sector being funded.

The Bank maintains that such conditions are necessary if the loan is to be successful, otherwise, it would abstain from financing the project. Although straightforward in appearance, this statement is not entirely unfounded. For example the cases of EPEOR (Algeria) and ONPT (Morocco) dealt with in the foregoing Chapter, demonstrate to some extent, that the Bank's action in the LDCs is not always futile. The appalling conditions of EPEOR and ONPT before the Bank's intervention, denote the utility and indeed the urgency of the agency's action. In that respect, the Bank's efforts can only be beneficial and surely no LDC government would dispute their veracity or their opportunity. Frictions between the Bank and its borrowers, however, arise over the manner in which the loan should be spent to tackle a particular economic issue.

The two successive world economic recessions led the Bank to the introduction of SAL and with it a conditionality package, which "revolutionised" the lending policy of the 1980's. The immediate effect of SAL was tougher and harder conditions being imposed on the LDCs. Yet from the legal point of view there is no provision in the Articles to suggest such a shift in the Bank's operations. This new generation of conditions is sometimes so hard for the LDCs to implement, that quite often the loan agreement turns into a major conflict between the Bank and its clients. At the roots of such a conflict, is the Bank's insistence on the implementation of a set of measures which are not always confined to the initial loan, but which extend well beyond it, to cover other major economic areas and sometimes the entire economy of the borrower. More irritating for the LDCs is that, the implementation of such measures require substantial legislative actions and institutional changes that must be satisfactory to the Bank.

As part of the measures, the Bank usually "recommends" to its borrowers certain forms of actions. The development of the private sector, or privatisation, is certainly the most favoured. The phenomenon has dominated the lending policy of the 1980's and all the signs are that it is likely to remain so for the nineties. This will be the main theme of discussion of the next Chapter.

Notes to Chapter Three.

1 R. Lavalle, La Banque Mondiale et ses Filiales: Aspects Juridiques et Fonctionnement, LGDJ,Paris (1974), in Chapter IV.

2 See the detailed discussions on the General Conditions in D. Zavala, Les Prets de la Banque Mondiale aux Services Publiques Indusriels et Commerciaux. Une Etude des Contrats, Themis, Paris (1981), especially in Chapters I and II.

3 Mason et al, The World Bank Since Bretton Woods, The Brookings Institution, Washington DC. (1973), at 132.

4 Supra note 1, at 236.

5 Ibid., at 238.

6 Loan Agreement No 5433 NIG.,1986, at 2.

7 Loan Agreement No 6001 ALG., 1984, at 2.

8 For example, The IBRD fiscal year starts June the 1st.

9 This is perhaps the most contested clause in the BGC by the Third World countries, See A. Fatouros, The Impact of International Organisations on the Legal and Institutional Change of the Developing Countries, International Legal Centre, New York, (1974), at 36.

10 H.T., Adam, Les accords de prets de la Banque Internationale de Developpement et de Reconstruction, 55, RGDIP 1951, at 163.

11 Supra note 3, at 189.

12 For a discussion on the negative pledge, see A. Broches, "International Legal Aspects of the Operations of the World Bank", in RCADI 1959, at 232.

13 Supra Chapter Two, at 35.

14 The equivalent of the French contrat d'adhesion in Common Law is adhesion or typical contract.

15 Supra note 1, at 203.

16 Loan Agreement. No 5438 ALG., 1987, at 3.

17 Loan Agreement. No 1232 HUNG., 1981, at 4.

18 Loan Agreement.No 4301 YUG., 1985, at 69.

19 Loan Agreement. No 4570 MOR ,1987, at 2.

20 Supra note 2, at 281.

21 Ibid., at 283.

22 Ibid., at 289.

23 Ibid., at 291.

24 Supra note 9, at 74.

25 Ibid., at 79.

26 Supra note 2, at 132.

27 Supra note 9, at 81.

28 T. Hayter and C. Watson, Aid: Rhetoric and Reality, Pluto Press, London (1985), at 90 et ss.

29 Supra note 12, at 246.

30 Ibid., at 257.

31 Ibid., at 291.

32 Supra note 2, at 119 et ss.

33 Supra note 1, at 204.

34 Supra note 12, at 89.

35 D.W. Bowett, The Law of International Institutions, (4th ed) Stevens, London, (1982), at 137.

36 A. Fatouros, "The World Bank Impact on International Law. A Case-Study in the International Law of Cooperation", in Jus et Societas. Essays in Tribute to Wolfgang Friedmann, Martin Nijhoff, the Hague, (1979), at 62-65.

37 Supra note 12, at 159.

38 See infra Chapter Two, at 61.

39 Loan Agreement No 3812 ALG., 1984.

40 EPEOR stands for: Entreprise de Production, de Gestion et de Distribution d'Eau d'Oran (the equivalent of a water suply company).

41 I gathered this information during an interview with M.B. the Manager of EPEOR, Oran, March, 1988.

42 Interview with B. B. M. Head of the Finance Department in the Banque Algerienne de Development (BAD), which is the main depositor of the World Bank loans made to Algeria, Oran, March, 1988.

43 See Official Journal of the Republic of Algeria (JORA), N°12, dated 14 May, 1984, at 632.

44 The Socialist Code of Entreprises was enacted at the height of the oil boom in 1975 by Decree N°8 dated 12 December, 1975.

45 Thus Article 5 of the Code reads:
"The State is the only legitimate owner of all public undertakings".

46 supra note 12, at 231; see also Mason et al, supra, note 3, at 76.

47 From personnel interview with the staff in the legal department, The World Bank, Washington DC, 29th April, 1987.

48 Id.

49 ie. that the rate clause in the case of EPEOR was not a condition of effectiveness for the loan to be awarded.

50 Supra note 12, at 218.

51 This is a Loan Agreement from a grey report, henceforth its correct references cannot be fully disclosed.

52 A2BZ is a fictitious name given to the borrower's telecommunication entity, to respect the confidentiality of the Bank's document.

53 In their original form, the fees are quoted in the borrower's currency. Their conversion into Dollars is meant to give an idea about the fees involved in the loan without unveilling the borrower's identity. All conversions reflect the value of the borrower's currency at the time the loan was made.

54 Supra note 12, at 212.

55 Supra note 9, at 35 et ss.

56 On procurement in general, see 12, Fin. & Dev. June 1975, at 26; also G. Delaume, Legal aspect of International Lending and Economic Development Financing, Oceana Publications, New York, (1967) at 251. See also, Assad U. Omar, le Financement International Public, Themis, Paris,(1979)

57 The first Guidelines were issued in 1964 and were reviewed since then several times. The latest and current edition dates from May 1985.

58 Supra note 12, at 211.

59 Loan Agreement No 342, MOR., 1987.

60 ONPT stands for: Office National des Postes et Telecommunications (National Office for Posts and Telecomminications).

61 See Article III section 3.02. of the loan agreement.

62 C. Payer, The World Bank: A Critical Analysis, Monthly Review Press, London (1982), at 143.

63 A typical clause in any loan agreement instructs borrowers to review their procurement with the Bank prior to any decision.

64 For Mason et al,"ICB remains one of the Bank's proudest procedural achievements." supra, note 3, at 187.
For A. Fatouros, "The Guidelines protect the Bank from charges of favoritism", supra note 9, at 63.

65 eg. In 1979, the World Bank suspended its disbursement to India because the Indian government wanted to spend the proceeds of the loan in the USSR, See D. Zavala, supra note 2, at 81.

66 *Cf.* Clause 1.5 of the Guidelines:
"Funds from Bank's loans may be disbursed only for goods and services provided by Bank members, Switzerland and Taiwan. Nationals of other (ie. non member) countries, should be disqualified from bidding for contracts financed wholly or in part from Bank loans."

67 Supra note 28, at 35.

68 Supra note 12, at 109.

69 The Pearson Commission recommended that with respect to local expenditure financing that aid givers(including the World Bank), should remove regulations which limit or prevent contributions to the local costs of the projects and make greater efforts to encourage local procurement, whenever economically justified.-Partners in Development, Report of the Commission on International Development. Praeger, New York, (1969), at 190.

70 See a series of articles on conditionality viewed from an LDC point of view, in F. Stewart et al (eds), International FinancialCooperation, Frances Pinter, London (1982).

71 Supra Chapter Two in note 16.

72 See J. Gold, "Conditionality", Pamphlet series No 31, Washington: IMF, 1979.

73 Supra note 3, at 421. See also, J. Gold, "Use of the International Monetary Fund's Resources: "Conditionality" and "Unconditionality" as legal categories",

in, 6, Journal of International Law & Economics, 1971-72, at 5.

74 See supra note 3, at 421 et ss.

75 T. Hayter, Aid as Imperialism, Penguin Books, London (1971), at 71.

76 P. Mosley et al, Aid and Power, The World Bank and Policy Based Lending. Analysis and Policy Proposals. Vol. I Routledge London, (1991), at 86; B. S. Hurni, The Lending Policy of the World Bank in the1970's: Analysis and Evaluation. Boulder, Colorado, (1980), at 132.

77 Supra note 9, at 98.

78 J. Gold, supra note 70, at 4.

79 Supra note 70, at 121, and , supra note 76, at 364.

80 See Irving S. Friedman, "Private Bank Conditionality: Comparison with the IMF and the World Bank" in J. Williamson, (ed), IMF Conditionality, MIT Press, Washington DC, (1983), at 109-124.

81 J. Gold, Legal and Institutional Aspects of the International Monetary System. Selected Essays, (2 Vols), IMF Washington DC. (1974-1984).

82 Supra note 28, 37 et ss.

83 Ibid., at 43.

84 Id.

85 Supra note 70, at 122.

86 Supra note 81, at 346.

87 Id.

88 Ibid, at 437.

89 S. Dell, "Stabilization: The Political Economy of Overkill", in J. Williamson, supra note 80, at 27.

90 Supra note 9, at 54.

91 This was recognised by the World Bank Report for 1987, which reads at 114: "In most instances, strong economic medicine is politically unpalaptable because of its side effects."
In the same line of thoughts G. K. Helleiner wrote:
"The medicine is bitter, but failure to take it is even worse, it is argued in the Fund's circle. For until it is swallowed, finances will continue to deteriorate. The dilemma, is that LDCs cannot precisely swallow it, in, Africa and the IMF, 152, Essays in International Finance, Princeton, New Jersey, 1983, at 16.

92 Supra note 70, at 3.

93 S. Please, "The Hobbled Giant": Essays on the World Bank, Boulder, London (1984), at 73.

94 On this point, see,N. Strarkis, Le Petrole a l'heure Arabe, Stocks, Paris (1975); A Guecioueur, An Arab Bank for Development, unpublished Ph.D. Thesis, Dept. of social Sciences, The University of Glasgow, 1978.

95 J. Williamson, supra note 80, at XIV. See also C. Payer, supra, note 83, at 29.

96 For an account of the recession years see,.S. Marris, "Managing the World Economy: Will We Ever Learn" ? 155, Essays in Int'l Finance, Oct. 1984.

97 Supra note 93, at.76

98 The literature on SAL is abundant. Amongst others, see R.E., Feinberg, Between the Two Worlds: The World Bank's Next Decade, Overseas Development Council, Washington DC, (1986).

99 See Irving S. Friedman, supra note 80, at 113 as he wrote:
"When I went to the World Bank in 1964, to create a general economic staff and a program of country economic work, I brought with me a bias in favour of conditionality, but conditionality applied realistically to achieve the purpose of the World Bank."

100 See The World Bank Anual Report, 1980, at 97-111

101 M. Constantine, "Structural Adjustment Lending", in 27 Fin. & Dev. 1987 at 7.

102 Supra note 98, at 170.

103 See The World Bank Annual Report, 1990, at 97.

104 Ibid, at 146.

105 For a critique of SAL see, W. Bello et al, Development Debacle: The World Bank and the Philippines, Institute for Food and Development Policy, San Francisco (1982), at Chapter VI; T. Killick, "The impact of Fund Stabilization Programs", in T. Killick (ed), The Quest for Economic Stabilization, New York, St. Martin, (1984). Also same author, "The Design of Structural Adjustment Programmes" in 6, Dev. Pol. Rev. 1988, at 395-413.

106 Reported in supra note 70, at 131.

107 Id.

108 See The World Bank Annual Report 1987, at 117.

109 See M. Bencheikh, Droit International du Sous Developpement, Berger-Levrault / OPU, Paris (1983), at 11.

110 See, Annexe (A).

111 In his studies J. King refers to a certain number of LDC countries which got into troubles with either the IMF or the Bank. See, John A. King, Jr., Economic Development Projects and their Appraisal, John Hopkins Press, Baltimore, (1967), at 39-123.

112 Supra note 101, at 7.

113 The instruments used in Fund-Bank collaboration include:
-Joint economic survey missions.
-Joint staff meetings.

114 Compare Article V section 8a IBRD and Article III sectrion 3 IMF.

115 Supra note 81, at 129.

116 Id.

117 Id.

118 Ibid, at 342.

119 G. K. Helleiner, "The IMF and Africa in the 1980's", in 152 Essays in International Finance, Princeton, New Jersey, (1983), at 17.

120 E. Stern, "World Bank Financing of Structural Adjustment", in J., Williamson, supra note 80, at 100.

121 Supra note 101, at 8.

122 Reported in supra note 70, at 118.

123 Supra note 80, at 203.

124 Supra note 101, at 7.

125 As E. Stern wrote:
"By focussing on the policy and institutional reforms..., SAL helps to create a more appropriate environment for the Bank's project lending.", in supra note 120, at 87.

126 Assad U. Omar, supra note 56, at 32.

127 T. Hayter et al, supra note 83, at 113.

128 Van M. A. G. Meerhaeghe, International Economic Institutions, (5th ed.), Kluwer, Lancaster (1987), at 52.

129 For a discussion on the concept of cross conditionality, see P. Mosley, supra note 76, at 168 -171.

130 W. Bello et al, supra note 105, at 167.

131 Id.

132 Supra note 81, at 472.

133 Supra note 72, at 14.

134 Id.

135 Supra note 81, at 437.

136 Supra note 3, in Chapter XIV.

137 For a critical view of the concept of leverage, see T. Hayter et al., supra, note 62, at 21-25, 49-50, 110, 154, 299, 345, and 350-351.

138 Supra note 105, at 249.

139 for a discussion on this point see, S. Please, supra note 93, at 29.

140 Id.

141 Supra note 70, at 119.

142 For a critique of the concept of conditionality, see, S. Dell, "On Being Grandmotherly: The Evolution of the IMF Conditionality", 144, Essays in International Finance, Princeton, New Jersey, (1981); *Idem,* "Conditioality as Bargaining Process: Structural Adjustment Lending 1980-86, 168, Essays in International Finance, Princeton, New Jersey, (1987); *Idem,* " Has the World Bank Got it Right" ? 17, Dev. & Change, 1986b, at 513-530; see also, G.K. Helleinker, "The Question of Conditionality.", in C. Lancaster and J. Williamson (eds), African Debt and Financing, Washington Institute for International Economic Development, (1986); J. Spraos, "IMF Conditionality: Ineffectual, Inefficient, Mistargeted", 166, Essays in International Finance, Princeton, New Jersy, (1986).

143 The isue of sovereignty has been raised by Mason et al, supra, note 3, at 34, but was left without answer. For a more complete commentary on this particular point, see E. R. Feinberg, supra note 98, at 64-85.

144 Supra n. 72, at 11.

145 For an opposite view, see, M. Bruno, Comments, in J. Williamson, supra, note 80, at 128.

146 Supra note 81, at 439.

147 Supra note 80, at 117.

148 For an economic analysis and evaluation of the concept of conditionality, see, P. Mosley et al , supra note 76, at 513 et ss.

149 J. Spraos, supra note 142, at 1.

150 A first review of experience with SAL programme undertaken by the Bank in 15 countries concluded that in 10 countries SAL results "have been mixed". See the Annual Bank Report for 1987, at 114-115. It should be noted in passing that the Bank rarely talks in terms of failure of its own experiences (or experiments) and uses always a camouflage language such as "mixed results", "the measures have been dificult to implement", or "the least successful were..." However, when it does talk about failure, these are always imputed to the borrower's indiscipline, or economic mismanagement.

151 H. Ribe and S. Carralho, "Adjustment and the Poor, Experience from the Bank's Lending for Stuctural Reforms", 27, Fin. & Dev., Sept.1990, at 15-17.

152 The SDA was launched in 1987 at the insistence of the UNDP and the AfBD. For an account of SDA programme, see, T. Addison and L. Demerly, "Alleviating Poverty Under Structural Adjustment", 24 Fin. & Dev. Sept. 1987, at 41-43. For an update of SDA, see, Ismail Serageldine and M. Noel, "Tackling the Social Dimension of Adjustment", 27 Fin. & Dev. Sept. 1990, at 18 - 20.

153 For a recent and critical evaluation of the social effect of SALs on the LDCs, see The London Institute of Economics seminar on "The IMF and the World Bank in Africa." April, 11-13, 1990.

154 Reported by D. Worwell, "Structural Adjustment in the Caribbean", in 111 The Courier, Sept-Oct. 1988, at 87.

155 See J. Williamson, supra note 80, at IV.

156 See V. Kohler, "Off the Peg doesn't Suit Everyone", in The Courier, supra, note 154, at 93. In the author's view:
"In countries where present income is close to subsistance levels, the sacrifice is unacceptable. This is particularly true now that it is becoming evident that the restructuring of an economy takes longer than the three to five years thought to be necessary."

157 See M. Fromont, "The Poor Bearing the Burden of Adjustment", in The Courier, Supra note 154, at 29.

158 M. Fromont, supra note156, at 94.

159 Supra note 28, at 29.

160 Id.

161 Supra note 28, at 30.

162 Supra note 157, at 95.

163 Id.

164 For full detail and comment on the resolution, see, V. Kohler, "The Adjustment Process in Africa: A European Council Resolution.", in The Courier, supra note 154, at 73.

165 In its conclusion the Resolution stated that:
"The Council emphasises the need for effective co-ordination between the Community, on the one hand, and the Wold Bank and the IMF, which play a leading role in the dialogue on structural adjustment, on the other... It hopes that the Commission and the Member States will impress on those institutions the Community approach defined above." Supra note 154, at 73.

166 The theme of the seminar was: "ACP-EEC: Structural Adjustment, Debt and Commodities" Dakar (Senegal), 11-14 July, 1988. For a summary of the seminar proceedings, see, The Courier, supra note 154, at I - IV (Annexe).

167 M. Fromont, supra, note 157, at 95. The author concluded his article by saying: "A general change of attitude in both the industrialised world and the developing countries to restore concern for the wellbeing of the population to a central place in decisions of an economic or monetary nature is, in the final analysis, the one and only condition for adjustment with a human face." In the same line of thoughts, see A. Cornia and R. S. Jolly, Adjustment with a Human Face. Oxford University Press, London, (1987).

168 Supra note 156, at 93.

169 The World Bank Annual Report, 1990, at 104.

170 Supra note 156, at 92. This seems to be also the U.K policy. According to Chris Patten the then Minister for Overseas Development:
"We must do all we can to help aid recipients make the painful adjustment which are sometimes necessary... For our part, we will devote a greater share of our aid budget in the coming year to policy reform in Africa." The Guardian, 19/03/1987 at 6, cols 7/8.

171 The literature on foreign aid is abundant, see among others, W. G. Friedman et al, International Financial Aid, Columbia University Press, New York, (1966); J. N. Bhagwati and R. S. Eckaus, (eds), Foreign Aid: Selected Readings, Harmondsworth, London, (1970). For a critical view on foreign aid, see namely, T. Hayter, supra note 75; J. Bourret, le Development Scandaleux, Paris, (1978).

CHAPTER FOUR.

THE CONTEXT OF INFLUENCE:
THE DEVELOPMENT OF THE PRIVATE SECTOR.

I- Preliminary.

Since the Bank entered the field of conditionality, one of the most common forms of advice it included in its loans to borrowers has been privatisation.(1) For the vast majority of the LDCs, this means abandoning their previous public sector policy, for a new "modern" private enterprise which, according to the Bank, will help them to overcome their economic problems of development. From the legal point of view, the passage from state owned ownership to private initiative is not without repercussion on the legal as well as institutional aspects of the borrowing countries. However, before adressing these repercussions which are the main concern of this Chapter, it may be worthwhile to give a brief review on the concept of privatisation in general, and to assess the reasons for the Bank's distrust for the public sector and its preference for the private initiative.

The word privatisation has been described by a British politician as "an ugly word for a beautiful concept."(2) In the opinion of C.Veljanovski, "to privatise is to render private, or to bring into the private sector."(3) In broad terms, it means that the state withdraws partly or entirely from the production of goods and services. The process has already begun in certain developing countries, and a large number of LDC governments have started taking steps "to trim the fat from the public sector". In Nigeria, for instance, the military regime in place has unilaterally slashed subsidies to public enterprises by fifty percent, and privatisation has become, after education, the most pressing issue for government. In Romania, Bulgaria, and Poland, governments have already sold some of their interests to the private sector, and high level panels are still exploring ways to strengthen the private sector. In Latin American countries such as Brazil, Argentina, Venezuela and Mexico, deep economic reforms are under way where the role of the private sector is given a prominent position. In the most centrally planned states of Africa such as Mozambique, Benin and Tanzania, there is a noticeable relaxation over private business activities coupled with a genuine government desire to explore further ways to improve public/private sector relationships. Everywhere, the debate on the public/private sector is gaining momentum.(4) In view of the importance of such a debate on the economic development of LDCs, it may be worthwhile to look into some aspects of this debate and to ask whether privatisation could enhance LDC's development efforts, as is often suggested by the Bretton Woods institutions.

A- The Public / Private Sector Debate

The core of the debate is whether the LDCs should abandon their public sector policy for a new private initiative. Before trying to seek any answer, a brief background to the evolution of the public sector in these countries is in order. The formation and results of the state sector differs from country to country depending on various historical as well as socio-economic factors. It is worth noting that many LDCs on the threshold of independence were receptive to ideas of state control because of many reasons; both external and internal.

- At the external level, it must be recalled that in all the newly independent countries, key economic activities and much of the countries wealth were owned by foreign monopolies and a local bourgeoisie suspected as part of foreign capital. There was, hence, the common need for gaining control over the national resources in the first place. It was then thought among many LDC leaders, that only a strong public sector could fill the gap left by the colonial administration.(5) In the vast majority of these countries the formation of the state sector has proceeded through the enactment of nationalisation laws which were applied indiscriminately to both foreign and domestic capital, and through allocations from the state budget. Most LDC politicians and economists in the Third World explain the development of the state sector as mainly a consequence or a legacy of colonialism:

> The historical situation and tasks of the newly independent countries which emerged from centuries of colonial rule gave rise to the necessity for the state to play an active role in socio-economic development. During the period since the collapse of their colonial system of imperialism, we have witnessed the gradual development of the economic role of the state in all developing countries which faced both common and specific tasks.(6)

For 'extremist' governments, there was in fact no better barrier against neo-imperialism than a highly developed state capitalism. Thus, fear of foreign infiltration, coupled with the rise of economic nationalism, led many LDCs to consider any private initiative economically parasitical, politically suspicious and socially inequitable. This attitude is to some extent understandable especially among those countries (eg. Algeria), which have experienced a prolonged and somewhat painful era of colonial domination that ended only with a war of liberation. This is why, for instance, revolutionary governments think that foreign penetration is still a permanent threat to their very existence, and consider the creation and expansion of the state sector as an anti-imperialist objective of paramount importance. As Rao emphasised:

> It is an incontrovertible fact that the public sector especially in the heavy and key industries in the developing countries has been playing an anti-imperialist role and helping the preservation and strengthening of their independence " (7)

• At the internal level, one explanation for the LDCs drive to the public sector is the lack of human as well as financial resources. In most new states, there was no single class which socially and economically possessed the capital and capability to undertake independent economic development. In addition, the task of reconstruction was immense and certainly beyond the private sector possibilities. This is particularly true since all Third World countries have inherited from their colonisers archaic and feudal economic patterns which made them raw material appendages to the mother colony. It was then imperative to break up these one-sided arrangements and lay the grounds for a new independent economy. It was believed at that particular time, that the state alone was in such a position as to regulate, plan and rebuild the economy, by making use of the entire national wealth on the basis of state ownership.(8) The public sector was thus considered as the motor drive and, as such, it encompassed all economic activities, from needles manufacturing to maize crops to chemical plants. As the Iraqi Charter of 1952 reads :

> The public sector is the corner-stone in the national economy with all its branches, be they agriculture, industry, trade or services. The State assumes the responsibility of guiding economic activity and working out the principles of laws, which organise it. A pre-condition in the economic work is to expand the public sector and boost it by all the possibilities that would increase its efficiency and ability to achieve the task.(9)

Besides its economic advantages, the public sector has also a social function. People are told in endless speeches and official statements that all the country resources are theirs and for their benefits. As the Algerian Charter of 1962 recalls:

> All principal means of production are owned by the state and placed at the disposal of the popular masses which exploit them for their benefits.(10)

The aim is to create a classless society, based on the principles of justice and equality. To that end the state, through the public sector, takes responsibility for regulating every aspect of social life, from employment, to housing, health and education. Furthermore, in many countries, the public sector has been instrumental in lessening regional imbalance inherited from the colonial era. In Algeria, for instance, since independence, considerable efforts have been made in successive development plans to revitalise backward parts of the country. This is done through massive investment in infrastructure projects as well as industrial and agricultural projects.(11) In other countries such as India the building of the state sector is said to have played a major role in strengthening the efforts of national integration. This is important in a federal state such as India which has a multiplicity of languages and religions (12)

Politically too, the LDCs strategy of economic development was felt vital because an ever-expanding and strong state sector would lead to an independent economy, which would sustain LDCs independent foreign policy, and makes its intervention in world politics more effective. In this context Girish Mirsha's statement on India's strategic role of the public sector is illustrative:

> It is now part of history how the state sector enabled India not to yield to the imperialist pressures on the issue of Kashmir, and the blackmail by Dulles after the liberation of Goa. Had there been no state sector, India would not have been able to defend its territorial integrity in 1962, 1965, and 1971, nor could it help the patriotic forces in Bangladesh in the face of the US threat to bring its 7th Fleet.(13)

Finally, it must be emphasised that in the development by the state sector, a major role has been played by economic assistance from the former socialist world in general and the ex-Soviet Union in particular. During the 1960's, at the height of the cold war, the Soviet Union which was not a colonial power, found a fertile ground in many newly created states to expand its ideology. Socialist aid came to LDCs on easier terms and conditions.(14) On many occasions, when LDCs were refused loans from international institutions (including the Bank), or Western governments, the Soviets were there to the rescue. Referring to the particular case of India, G. Mirsha wrote:

> However no Indian can forget how the western countries tried to dissuade India from building up a state sector. The World Bank opposed India's move to have state refineries and the USA ditched India on the issue of financing and technically aiding the proposed Bokaro steel plant. One also remembers the attempts by the western oil cartels at preventing India from exploring for oil deposits by saying that there were no such deposits in India. One also remembers the generous help given by the Soviet Union and other socialist countries in fulfilling India's aspirations.(15)

The historic agreement between the Indian government and the USSR to build the Bhila steel plant is another illustration of Soviet friendly rescue after the World Bank refused to finance the project.(16) The Aswan dam in Egypt is another example where the Soviets supplied the funds after the Bank and Western investors declined to finance it.(17) F. Nelson who studied Soviet aid to LDCs, reveals that 99.3 percent of Soviet assistance was directed to the public sector.(18)

The existence of a powerful socialist world system has created favourable conditions and provided material help for the development of a heavy state sector in many Third World countries. Since the sixties, many socialist countries have also been very active in many LDCs in the construction of numerous projects such as mills, oil refineries, fertiliser plants and livestock breeding farms. They granted loans to Third World governments, providing them with equipment and knowhow, and helping them to train the national managerial personnel for the enterprises that were to become part of the public sector. And all this assistance was untied to any particularly stringent conditions.[19] "This", write G. Mirsha:

> has strengthened the hands of the newly liberated countries in bargaining with imperialists and withstanding all their pressures to change the pattern or strategy of economic development. If the advanced capitalist countries have reduced their rates of interest or stopped their campaign against the efforts by the countries of the Third World to pursue the path of independent capitalist development, it is largely because of the presence of a powerful socialist world.(20)

In the midst of such a fervour for the public sector, by the vast majority of LDC governments, it may be perhaps worth asking what is the Bank's attitude to such a debate.

a)- The Bank's Position in the Public / Private Sector Debate.

If the Bank's attitude towards the private sector has been made clear and formally recognised in its Statutes, (Art I (ii)) its position, however, towards the public sector has never been defined accurately. It is certainly one of the most puzzling areas when looking at the Bank's policy through the years. A great deal of the confusion stems from the fact that the Bank's philosophy towards the public sector is not included in its statutory objectives; that is to say, the development of the public sector does not stand as one of its priorities. Yet, in practice, a large number of requests for loans to finance state owned projects have been made, and the Bank has responded favourably.[21] Furthermore, which areas of the public sector the Bank was prepared to finance is also difficult to answer. It is rather unusual for an international organisation not to have all its objectives clearly set out in advance. Ambiguous and often contradictory statements regarding the public sector from the Bank's officials do not either contribute to fix a proper idea of the whole business of the Bank in that sector. Last, but not least, why has the Bank suddenly chosen in recent years only to shift towards the private sector? Does this mark the end of its scrambling policy towards the public sector ? Has it been unsuccessful ? What are the legal implications on the borrowers' laws; and finally what is the prospect of the Bank being followed by its borrowing members in its recent call for privatisation ? Before answering these questions, it may be useful to shed some light on the general belief that the Bank has been supportive of the public sector in many LDCs.

This point is particularly sensitive and has been the subject of many controversies in the Institution's literature.(22) Generally speaking, no one can deny the Bank's efforts to promote state enterprises in many of its developing member states. The stumbling point, however, is that such assistance has always been very selective and limited in size and time. For reasons of convenience, the Bank's attitude towards the public sector may be clearly traced throughout three different periods of time in the history of the institution. Each period is characterised by certain events which have in turn led the Bank to increase or decrease its support for the public sector.

(i) Early Lending (1947-1967).

In its early days of operations, the Bank directed its lending mainly towards the public sector. The type of projects financed was in infrastructure such as roads, ports, electricity power plants, transportation. These so called utility (or hard) projects were totally owned by the host state and run by its economic companies. The Bank justified such assistance on the ground that the LDCs' public sector was economically weak and inefficient and that radical transformations were needed to make it perform more efficiently.(23) The reasons for assisting the public sector may be summarised in three points:

Firstly, there was a *de facto* situation that the public sector was dominant in the vast majority of LDCs. The Bank could not change this reality overnight for fear of being simply unwanted. It had therefore, to act tactfully in order to show that it was there to help. This would be the first step to set foot inside the LDCs and win government confidence. Secondly, the Bank was, to some extent, obliged to finance such projects in the public sector because there was no one else to do it. In fact, these projects were so huge that no private capital, whether foreign or local or both, were ready to undertake them. The reason being that the projects were high cost, time consuming and above all they did not generate immediate profits. Thirdly, and perhaps more importantly, is that all these infrastructure projects were, in the Bank's view, necessary for the development of a future private sector.(24)

(ii) The McNamara era (1968 to 1981).

The seventies were probably the best years in terms of public sector financing. Not only did the Bank increase its funding to state owned enterprises but, unexpectedly, it shifted its funds towards new areas in the public sector such as housing, health, water drinking projects, sanitation, education, and even tourism. Those so called social (or soft) projects were widely considered to be as fundamental to development as were utility projects. Here are a few examples of social projects involving income and wealth redistribution to help the poor in Third World countries that were undertaken by the Bank under McNamara's leadership:

• A $ 32 million loan to the Philippines to upgrade the homes of about 180.000 residents of Tondo, one of Manilla's worst slums. One component of the loan was also used to finance an urban development project in which health, nutrition and other social services were integrated with improvements in water supply, sewerage and drainage projects.[25]

• A $ 87 million loan to India where capabilities of the administrative authorities in the Calcutta Metropolitan District were expanded and upgraded. About 1.8 million poor residents benefited from huge development and slum improvement schemes, and some 45.000 people have had improved housing and many other social facilities.[26]

• A $ 70 million loan to Brazil to improve the living conditions for the mostly poor residents of eight medium sized cities, by providing central food warehouses to support retail grocers in poor areas, and stalls for open air markets[27]

• Another $ 93 million loan to Brazil to improve housing conditions, education facilities, and better health for more than 80.000 low income families in two North-Eastern states and in Greater Sao-Paulo.(28)

• A $ 71 million (rather unusual) loan to Romania to help the country increase the supply of pork available for domestic consumption.[29]

One major event which contributed to the introduction of social projects in the Bank's lending, was the arrival of President McNamara at the Head of the institution. Since his appointment, McNamara waged a veritable war against poverty and misery in the Third World countries. His speeches during various IBRD/IMF meetings raised the eyebrows of many Westerners and gave renewed hope and trust within many LDC governments.[30]

(iii) Late Development (from 1981- onwards).

At the beginning of the 1980's, the world economic outlook changed dramatically for both the DCs which suffered recession and the LDCs which were heavily indebted. The euphoria of the seventies elapsed and the prospects for LDCs economic development were seriously jeopardised. Public official aid (i.e. loans from government to government) became rare and very hard to secure because it was tied aid. Similarly, private aid from commercial banks was severely cut because bankers were on the verge of bankruptcy as LDC borrowers were unable to repay their debt. In all cases, borrowers were told by official donors and private lenders to make arrangements with the Bank and the Fund before concluding any private loan.(31) Scarce resources also hit the Bank as it too could not secure borrowing from the financial markets. This meant for the Bank less money and more borrowers coming in.(32) As a consequence, the Bank's funds became even harder to secure, and the institution ultimately responded by introducing SAL in its lending policy. As already discussed, one of the main objectives of SAL is public sector reform. So, it is within SAL that the role and function of the public sector have been formally reduced.(33)

b)- An Evaluation of the Bank's Attitude Towards the Public Sector.

The Bank's involvement in the public sector drew sharp criticism from both the right wing (i.e. liberal tendency), and the left wing (i.e.socialist tendency) of the political spectrum. The right wing was discontented because it alleged that by financing the private sector, the Bank had departed from its original objectives as set in its Articles of Agreement, namely Article I (ii) which explicitly directs the institution to work for the promotion and expansion of the private sector. For this category of critics, the intention of the framers of the Articles was quite clearly to establish an institution that would facilitate the international flow of private portfolio investment. It was also clear that, from the very beginning, the primary aim of the Bank was to "encourage private capital to go abroad for productive investment, by sharing the risks of private investors in large ventures."(34)

Underlying such a criticism is the fear that, by helping the public sector in the Third World, the Bank is subsidising, supporting and modernising state industries in the developing countries. This, claim the critics, is in direct competition with western trade and business. This view is strongly supported by the American business community which thinks that a rehabilitated public sector in the LDCs would considerably reduce the sizeable Third World market for US products and create the potential of a major new international supplier. These fears are reported by the Wall Street journal in the following terms:

> Should this have occurred as a result of a competitive environment, there could be no quarrel with the growth of (LDC) industry. As part of a wave of subsidies, it is outrageous.(35)

From the left wing, there were also many criticisms aimed at the Bank's attitude towards the public sector. One permanent claim which looks more like a desirata than a criticism is that the Bank has not done enough for the public sector.(36) Without under-estimating this point, it may be argued that since the Bank's resources are limited, so should its lending capacity be. However, a more serious criticism is of the Bank's refusal to finance governments' industrial sectors; namely in the big and heavy industry. Unlike infrastructure which involved large sums of money, parastatal enterprises in industry were not and still are not eligible for Bank's lending.(37)

The Bank's response was that "it has as a matter of principle always been opposed to big industrial projects."(38) The few projects which were funded were in small scale industry and were taken on a selective basis. In fact, the Bank's hostility towards public industrial projects was known from the very beginning of the Institution's operations.(39) The Bank not only abstained from financing heavy industries in the Third World countries, but it formally discouraged the development of such a sector. D.W. Subasinghe reports that a mission of the World Bank submitted a report in 1951, where it was stated that Sri-Lanka should not embark on industrialisation.(40) Similar reproaches were made in the 1970's to the Algerian government, which was strongly advised not to invest in big oil and gas refineries projects, despite Algeria being the second most important gas producer worldwide. The Bank instead advised the Algerian government to concentrate on agriculture, and only if necessary, on certain light, small scale industries, as T. Hayter put it, producing Biro pens.(41)

In the Bank's opinion, big industrial projects are inappropriate investments by virtue of their being too complex to run technologically, too big to manage efficiently, too costly to cover and control financially. Moreover, the lack of qualified personnel and expertise, the uncertainty of the International market, and competition from western industries which are better equipped may hamper seriously the development of a truly Third World industry. Instead, the Bank advises many LDCs to concentrate on the development of agriculture; implying that the LDCs should rely for their industrial needs on the West, according to the nineteenth century Ricardian theory of comparative advantage.(42) In this context, D. W. Subasinghe wrote:

> The industrial sector in most developing countries is small and is based more on the employment of machines than people; even rapid industrialization can rarely create enough jobs to keep pace with the growing labor force. The most appropriate and direct way to improve living standards, therefore, may often be to help countries develop their agriculture which provides more for the population with their basic needs- foods and jobs- more effectively than industrialization.(43)

As far as social projects are concerned, the LDCs' hope faded away by the end of the seventies when it then became clear to the LDCs, that Mc Namara's war against poverty was not dictated by human need nor a willingness to re-orient seriously the Bank's policy towards the poor LDCs. Mc Namara's generosity coincided with the 1970's which, it may be recalled, was a fast decade in terms of international lending. During that period, many LDCs took advantage of the favourable conditions and borrowed heavily from the commercial banks (hence their indebtedness).(44) Realising competition from private lenders, the Bank extended its loans to social projects in order to look attractive and also to keep business going.

With the 1980's, the world economy went into recession, and social projects were simply cut, to be replaced by SALs whose basic philosophy is to give priority to governments who are willing to develop private initiative, namely by opening their markets to foreign capital. But this latter is not always available unless a favourable environment exists in the recipient country. Realising the difficulties in installing such a favourable climate within the LDCs, the Bank directed its efforts to the creation of its own safeguards involving both foreign investors and the LDCs. Before attempting such an investigation, it may be useful to state, albeit briefly, the reasons underlying the Bank's preference for the private sector as a basis for its privatisation programme.

II- Character of World Bank Privatisation.

Taking advantage of the worsening global economic conditions of the eighties, the Bank put much of the blame on those countries which were following a public sector policy. Mismanagement, corruption and inefficiency are often the words used by the Bank's management to describe the public sector.(45) Instead, the Bank advises its borrowers to open their economies to allow the market to work. Much of the Bank's argument for privatisation is based on the supposed gains in efficiency that can be gained through the introduction of competition. A great deal of the Bank's policy towards the private sector has been laid down in the 1983 World Development Report.(46) The Report adresses several issues such as "Management in Development", "Research for efficiency", "The Role of the State" which have a more political colouration than being a truly economic analysis.(47) In sum, the Report strongly advised the LDC governments to give up their support for the public sector, and opt for a a new private enterprise, of which the Bank was considered as the main catalyst. The question worth asking at this stage is whether the institution is well equipped to implement such a programme.

A- Legal Instruments Used by the Bank to Enhance Privatisation.

Since domestic capital is usually missing in most of the LDCs, it is foreign capital which plays the predominant role in the privatisation process. It is therefore essential for the Bank to provide a satisfactory climate for private investors. In fact the Bank is expressly required by its Statutes "to promote private foreign investment by means of guarantees or participation in loans and other investments made by private investors..." (Art. I (ii)). Through the years, the Bank has spotted the likely obstacles that may halt the expansion of foreign flow, and has accordingly responded by setting up a panoply of legal instruments. The purpose of these instruments is to provide foreign capital with the maximum of safeguards, so it can expand rapidly and safely. In short, to hand over the LDC economies to private bankers of the West without whom Bank assisted programmes of privatisation become impotent. A brief survey of the institution's actions to attract foreign private investors is given below.

a)- The International Finance Corporation.

The first channel which the Bank uses to encourage the flow of private investment into LDCs is the International Finance Corporation.(IFC). The Corporation was established in 1956 as an affiliate of the World Bank. According to Article 1, the purpose of the Corporation is to provide and bring together financing, technical assistance and management needed to develop private investment opportunities. The IFC was created as a result of the Bank's inability to assist the private sector more directly by lending to private enterprises without government guarantee. Since many LDC governments were reluctant to guarantee private initiatives, the Bank's action in that field became very limited. In other words, the IFC was conceived to do what the Bank could not statutorily do.(48)

b)- Cofinancing.

SInce the World Bank is able to provide only a small amount of the external resources that the LDCs need, it encourages and helps its borrowers to obtain financing for Bank assisted projects from other sources in the form of cofinancing. These resources are varied and include multilateral aid, regional development banks, export credit agencies and private commercial banks.

The Bank justifies its initiative of cofinancing as necessary to maintain commercial flows at a time of increased restraint of official (public) lending. Since the beginning of the 1980's which coincide with the Bank's launching of its privatisation programme, cofinancing has been increasing steadily. The 1991 IBRD Annual Report states that almost half of the projects approved annually work with other sources of financing.(49) Bank projects have become interesting for many private lenders because they give cofinancers more security and assurances over repayment than if they had acted individually. Through cofinancing, the Bank plays an intermediary role in linking the private financial flow with the economic development of the LDCs in order to initiate these latter to the techniques of the free market mechanism, while giving the opportunity to private investors to widen their scope of investment and naturally their profit.(50)

c)- The International Centre for the Settlement of Investment Disputes.

Foreign investors do not need only laws to operate in their favour, but also a reliable judiciary to protect them in case of conflict between them and the host country.

To that effect, the Bank established in 1965, the International Centre for the Settlement of Investment Disputes (ICSID), which came into being in October 1966. The ICSID provides a *forum* for conciliation and/or arbitration of disputes between member states and private foreign investors who are nationals of other member states. The jurisdiction is based on consent by both parties: the investor and the relevant government to an investment dispute.(51)

The number of cases submitted to the Centre for resolution remains relatively low. Since its inception, twenty five years ago, the number has reached thirty two cases, most of which were submitted in the past five years, whereas the vast majority have been resolved amicably.(52) The underlying purpose of the Centre is obviously to ensure private lenders that in case of litigation with the LDC borrowers, they will not be subject to the national laws of their debtors.

d)- The Multilateral Investment Guarantee Agency.

The last initiative by the Bank to encourage the flow of private investment to LDCs is the Multilateral Investment Guarantee Agency (MIGA). The project for MIGA was revived at the World Bank 1981 Annual Meeting in Seoul, (Korea), four years after President A. W. Clausen launched the idea of forming such an institution.(53) MIGA was created by a Board of Governors' decision on the recommendation of the Executive Directors. The new institution is designed to promote the flow of international investment to LDCs. The MIGA initiative was seen as particularly timely for several reasons:

- The LDCs growing needs of private flow from commercial banks.
- The decline of lending from private funding sources due to the worsening of the international economic environment.
- The need to reassure the international financial community about non-commercial (ie. political) risks surrounding investment in LDCs. The aim of

MIGA is precisely to reduce the obstacles to the flow of international investment, by issuing guarantees of potential existing commercial and non-commercial risks, some of which are:

- The transfer risk resulting from host government restrictions on conversion and transfer.
- The risk of loss resulting from legislative or administrative action or omission of the host government which has the effect of depriving the investor of ownership, control, or substantial benefit from his investment. (ie. expropriation / nationalisation).
- The risk resulting from the repudiation of a contract by the host government, when the investor has no access to a competent forum, faces unreasonable delays in such a forum, or is unable to enforce a final judgement.
- The risk of war and civil disturbances.

The Convention took effect on 12 April 1988. The first guarantees for four projects were signed in 1990, representing a total of $ 1.04 billion in direct foreign investment. As to July 1991, 101 countries had signed the Convention, providing for subscription totalling over $ 9.4 billion.(54)

B)- Commentary.

Within a relatively short period of time the Bank has produced more institutions for the international private financial community than it did for the Third World countries. Apart from the long contested IDA, there is no real interest in the deep economic problems of the LDCs. The institutions created by the Bank such as the IFC, ICSID, and MIGA, serve the West's interest and its bankers better than they do the Third World governments and their underdeveloped populations. Although membership in these institutions is open to all Bank members, there has been, until recently, a total indifference from a large number of the Third World countries in joining the institutions. For example, ten years after their creation, the IFC and ICSID were almost deserted by many LDCs which identified them as further instruments to promote capitalist ideology.(55) The reason is obvious: none of the newly created institutions had specific provisions to protect the LDCs economies from foreign capital deficiencies. For instance, the IFC Statutes call for unlimited liberalisation and uncontrollable flow of private investment. Again, the MIGA's constitution encourages the repatriation of profit made by foreign investors, against any risk, including that of war. In sum, all the institutions plead excessive liberalism, regardless of the negative effects of this latter on the LDC economies.

The intention here is not to put the Bank's institutions on trial, but it is a fact that none of them address the specific problems of the LDCs in relation to private foreign investment. On the contrary, the respective Charters of these institutions are designed to protect a financially strong minority of individuals who, according to the Bank, possess the key to development, against a capital-starved majority of states in search of development.

Since the end of the last decade, however, as the process of privatisation has been reactivated, so seems to be the role of the IFC, ICSID, MIGA and cofinancing. The first three institutions have doubled their membership, whereas cofinancing is now present in more than half of the Bank's projects. Whether the increase in LDCs membership in the IFC, ICSID, and MIGA, is voluntary or carried out under some sort of implied coercive force goes beyond the scope of this study. In all cases, however, the spectacular revival of the Bank's institutions coincides with the Bank's launching of its programme of privatisation.

From the cases reviewed, it appears that the Bank's recommendation for privatisation to its borrowers take one of two forms. The first and most favoured is to require the borrower to go private. That is to say, to hand over his public assets to private undertakings, as was exemplified by the Polish experience. This type of privatisation is generally patterned on existing economic models found in western liberal democracies such as the United Kingdom, which became, in fact, a leading school for privatisation during the Thatcher years of government.(56) The LDCs in which such a type of privatisation has been recommended by the Bank include those countries where an embryo of capitalism is either available or can be created without too much resistance. Examples include the Eastern and Central countries of Europe, a few Latin American countries (Brazil, Argentina, Mexico and Venezuela), and Zaire, Egypt and the Ivory Coast in Africa.

The second form of privatisation is more cautious and time consuming. It consists in advising borrowers to introduce substantial reforms on state enterprises as a preliminary stage for a future wholesale privatisation, as is illustrated by the case of Algeria. Through this second type of privatisation, the Bank implicitly recognises that the public sector in many LDCs remains "an inevitable concomitant of economic development and it is better to contain this sector within the bounds of usefulness for the growth of capitalism".(57) Third World countries in which such a "soft" method of privatisation has been advised by the Bank include countries like Algeria which have followed a rigid socialist ideology in their development. Presently, all Bank privatisation programmes in the LDCs follow one of these two approaches.

A)- Comparative Approach.

The purpose of this comparative approach is to demonstrate that, in promoting the same economic institution -privatisation- in both Poland and Algeria, the Bank met with same economic institution -privatisation- in both Poland and Algeria, the Bank met with a set of obstacles relating to the specifities of each country. In both countries the process of privatisation, as the Bank wished, seems to be a very difficult enterprise, especially in the case of Algeria and to a lesser degree in Poland. The difficulty in privatising the Polish and Algerian economies reinforces the view held in this thesis that, economic concepts and institutions which are copied on the liberal pattern, may not be easily implemented in all the recipient countries.

a- The Polish Approach to Privatisation.

Although Poland is not a member of the Third World caucus, it nonetheless shares almost the same economic development problems that most LDCs face presently. Furthermore, the choice of Poland presents a model of experiment for the Bank (and the West) in persuading former socialist countries to shift from a centrally planned economy to a market oriented system. Broadly speaking, the West's interest (represented by the Bank) in Poland started at the end of the seventies, when the trade-union movement Solidarity, led by L. Walesa, arose as a political force against the established communist regime. Poland was then seen in the beginning of the 1980's as the first Eastern country to detach itself from the Soviet sphere of influence. It was in the interests of the West, headed by the Americans through the Bank, to help Solidarity achieve that goal. By late 1989, Poland had formally broken its ties with the former Soviet socialist camp and entered the open market economy.(58)

Both the Bank and its private arm, the IFC, became increasingly active in advising the Polish authorities on the design of divestiture strategies, providing financing to privatised firms, helping to develop capital markets, and assisting countries in solving procedural and legal issues.(59) As soon as the first SAL was made to Poland in 1989, plans were drawn to privatise the entire public sector which accounted for 90 percent of economic activities. With some simplifications, the initiative to carry such a task was delegated to three organs:

a) The enterprise itself can embark on a privatisation through filing a joint application by the Director of the state enterprise and the Employee's Council.

b) The founding organs of the enterprise may also lodge an application for the privatisation of the enterprise with the consent of the Employee's Council.

c) The Ministry itself may initiate a compulsory privatisation. The ministerial decision does not require consent from the enterprise which is to be privatised.

The privatisation process may begin after the privatisation decision has been made. The government prepares the Articles of incorporation. The new corporation gains its legal personality at the moment of registration and the former enterprise is deleted from the registrar of state owned enterprises.(60)

b)- The Algerian Approach to Privatisation

Before looking into the economic reforms in Algeria, it is worth noting the government's change of attitude towards a certain number of institutions in which it has for a long time neglected its role or treated them as contrary to its own view on development. One of these changes is the Algerian request for an IMF stand-by agreement in 1989, breaking thus an unprecedented record of twenty six years without calling on the Fund's resources, since Algeria joined this organisation in 1963.(61) The second major change is the recent admission of Algeria into the IFC which, in the past, she has never dared to join because of its private policy orientation, which was contrary to the Algerian ideology of development.(62) The third move is the formal application for membership of Algeria in the GATT system which successive Algerian governments refused to join for the same reasons spelled out for the IFC.(63) All these "preliminary" measures were intended to put the country in the capitalist orbit, which the Bank considered as a *sine qua non* for the implementation of the reforms.(64)

In Algeria, the reform of the public sector is perhaps simpler but substantially slower and longer in terms of time. In order to ensure a smooth transformation of the public sector, the Algerian reformers announced a two stage plan, leading to a third undeclared but nonetheless predictable stage of privatisation

(i) The Restructuring of National Enterprises.

Following the Bank's recommendation, the Algerian government started under the first five year plan (1980-1985), a major restructuring programme of all its public companies. It consisted mainly in the breakdown of the previous 350 or so major state companies into a plethora of some 4500 small enterprises.(65) It was the Bank's initiative that, instead of having unmanageable and uncontrollable big enterprises, it was better to have a larger number of small but, economically and financially, governable enterprises. Theoretically, then, the number of state owned enterprises has increased; whereas in the Polish example, it has decreased. The newly created enterprises were dispersed across the country instead of being located in the major urban areas and their vicinity. The aim was to provide a better spread of employment, reduce regional disparities, but most important of all to go into areas where the private sector was not willing to invest.

On the whole, the restructuring process was more technical than political. That is to say, the breaking down of big enterprises into smaller units, did not provoke any discontent or reaction from the people. As long as the new units remained in the public sector, there was virtually no opposition to the restructuring programme.(66)

(ii) The Autonomy of the Enterprises.

After the restructuring process was completed, a new law was passed directing a change in the behaviour of the newly created units. It was mainly stressed that the new entities, although still attached to the public sector, must be run on a business like basis. By the 1990's, more then 350 national companies had become Enterprise Publique Economique (EPE), under the government's policy to free companies from direct state control. The basic principles laid down by the various laws on the autonomy of the enterprise state are in substance, that:

- The EPE is a moral person, entirely distinct from the state.
- The state does not run the EPE.
- The state is a shareholder in the capital of the EPE.
- The EPE is a trading (business-like) entity.
- The EPE is no longer financed by the state only and may call on extra non-governmental funds such as private investors, or commercial banks.
- The EPE is no longer created by governmental decree. (This is very important as far as the real independence of the enterprise is concerned.)(67)

c)-The Limit to the Privatisation Process in Algerian Law.

The laws on the autonomy of enterprises are not absolute in the sense that the enterprise is not completely free to act as it wishes on the economic scene. The difference between the Polish and the Algerian experience is that, in Algeria, there is no such a plan as privatisation. That is to say, there is no real transfer of ownership from the public to the private sector. Algerian officials avoid even using the word privatisation, and, when asked, deny the existence of such a project either in the short, medium or long term. The official language is rather on the reform of the public sector, than the privatisation of the public sector. There is an emphasis on reviving the role of the private sector, rather than transferring public assets to the private sector.(68) However, if state intervention has been greatly reduced, it has not been entirely and definitely phased out. There are two main areas where the state's presence may still be felt after the autonomous status of the enterprise has been acquired.

(i) Ownership.

All state assets and equipment remain the property of the state. The issue of ownership is crucial to both the enterprise and the state.(69) For the former it reflects a certain real autonomy and freedom *vis-a-vis* the central administration. It gives the enterprise the opportunity to use its full capabilities without having to be accountable to any administrative body or political organ within the government hierarchy. For the second (ie the state),to keep control over its assets is to keep a powerful hand over the enterprise. In fact it is a strategic stand before anything else. It signals to public opinion that, contrary to the belief of some, the state is not selling public assets, which belong after all to the tax payers. Moreover, by retaining ownership, the state retains also some sort of deterrent over the enterprise. The state can thus be sure that the enterprise will still comply with government directives, namely those relating to the national development plans which are centrally conceived. In short, if the state gave away its assets to the benefit of the enterprise, it will undoubtedly lose all powers over it, henceforth putting the whole economic programme of reform into jeopardy. These are some of the arguments which demonstrate why the Algerian legislator prefers to speak of a mere transfer of ownership rather than a cessation.

(ii) Planning.

It was made clear during the debate on the economic reforms that the Algerian economy must continue to be centrally planned. The main objective of the autonomy process, it was emphasised, was not to free the enterprise to produce whatever it likes, outwith any national development plan. In fact the drafters insisted that the newly created enterprise must remain the chief instrument in the realisation of the economic objectives fixed in advance by the state. In the Report on the Autonomy of the Enterprises presented by the government and adopted by the National Assembly, the role of the new public enterprise is defined as follows:

> La vraie planification de l'economie nationale ne saurait longtemps survivre et imprimer la rigueur et l'efficacite attendues d'elle sans etre reellement appuyee par des enterprises publiques pleinement responsables de leurs activites.(70)

What seems paradoxical, in the Algerian experience, is that on the one hand, Algerian officials want to free public enterprise, which means, *inter alia*, creating new mechanisms which would liberate the enterprise from any form of state interventionism. On the other hand, they want the same enterprise to comply with strict economic rules which are not always compatible with the meaning of autonomy and all which that implies in terms of economic management. To this state of confusion, the Algerian reformers reply that it is only the method in reorganising the national economy that has changed. The purpose remains the same: to achieve, as usual, the economic objectives centrally planned by the government.

The task is to marry the planning system with the techniques of the free market. In other words, the state will continue to plan the economy and at the same time ask the new enterprise to work "freely" toward the achievement of the planned goals.(71) This sounds very much like the "capitalisation" of socialism in contrast to the "socialisation" of capitalism preached by the Thatcher government in the mid 1980's.(72) Algerian officials, however insist that even their approach to development planning has changed. It is rather flexible and efficient planning, far from the cumbersome and heavily bureaucratic system that existed in the past. Government's insistence on planning rests basically on a set of defendable arguments.

In the first place, it would be politically dangerous to withdraw from the planning arena. The national and international economic situations being what they are, ie unsatisfactory, it would be unwise to leave an infant economy to the merciless greed of the free market. Hence, the need for the state to confirm its presence by orienting, regulating and controlling, through appropriate instruments and within the respect of decentralisation, the evolution of the national economy through elaborated development plans.

Secondly, only the state can decide over most important and strategic economic issues, and ensure its independence vis a vis other nations. The state has the means, human and material, to protect the economy from unmotivated free enterprise initiative. The experience of the Egyptian "open door policy" or *Syassat el Infitah*, is too near to be remembered.(73) Instead of manufactured goods, foodstuffs, machinery and equipment, the Egyptian economy was flooded within a record time with crisps, soft drinks and cosmetics manufactured by the private foreign companies in search of easy and quick profit.(74)

Thirdly, there is the crucial question of the satisfaction of the basic needs of the population. This is too sensitive an area to be left to private initiative -whether local or foreign- and which many LDC leaders fear most. A hungry population is political suicide for any Third World regime. In most of these countries "he who controls people's bellies, controls their brains."

A significant detail which must be recalled, is that the whole process of the economic reforms in general and the autonomy of the enterprise in particular was carried out under the supervision of the World Bank. The contradictions that were spotted in the process of the implementation of the public sector reflect in reality the arm twisting between the Algerian government and the Bank on the speed and extent of the reforms.(75) Since the Bank has not objected so far, it means that it agrees with the progress of the reforms with, perhaps, one reservation. Sooner or later, the Bank expects the remaining traces of socialism to disappear and the new enterprise to become genuinely autonomous, that is to say, market-oriented. In short, privatised.(76)

IV- Some Common Issues in Privatisation.

Despite divergence in their respective approaches to privatisation, both Poland and Algeria share almost the same issues which are in fact characteristic of all LDCs engaged in a Bank assisted privatisation programme. The most common issues are of a legal and institutional nature.

A) Legal Issues.

The first legal obstacles for Poland and Algeria are constitutional. On the one hand, to be legitimate, any privatisation programme must rely on a certain legal basis; that is to say on specific provisions setting out clearly the individual's freedom and right to own private assets that are constitutionally protected. On the other hand, constitutional reforms are needed in order to guarantee that privatised enterprises and assets will not be nationalised in the future. In the cases of Poland and Algeria, both countries had in the past national constitutions which were heavily impregnated with socialist principles that became incompatible with the new economic reforms. Therefore, the immediate task for both countries was to introduce radical changes in their respective constitutions.

a) Major Changes in Polish Law.

In Poland the previous constitution was replaced straightaway by the enactment of a new constitution which espoused almost the opposite principles and ideals held for nearly half a century. In the midst of a popular fever, the new constitution was overwhelmingly supported by the Polish people, and subsequently adopted by the new parliament.(77) Following the promulgation of the new constitution, a large number of certainly the most important.[78] The main features of this law are described below.

(i) The Privatisation Law of 1990.

The intention is not to provide a full examination of the privatisation law, but to give a hint at the kind of legal arrangements which the Polish legislator had to introduce to give effect to the Bank's assisted economic reforms.[79] To be further concise, two main characteristics of the privatisation law are selected for analysis. These are:

• The Restructuring of Public Companies.

As far as public companies are concerned, the privatisation law allows for state enterprises to be transformed *ipso facto* into limited liability companies (Arts. 5-17). These are in turn made subject to commercial law, denoting thus their withdrawal from public law and their submission to private law.

The ancillary issue of shares and shareholders is also largely regulated by the new privatisation law, which provides that shares of up to 10 percent will be sold to private parties, domestic and foreign (Arts 29-32). However, foreign investors may acquire more than 10 percent with special permission from the Foreign Investment Agency. Worth noting, too, in the new law is the employment contract and the provisions relating to employment relations. These provisions affect the Executive Directors and the rest of the managerial staff of the former state owned enterprises (ex. Nomencklatura) some of which were discontinued *ex lege*. Also affected are the employees and trade union movements who saw their mandatory participation in corporation management dissolved.

• The Banking System.

The banking system is the second major area of the new privatisation law where noticeable changes have been introduced. With the technical assistance of western noticeable changes have been introduced. With the technical assistance of western banks, namely the British merchant bankers (Midlands, Rothschild, and B□arclays), the entire financial system has been reviewed. In the first move all the state and state cooperative banks were transformed into joint stock banking companies, and their role was redefined in the light of reforms to respond better to the needs of the private sector.(80)

b)- Major Legal Changes in Algerian Law.

In Algeria, the legal process has been very active and intensive since the beginning of the 1980's. Most of the legislative work carried out by the Popular National Assembly (APN), consisted mainly in the revival of the private sector, whose role in the economic development of the country was until then completely neglected.

(i) The Rehabilitation of the Private Sector.

For the first time since independence, the existence of the private sector was guaranteed and the failure of state ownership openly recognised. The bulk of legislation which followed subsequently is considerable and it will be inconvenient to seek a thorough examination of such laws here.(81) However, a hint may be made at the second five-year plan (1985-1990) as a revolutionary turn in the economic history of the country. Under the title of: The Development of the Private Sector and its Inclusion in the Planning Process." Section III of the plan pointed out that the private sector has for a long time been neglected by government economic decision makers. Its expansion has been severely undercut by indiscriminate legislation which looked upon the private sector as a parasite rather than a complement to the public sector.(82)

When details of the plan emerged, there was bitter opposition from some conservative members in the one party system at that time. They saw in the recognition of the private sector a betrayal of socialist Algeria and, above all, an unconstitutional act. Indeed, the 1976 Constitution not only neglected private ownership, but Article 16 explicitly forbids it.

(ii) Constitutional problems.

Like in Poland, the first major legal obstacle facing the Algerian reformers was the existence of a constitution that was far from accommodating to the new economic measures. However, unlike Poland, Algeria did not opt for a new constitution. Instead, the Chadli government which was determined to push with the reforms, proceeded in two steps. In 1986, it called for an "enrichissement" (modification) of the constitution in force. This technique does not exist in state practice, but it was accepted as a clear device to change some aspects of the Constitution without going into the core of its fundamental principles.(83) Title III, Chapt.1, of the newly rewritten 1986 Constitution rehabilitates the role and importance of the private sector in the following terms:

> The development of the national private sector must be integrated and supervised in the framework of the development plan and conform to the priorities mentioned in it. It will also be necessary to organise the rigorous orientation of this sector, its cadres, and its control in order to ensure complementarity rather than rivalry between the public sector and the private sector.

The second stage was carried two years after the modification of the constitution, after ten days of social unrest and street riots in October 1988 forcing the Algerian government to the enactment of a new constitution in 1989. On the political front, the new constitution recognised for the first time the institution of pluralist society. On the economic front, the constitution provides for more liberalisation in order to accelerate the reforms started earlier.(84)

(**iii**) Other Changes.

After the promulgation of the constitution, all the previous restrictions on the private sector were lifted, and more liberal laws were introduced, among which the most relevant are:

- The Law on Money and Credit.
- The Law on Currency Convertibility.
- The New Law of Foreign Investment.

In parallel to the newly created laws to enhance the private sector, changes in the public sector have made alterations in other areas of the Algerian law indispensable.(85) Thus, many codes have been substantially reformed such as the civil code (contract law), penal code, commercial code, and company law to cite only these areas. There were also significant adjustments in the administrative law, as the notion of public ownership and state enterprise was reviewed. The entire Banking system has been entirely reformed, with a dominant role being given to enhanced autonomy to the Banks, while further steps were made to put them on a more commercial footing .(86)

B)- Institutional Problems.

Both Poland's and Algeria's legal reforms in the private sector were debated and approved by both Parliaments. In both cases there are reports that the political debate was long and quite often turbulent.(87) On the institutional front, the privatisation drive in the two countries has brought into being new institutions which are peculiar to each country.

a) Poland.

In Poland, the Parliament enacted the so called "Main Directives" of privatisation. These directives deal with the scope of privatisation and the distribution of revenues collected from the sale of state enterprises. Two executive bodies were entrusted with the enforcement of the privatisation programme.

(i) The Council of Ministers.

The Council comprises all members of government. Its task is to prepare all privatisation plans before tendering them to parliament for acceptance. It lists a special group of enterprises for privatisation. This provision is intended to give the government the last say in privatisation of important public sector enterprises such as radio, television, or railways, as well as those producing for the military sector.(88)

(ii) The Ministry of Ownership Transformation.

This is a new office which was created on the insistence of the Bank. It is a policy making body as well as an executive organ which deals with the day to day privatisation process. All decisions as to whether or not to privatise an enterprise must be approved by the Minister (except those enterprises on the government special list).(89)

b) Algeria.

In Algeria, no major institutional changes on the Polish pattern were involved, as there was no real transfer of ownership from the public to the private sector. The reforms were carried out within the existing institutional framework. Perhaps the only originality of the bulk of the Algerian reforms is the establishment of the Conseil de la Monnaie et du Credit.(CMC) (The Money and Credit Council). The Council is considered by most observers as the cornerstone of the Algerian reforms in general and the privatisation programme in particular.(90)

(i) Le Conseil de la Monnaie et du Credit (CMC)

Following the approval in March 1990, of the Money and Credit Law, the CMC was established. The Council is intended to control the free movement of capital flow, to promote foreign investment and more importantly to open the way for private (national) companies to establish international ventures. The CMC is seen by most financial analysts as a sign of the government commitment to radical overhaul, offering an unprecedented opening of the Algerian market to foreign investment.(91)

(ii) Le Delcgue des Reformes Economiques.

Another, but relatively less important institution, which was established in the midst of the Algerian reforms, is the post of "Delegue des Reformes Economiques". It is not a ministerial function with substantial powers like in the Polish experience. Instead the role of the Delegate is to coordinate the work of various ministries directly involved in implementing the economic reforms, and to report their progress to the Prime Minister.(92)

From the foregoing comparison of the Polish and Algerian experiences, it appears that, in addition to its economic impact, privatisation affects also major facets of the legal and institutional aspects of the borrower. These changes are necessary, says the Bank, for without them, the economic reforms cannot be implemented, and the whole process of development will be disturbed.(93) But does privatisation really enhance the development process of the LDCs? In other words, will its successful implementation be <u>The</u> solution to the Third World's poverty and economic retardation?

V- The Impact of Privatisation on Development.

It has been discussed in this chapter that the Bank in its capacity as a development agency has been the main actor in advocating the LDCs to go private. Does this statement mean that the development of the Third World economies can be achieved through massive privatisation programmes ? The question is worth exploring at least theoretically, since it represents a review of the general theory of development. So far, the LDC governments have relied on the public sector as the only way to get out of their underdevelopment for the reasons explained earlier. This theory was developed in the late 1950's and the beginning of the 1960's in the aftermath of the decolonisation process. It was academically reinforced in the 1970's by the emergence of a new Third World elite which elaborated the idea of a Right to Development.(94) The UN became suddenly the focus of the LDC grievances, especially during the seventies when great emphasis was placed in official statements and international documents on the virtues of the public sector in the process of the LDCs economic development.(95) In a relatively short period of time, the number of state owned enterprises took on considerable proportions.(96)

The radical shift from the public to the private sector that started in the early eighties is far from being completed, and it may be too premature to rely on any given experience since results are difficult to assess. Therefore, one can only speculate or elevate the debate to a purely theoretical level.

A)- Conceptual Approach.

To begin with, privatisation and development seem in the particular context of Third World economic problems, to constitute two words that are conceptually opposite. On the one hand, privatisation means, among other things, doing business in the capitalist sense of the word. It includes such concepts as share, shareholder, dividend, and profit. Customarily private ownership equals individual property, individual fortune, and above all individual welfare. There is a notion of individuality which is often connected with selfishness, greed and vocabulary of the like which excludes *de facto* any notion of group or collectivity. In a general manner, privatisation is a concept proper to a certain type of society which relies on private ownership to meet its basic economic needs. A private owner would not think in terms of developing, *prima facie*, the welfare of a society. In the United Kingdom, the Thatcher government's view of the mid 1980's was that once some individuals are well off, they create jobs and welfare for the others.

In the legal sphere, a liberal society is characterised by a strong and ramified private law, heavily influenced by the principle of individual freedom in many of its aspects such as commercial law, competition law, business law. Accordingly, much of the laws on manufacturing, pricing, and selling are dictated by the market, rather than by sterile and bureaucratic government decrees.

Development, on the other hand, in its economic sense and Third World context, refers to a certain unsatisfactory level of economic welfare. Broadly, development is synonymous with poverty, hunger, poor housing, and unemployment. Unlike privatisation, development implies the notion of community or collectivity. Some LDC leaders, namely in Africa, tend to give development an ethical meaning. President J. Nyerere of Tanzania for example, talks of the moral duty of the industrial world to help the poor countries.(97) In a wider sense, development is ensured by the collective management of the national resources which are put at the disposal of the state organs. In backward economies, people do not believe in individuals bringing wealth to other individuals unless the state intervenes. In such economic systems, the predominant view, is that it is the peoples who own and run the country's national resources. Since the public sector is perceived as a fundamentally non-profit making sector, it offers certain guarantees such as employment, housing facilities, a free health service and education.

It is unthinkable for many LDCs that such policies could be promoted by any private ownership. For, it is difficult to see how any government can achieve any socio-economic development by sitting idly while the country's resources and capital are drained away by private individuals, be they national or expatriate, in the aristocratic words of the late Lord Stockton (H. McMillan):

> First all the the Georgian silver goes and then all the nice furniture that used to be in the saloon. Then the Canalettos go.(98)

In the LDCs, the Bank's objective is even wider, since it is the very essence of socialist thinking and behaviour, which the institution seeks to replace through its assisted programmes of privatisation. Such an attitude is translated into legal form by a highly developed corpus of public law where most economic decisions are taken by massive government legislation. To enforce such laws, a heavy bureaucracy is usually set up supported by an extensive and elaborate administrative law. Furthermore, privatisation is not just an economic concept which would transform a state economy through a public sector substitution. Take for example Algeria, whose people have held for more than thirty years, since independence, that *res publica* is sacred. It belongs to everyone. The civil code regulates it, the penal code punishes he who violates it. So, it is just not conceivable to tell the same people overnight that what used to be theirs, is now the property of one person who may be one of them or an expatriate.

In addition to its economic and legal impact, the political cost of privatisation may also be high to pay for many LDC leaders. How can previously socialist governments justify, after so many years of public ownership, a sudden shift to private property? This raises the question of trust between government and citizens. The whole reform may become jeopardised if governments which carry them out are not trusted by their people. Privatisation, thus, does not need only a government which is committed to it as the Bank's officials often insist.(99) It also needs a given public mentality which is ready to accept it, and a given economic environment which is able to sustain it. This is why, for instance, the Algerian reformers did not want to hurry things up, but they preferred to proceed by steps. In most LDCs where social commitment is lacking, privatisation programmes have little chance of succeeding, and with them the entire economic development is at risk. Therefore, any privatisation programme which does not take into account the degree of social readiness may not achieve its objectives. The dilemma, however, is the time factor. Economic development in essence, calls for rapidity and confidence, i.e. the quicker the economy progresses, the better off the masses will be. But a change in people's mentality needs strenuous efforts and a long period.

Similarly, privatisation involves a change of attitude in peoples' mentality, by imposing on them a new style and economic way of life. Unless these psycho-sociological obstacles are overcome, privatisation may not achieve its socio-economic targets. In Algeria, eg., after five years of SAL implementation supposed to lead to a privatisation of the national economy, a large segment of the population from various backgrounds, do not hide their regrets over the loss of "the old golden days of socialism"(100) Whether this is only a temporary transitional period as the Bank and government officials claim, remains to be seen. In sum, privatisation programmes advised and supported by the Bank are not always as perfect as the institution claims. They too, have their loopholes and shortcomings.

a) The Side Effects of Privatisation.

All privatisation programmes rely to a large extent on the sacrosanct economic principle of price liberalisation.(101) An application of this principle implies a removal of state subsidies, which are an essential ingredient in the economic structure of many LDCs. From the Bank's point of view, price liberalisation and state subsidies are conceptually contradictory, and as such cannot work effectively side by side within the same economic system. According to the Bank's economists, the purpose of price liberalisation is precisely to restore the real value of the market which may be distorted by a policy of state subsidies.(102) For the less privileged part of the population, which cannot bear the high cost of living, the Bank has developed a policy of targeting.(103) As will be seen, despite its good intentions, this policy was not always welcomed by recipient countries.

a) Targeting, or the Food Coupon Policy.

Since the implementation of the Bank's first assisted programme of privatisation, it became apparent that such a programme cannot function in a society where the vast majority is sometimes below the breadline. To ease the tension, the Bank has devised a policy which consists of "targeting" the less privileged segments of the population and providing them with extra help in the form of food coupons, which the beneficiary can use in any shop to buy certain basic consumption foods. While such policies seem to have succeeded in some countries of Latin America (Chile) and South Asia.(104) it has been less attractive not to say unpopular, in many other LDCs. In Algeria, the introduction of the food coupon was severely critisised by the press as "humiliating and morally degrading for the Algerian's self-esteem and dignity".(105) The coupon story became later an issue of strategic importance for opposition political parties during the legislative elections of December 1991. Under the pressure of the street, the Algerian governement abunded the coupon policy and replaced it by a system of (financial) allowances on the westen model. The new formulae was accepted in the form but not in substance as the amount of money allocated was significantly below people's expectations. In many other countries, for example, Egypt, Morocco, or Tunisia, such a policy is regarded by left wing activists who oppose privatisation, as increasing social disparities and perpetuating the domination of those who have against those who have not.(106) The Bank's view is that such a policy is temporary and the trends will be reversed, once the economy is back on its feet.[107]

b) Subsidiary Shortcomings.

Despite the Bank's praise and drive for privatisation, the implementing of this latter has been seriously hampered by a series of loopholes which may be summarised in a single word: malpreparation.

• In the first place, there is a problem of management. For example, the transformation of many state companies into private businesses in Poland and the reform of the public sector in Algeria was carried out by the previous managerial staff, who were not prepared for such an enterprise. The former managers not only lacked the skill, experience, and techniques of a liberal economy, but they were also sometimes unconvinced and unmotivated. In Algeria, for instance, the former managers of the public sector have gathered in a "Groupement" to show their discontent at the reforms and their manifesto claims openly to resist and prevent privatisation.[108]

• The second problem relates to the issue of subsidies. It is not possible to convince a population seriously hit by the removal of subsidies to support an austerity programme. As a Russian anti economic reformist said in an interview to the BBC "Why should we support reforms which cannot feed people and which make life harder."[109]

• Thirdly, and perhaps more importantly is the weighting of the losses due to parastatal insufficiency and the costs of the LDCs continuing to rely on foreign investors given the predilection of these latter for repatriating profits.

• Finally, there is a question of legal transplant where comparative lawyers may be of some help.[110] For, what the Bank is doing simply boils down to transplanting an economic concept or institution (privatisation) into a totally new socio-economic environment.[111] Free enterprise may be acceptable in western democracies, but may not prove successful in other parts of the world. The reasons are various and relate to a multitude of factors such as the structure of the economy the type of society; or even to metaphysical factors such as religion. These are, naturally, conditions which are inherent to each society and which cannot be overruled by the implementation of (an alien) privatisation type of economic development.

In the Bank, senior officials admit that the privatisation programme is not easy, and that the management is well aware of the difficulties that the LDCs face in the implementation of such a programme.(112) The Bank argues that all it does, it does it for the benefit of the LDCs.(113) But, are there not other "hidden" long term objectives behind the Bank's drive for privatisation ?

B)- The Political and Ideological Objectives Underlying the Bank's Privatisation Programme.

According to the neo-classical view, government spending in the public sector diverts funds from development.(114) On the basis of that view, the Bank requires from its borrower either to go private (as it is the case in Poland) or to run the public sector on business like enterprise before a wholesale privatisation (e.g. Algeria). In both cases, the immediate purpose is to create an environment where capital and profit are dominant. The ultimate goal being eventually the development, expansion and promotion of the capitalist system.

a) The Expansion of the Capitalist Ideology.

The Bank has been in fact nourishing such a project since the early days of its inception, as it was reported in its third Annual Report:

> One of the principal objectives of the Bank... is to help to create conditions which will encourage a steady and substantial stream of private investment... flowing into

its underdeveloped member countries.(115)

Needless to say that this view reflects the US policy in the aftermath of World War II, for which the Bank was looked upon as the future instrument and porte parole of American expansionist policy. As President Eisenhower said in his address to the first Annual Meeting of the IBRD Board of Governors:

> The well being of the free world can only be achieved through the sacred trinity of free trade, sound monetary policy and currency convertibility. Once the above conditions are realized, a great deal of flow of private investment can take place and presumably, the Bank needs guide only the direction of the flow.(116)

It was seen in the experiences of Poland and Algeria that privatisation programmes cannot be conceived as a purely internal process, confined within the limits of the state's boundaries. When the Polish government embarked on its privatisation programme, it made it clear that it counted on foreign investors for the successful completion of its programme.(117) Similarly for Algeria which had to pass laws on private foreign investment to sustain its private sector reforms. Thus, it appears as if all privatisation programmes initiated by the Bank cannot be achieved domestically without external assistance. The Bank's long term objective is precisely to establish a link between national private ownership and its foreign counterpart, with a view to perpetuating free capital movement. As Parakal et al wrote :

> Besides its profit motive, this [privatisation] policy enables the Bank to strengthen its foothold in the young states and to perpetuate the economic dependence of the latter on the capitalist states ... as such, the aim of the Bank is to develop a dependent capitalism.(118)

To help LDC countries adopt a supportive environment for the private sector, the Bank research programme has been actively involved in devising different initiatives to increase the effectiveness of the Bank's activities in that sector. In early 1989, it suggested the creation of two major institutions:

(i) The Private Sector Development (PSD)

The Private Sector Development (PSD) is the first initiative which was launched by the Bank's research programme in January 1989 to enhance privatisation. According to the Bank's own manual, the PSD was designed:

> To fill in the gaps in the Bank's Group activities in private sector development, integrate private sector development into Bank operation, identify areas in which efforts should be intensified, and focus on ways to improve coordination among the Bank, IFC and MIGA.(119)

PSD's priority areas are the business environment, enterprise restructuring, and financial intermediation. A subsequent review of the implementation of the PSD in fiscal 1991 concluded that cooperation within the World Bank Group was essential, and re-emphasised the need to strengthen the role of the IFC through additional resources to meet the demand of an expanding private sector.(120) If such a trend continues, all the odds are that the IFC will overtake the mother institution as the main lending agency of the Bank Group. This will depend obviously on how successful the implementation of the Bank's privatisation scheme will be. In sum, the more the programme is successful, the more the Corporation will become involved and the less the Bank's role will be important.

(ii) The Socialist Economies Reform Unit.

The main task of the unit is to help address the problems involved in transforming socialist economies into market-based systems, in the former communist block.

Through the Unit, the Bank seeks to strengthen and encourage research in socialist reform programmes.[121] Although the country coverage of the Unit was initially set up for Eastern and Central Europe, it was later extended to China, and a number of other countries in Asia and Africa.[122]

b) The Redefinition of the Role and Function of the State.

Since the last decade which coincides with the introduction of Bank SALs, remarkable changes seem to have occurred in the thinking about the role of government in economic development. Under SAL programmes, an increasing number of LDCs of all political colours have been moving towards policies that favour a reduced role for the public sector, and greater reliance on the private sector. But the will for change has not always been matched by the ability to effect a change.

For many LDC governments, the implementation of the Bank's privatisation programme has drained away the state's authority over its economic agents. Under the Bank's recommendation, many LDCs found themselves left with a set of corporations upon which they did not have any power or control, "liberalisation obliges." This has upset many LDC governments for which, as H. Fox wrote:

> As a sovereign state, a developing state enjoys reserve public powers which entitle it to regulate its activities by reference to the needs of its country, rather than to be treated as a contracting party to a commercial transaction.(123)

Another factor which seems worrying for many LDC governments future in economic activities, is the size and volume of foreign investment penetration. The issue of expatriate capital is seen by most LDC leaders as a double edged weapon. On the one hand, they are aware that their privatisation programmes cannot be carried out without an extra flow of capital from abroad. On the other hand, unlimited cash flow may pose a threat to the state's control over its economy, bringing thus to the fore front the crucial issue of outside interference and decision making in key economic activities.

Generally speaking, fear from foreign investment take over is not peculiar to Third World governments only. Even in the most liberal economies such as the United Kingdom and the United States, there are sectors which are closed to private foreign capital (eg. the military), and sectors where this capital is limited by laws.(124) The problem of being taken over by foreign capital is, however, felt more acutely in the Third World because of their economic vulnerability. In many LDCs the principle of economic independence is closely linked to political independence. This is clearly recalled in the UN resolution on the Permanent Sovereignty over Natural Resources adopted in 1962 on the Third World initiative.(125)

For many LDCs a wholesale liberalisation of the economy is simply losing control over the country's political destiny. Furthermore, many LDCs have learnt that foreign investment is not always the right answer to their economic problems. Experience today shows that it often creates additional problems for many LDCs of which the most common are:

• Foreign investment is unstable and uncertain, and as such it cannot be a reliable source of financing, because it is largely open to unpredictable political factors. The slightest diplomatic row between the recipient country and the government to which the private investors belong, may lead to a standstill in part or the whole of the national economy. For example the dispute between the US and Libya in 1986 led the White House to call on all American companies to quit Libya. Later on the US made several efforts to influence their western allies, namely the EEC, to take similar action, because of the alleged Libyan leader's involvement in state sponsored terrorism.

• Too much involvement of foreign investment may also be detrimental to the national economy of the borrower which then becomes heavily dependent on it.

• Another important issue is the repatriation of profits, which means hard currencies going abroad as most of the time foreign investors are not interested in reinvesting in the recipient country.

These are some of the issues that the Bank seems to underestimate, for the simple reason that privatisation is conceived as a merely economic phenomenon, whereas its political and social aspects are equally important. Unless these issues are properly addressed by the Bank, the chances for implementing its privatisation programmes may well continue to be seriously obstructed in the future.

Conclusion to Chapter Four.

Under the Bank's pressure, development strategies in most LDCs have been changing over the past decade, moving toward a greater emphasis on private activity and competitive markets. From the 1940's into the 1970's, economic policy in much of the developing world was characterised by confidence in the capacity of the government to spur growth and bring about economic welfare.

The beginning of the 1980's saw a sweeping wave of the privatisation phenomenon in many LDCs and Central and Eastern European countries. Several factors contributed to this event. One of them is the appalling state of the Third World planned economies. Another factor, is the failure of centrally planned economies which had a negative effect on the LDCs which were following the socialist patter of economic developmen. For the Bank, there was no other better time to implement at last one of its cardinal objectves set out in its Articles of Agreement, which is the support of the private sector. As a result, the public sector in many Third World, Central and Eastern countries has been subject to radical transformations, leading sometimes to its disappearance from the economic scene.

These economic reforms were preceded from the legal point of view, by massive legislative action in almost every aspect of the borrowers' legal systems, ranging from their constitutions, down to the ordinary custom laws. The bulk of this legislation was intended to lower the state's interference in economic life. As a result, the role of the state became increasingly aleatory both at the internal as well as external level. Internally, the divestiture of key economic enterprises signified an end to the state's authority and monopoly over key economic sectors, and accordingly a lower role in the conduct and control of many aspects of the national economy. Externally, the increasing flow of foreign capital investment made the borrower's sovereignty open to bargaining in the market place.

As the 1980's drew to a close, it appeared to the Bank that its economic reforms in general and its privatisation programme in particular were well below its expectations. The Bank blamed low economic performance on the LDCs' political structure which, according to the institution, prevented the successful implementation of the reforms.

To remedy the situation, the Bank announced in the early 1990's that its future lending would be conditional on the LDCs' readiness to introduce, in anticipation of any loan request, major reforms in their political system. In short the Bank has in addition to its economic conditionality subjected its clients to a second type of conditionality, this time of a political nature.

In the following Chapter, an attempt will be made to examine the major features of this new lending policy and to assess the legal implications of this dual conditionality on borrowers.

Notes to Chapter Four.

1 Almost all loans since 1980 have provisions calling either for privatisation, or a re-examination of the public sector policy of the borrower. See various Annual Reports since 1980 onwards which give a summary of projects approved annually by the Bank.

2 Reported in C. Veljanovski, Selling the State -Privatisation in Britain, G. Weidenfeld & Nicolson Ltd.,London (1987), at 21.

3 Id.
However, the British anti-privatisation group sees privatisation as "an umbrella term for a diverse set of policies, albeit linked through an underlying judgement in favour of strengthening the market at the expense of the state". See David Steel et al (eds), Privatising Public Enterprises, Roy. Inst. for Publ. Admin., London (1984), at 21.

4 See the interesting Special Report on Privatisation in the weekly Observer, London, 15 October, 1987 at 9-11.

5 See, The proceedings of the international seminar on "The Role of State Sector in Developing Countries", sponsored by the People's Publishing House, New Delhi (India), September (1977).

6 D.W., Subasinghe, State Sector in the Economy of Sri Lanka, in The Seminar, supra note 5, at 47.

7 supra note 5, at 1.

8 As N. K. Krishman wrote:
By its intervention, the state helps to break the barriers of underdeveloped productive forces. By its regulatory measures, the state provides conditions for more effective functioning of the productive forces and protects key branches of the national economy from the anarchy of private capital. In the countries which follow the socialist path, the state sector, becomes a bearer of new socialist relations, it strives to embody the most consistent course towards economic independence". See N.K. Krishman, "Key Issues of National Democratic Revolutions", in The Seminar, supra note 5, at 390.

9 Sabah al Dhura, Development of the Public Sector in Iraq, in The Seminar, supra note 5, at 108.

10 *Cf.* the Preamble of the Algerian Charter of 1962.

11 Amongst the biggest projects of international dimension carried out by the public sector in Algeria are:
(i)- The Green Dam, which is a 1200 km and 20 km width belt of forestry to prevent the advance of sand from the Sahara desert to the coastal north.
(ii)- The Transaharan (or the Road of the African Unity), is a 2000 km road through the Sahara to link Algeria with neighbouring African states of Mali, Niger and Mauritania.

12 G. Mirsha, "Role of the State Sector in the Indian Economy", in The Seminar, supra note 5, at 186.

13 Ibid., at 188.

14 On socialist aid to LDCs, see in general, M.I. Goldman, SovietForeign Aid. Praeger, London (1967); also J. Hart, Aid andLiberation, a Socialist Study of Aid Policies, Gotlancz, London, (1973).

15 Supra note 12, at 185.

16 Ibid, at 181.

17 Meagher et al, International Financial Aid, Pergamon, New York, (1968), at 465.

18 J. M. Nelson, Aid, Influence and Foreign Policy, McMillan, London, (1968), at 63.

19 Ibid, at 71.

20 Supra note 12, at 185.

21 Mason et al, The World Bank Since Bretton Woods, The Brookings Institution, Washington DC. (1973), at 258, 357, 364, 379.

22 Ibid, at 743-45.

23 World Bank Annual Report, 1986, at 118.

24 Supra note 21, at 466. In the authors' view:
The very few publicly controlled industrial projects the Bank financed in its early years were all designed to be turned over to private control at a specified stage".

25 Reported in Melvyn. B., Krauss, Development Without Aid: Growth, Poverty and Government, New York, (1983), at 166.

26 Id.

27 Ibid, at 167

28 Id.

29 For a discussion of these loans, see supra note 25, at 165 et ss.

30 See Robert. S. McNamara, The McNamara's years at the World Bank: Major Policy Adresses of R. S. McNamara 1968-1981, J. Hopkins University Press, Washington, (1981).

31 Ramzi Fawzi, Monetary History of Underdevelopment: A Study of the IMF in the LDCs (in Arabic), Collection *Alam el Maarif* Kuwait (1987), at 321. (author's translation)

32 See the World Bank Annual Report, 1982, at 52-58.

33 E.Stern, World Bank Financing of SAL, in J. Williams (ed), IMF Conditionality, MIT Press, Washington DC. (1983), at 87-108.

34 For Mason et al,
"The Bank is intended to cooperate with private financial agencies in making available long term capital for reconstruction and development"., supra note 21, at 18.

35 Wall Street Journal, 22 April 1987, at 3.

36 Supra note.5, at 87-89.

37 In President's Woods' opinion:
"We have been reluctant to finance state owned industrial enterprises primarily because of the difficulty of assuring that they would be managed on a

businesslike basis, free from political pressure. Address by G.D. Woods to the ECOSOC, 26 March 1965. Reported in Meagher et al, supra note.17, at 466.

38 Mason et al, supra note 21, at 150-51, 371-72

39 Ibid, at 374.

40 Supra note 5, at 51.

41 See T. Hayter and C. Watson, Aid Rhetoric and Reality, Pluto Press, London (1985), at 210. The authors wrote:
"One of the Bank's arguments was that such industries would compete with those of the already industrialised countries which were capable of supplying the needs of Algeria. Algeria should therefore stick to food processing, textiles, "biro" pens or whatever in line with its comparative advantage".

42 According to this 1817 theory,
"The Citizens of each country become "better off" as a result of trade, with the extent of the gains from trade depending upon the degree to which the terms of trade exceed the domestic comparative cost ratio". See J. Eatwell et al, The New Palgrave. A Dictionary of Economics, Vol. 1 A to D, (1990), at 515.

43 Supra note 6, at 51.

44 See, supra, Chapter Three, at 146-47; also, the World Bank Annual Report, 1980, at 17.

45 Supra note 40, at 209.

46 World Development Report, (IBRD Publication), 1983 at Part II.

47 For a criticism of the Report, see T. Hayter, supra note 41, at 141.

48 Full details of the IFC activities can be found in the Corporation's Annual Report.

49 The World Bank Annual Report, 1991, at 78.

50 For a general reading on the types and techniques of cofinancing, see, R. A. Hornstein, "Cofinancing of Bank and IDA Projects", in 4 Fin. & Dev. (March

1977), at 36-30.

51 For an overview of the Centre, see S. Boskey and P. Stella, "Settling International Disputes"., in 2, Fin & Dev., Sept. 1965, at 129-133.

52 For an updated review of the activities and initiatives of the Centre, see, The ICSD Annual Report.

53 F. I. Ibrahim Shihata, "Towards a Greater Depolitization of Investment Disputes: The Role of ICSID and MIGA", in 1 Foreign Investment Law Journal, Spring 1986, at 1 - 25.

54 The World Bank Annual Reports 1990, at 13, and 1991, at 107.

55 The World Bank Annual Report 1991, at 106.

56 Supra, note 4, at 48.

57 Supra note 5, at 48. The same view is admitted by a Bank senior official who wrote:
"The objective of this effort is to help define an appropriate framework, or "rules of the game" for the operation of the public enterprise sector whereby it could operate on a competitive and cost effective basis, free from day to day intervention, and phase out activities for which it is ill-equipped" See E. Jaycox, "What can be done in Africa", in S.K Commins (ed), Africa's Development Challenge and the World Bank. Hard Questions, Costly Choices, Rienner, London (1988), at 41.

58 For an analysis of the socio-political and economic changes that occurred in post communist Poland, see J. Sachs & D. Lipton, "Poland's Economic Reform", 69, Foreign Affairs, 1990, at 47-66.

59 The World Bank Annual Report 1990, at 49, 69.

60 For a full discussion of the Polish reforms from a lawyer's point of view, see, M. S.Zbigniew, "Polish Privatisation Law of 1990", in 18, International Business lawyer, Dec. 1990, at 456-58.

61 See IMF Annual Report 1990, at 14.

62 Algeria joined the IFC in February 1990.

63 Algeria joined the GATT in 1976 as an observer member. Since November 1991, negotiations hace been taking place to secure full membership.

64 *Cf.* Africa Review,1991-1992, at 27-32.

65 On the process of the restructuring of enterprises in Algeria from a legal point of view, see, R.N. Saadi, "La Restructuration des Entreprises d'Etat: Essai de Presentation Analytique", in XXI Rev. Alg, June 1984, at 305-362.

66 The main opposition came from the Managing Directors of the former big enterprises who saw their power and especially their privileges undermined by the dismantling of the state companies.

67 The whole process of the autonomy of enterprises is discussed in a series of articles by A. R. Hadj Nacer, Rapports surl'Autonomie des Entreprises. in, Collection Les Cahiers de la Reform, (2nd edition) 5 vols, ENAL Algiers, (1990).

68 It may be interesting to note that the Algerian Ministry of Finance A., Benissad has been dismissed two months only after his appointment. At the origin of his dismissal was an interview which he gave to a local newspaper and in which he refered to a posible wholesale privatisation of the Algerian economy in the near future. This statement prompted an angry reaction from the working class and the trade union movements. To calm down public opinion, the Prime Minister dismissed his undelicate Ministry of Finance. See various issues of the Algerian daily press in general and El Watan in particular (September 1991)).

69 As far as the capital of the EPEs previously held by the state, it was transferred to 8 holding companies called Fonds de Participation established in 1988.

70 Supra note 66, Cahiers de la Reforme, Vol 1, at 29.

71 Ibid, at 31.

72 Supra note 4, at 11.

73 When President Sadat took over from Nasser of Egypt, he remarked:
"It was clear to me in 1970 that what we called the socialist experiment, and which we carried out in the 1960's. was a 100% failure" See B. Barlett, "The Rise and Fall of Egyptian Socialism", in 4, Jour. of Econ. Growth Winter 1989-90, at 22.

74 Almost the same scenario happened in Algeria. Since the New Law of Investment has been promulgated, 3 Dutch private companies applied for licenses to produce crisps in 3 major Algerian cities. This is obviously not the kind of foreign investment that could help Algeria, or indeed any LDC, to overcome its huge developmental problems

75 Since 1990, successive IMF, IFC and Bank missions visited Algeria, denoting the special interest and involvement of these institutions in the process of the economic reforms taking place in that country. For more detail see the national daily press.

76 See the daily El Watan dated 21/3/91, at 7.

77 The latest Polish constitution was promulgated in 1989.

78 20 ILM, 1990, at 1226.

79 Supra note 60.

80 Ibid, at, 456.

81 On the legal aspect of the economic reforms in Algeria, see, C. Bernard, "En Algerie, une Nouvelle Valeur: l'Auto-Emploi", in XXIX Revue du Tiers Monde, Avr-Juin, 1988, at 300 et ss.

82 Ibid, at 321.

83 For a comprehensive analysis of the economic changes in Algeria, see the Special Report on "The 1985-1989 Algerian Development Plan. Outlines and Economic Background" by the London based consultant group COMET. London, 1986.

84 The constitution was adopted by 98.37% of the votes cast.(Source, The Interior Ministry).In political terms this means a large support for the reforms including a more liberal private sector.

85 See H. Benissad La Réforme Economique en Algerie. (ou l'indicible adjustement structurel), OPU, Algiers, 1991.

86 Id.

87 See respectively, for Algeria, supra note 66, at 38; and for Poland, see supra, note 78, at 456.

88 Supra note 60, at 458.

89 Similar institutions have been set up in many LDCs undergoing economic reforms. eg.,the Ivory Coast, Egypt and Zaire, all have a Ministry of Ownership Transformation, or Ministry of Privatisation whose main task is to ensure the implementation of the Bank's assisted privatisation programme.

90 Supra note 64, at 29.

91 Id.

92 Id.

93 For a following up of the economic transformations that are currently taking place in Algeria, see the weekly (MEED), and especially the following issues:
The MEED, 6/4/1990, at 9.
_________, 13/4/1990, at 11.
_________, 5/6/ 1990, at 13.
_________, 12/6/1990, at 7.
_________, 29/6/1990, at 16.
_________, 20/12/1991, at 9.

94 It may be worth noting that Third World views on development were also shared by many western lawyers, namely P. Virally, G.Fuer, A. Pellet in France; R. White, R. Higgins and B. Ward in the UK; Pieter V. L.Themaat in Holland; and A Fatouros, J. White in the United States, to cite only these few examples.

95 *Cf.* UNCTAD Resolution on "Needs of the Public Sector in the Transfer of External Resources to Developing Countries." UN Trade and Development, 50 Annex A, IVB. The resolution was adopted by 117 votes to 1, at the 1964 Geneva Convention. For a discussion of the resolution, see Maghear et al, supra note 17, at 467.

96 In his study, Juan. F. Bendfeld reveals that Mexico had 150 state owned enterprises in 1960; by 1980, the number had risen to 600. Brazil had 150 in 1960, and more than 700 by 1980. In Tanzania, the 1965 figure of 50 grew to 400 by 1980. See J. F. Bendfeld "Privatisation: An Opportunity", 4, Journal

of Economic Growth, 1989-90, at 29.

97 See eg. President J. Nyerere's new year message 1980 address to the diplomatic corps accredited in Tanzania. Reported in 2, Development and Dialogue, 1980, at 7.

98 Address to the House of Lords, February, 1985.

99 M. Constantine, "Structural Adjustment Lending", 27 Fin .& Dev. 1987, at 9.

100 The Algerian weekly magazine, n°1445, Revolution Africaine, Nov. 1991, at 8.

101 See the series of articles launched by the IMF/Bank's publication Finance & Development to promote its privatisation campaign., especially the following: Susan. K. Jones, "The road to Privatisation" (March 1991); Helen Nankani "Lessons of Privatisation in LDCs" (March 1990); Mary Shirley, "Experience with Privatisation" (Sept. 1988); R. Hemming & A. Mansoor,"Is Privatisation the Answer (Sept.1988).

102 Id.

103 Id.

104 World Development Report 1990, at 4.

105 Supra note 100, at 8.

106 See the weekly newspaper Algerie Actualite, N° 4389, August 7-13, 1990, at 3.

107 Supra note 49, at 17.

108 Union Nationale des Entrepreneurs Publiques (UNEP), is a pseudo union whose purpose is to mobilise public opinion against the selling of state's assets and prevent the privatisation of the public sector.

109 BBC 2 News Night, 22 November, 1991.

110 See A. Watson, Legal Transplants, Edinburgh, (1974); also Ahmed. Aoued, "The Problematical Nature of Mixed Jurisdictions" LLM. Thesis, Glasgow University, 1980.

111 For Lucien Pagni, one of the major causes of the rather limited success of the development programmes run over the past three decades is the adoption without distinction of foreign models in many LDCs. See the author, "Structural Adjustment", in 111 The Courier, Sept-Oct. 1988, at 51.

112 Supra note 99, at 7.

113 In its 1990 Annual Report at 54, the Bank stated that:
"Poverty alleviation is what economic development is all about. Practically everything that the Bank does, either in its lending or in its policy work, bears directly or indirectly on poverty reduction".

114 Supra note 21, at 151.

115 The World Bank Annual Report 1949, at 20.

116 The World Bank Annual Report 1947, at 19.

117 Supra note 60, at 456.

118 Pauly V. Parakal and S. Mitra, "An Introduction to the role of the State Sector", in The Seminar, supra note 5, at 171.

119 The World Bank Annual Report 1989, at. 44

120 the World Bank Annual Report 1990, at 49.

121 The World Bank Annual Report 1991, at 68.

122 Id.

123 H. Fox, "The Significance of the Distinction between Private and Public Law for Developing States" in F, Sydner & P. Slinn (eds), International Law of Development: Comparative Perspectives, Professional Books, London (1987), at 144.

124 Supra note 2, at 116.

125 *Cf.* UNGA Resolution on Declaration on Permanent Sovereignty over Natural Resources. 1803 (XVII), 14 Dec.1962. Reproduced in P. Mathurika (ed), The International Law of Development, Basic Documents, Oceana Publications,

New York, (1978-), Vol. 1, at 571.For a discussion of the resolution, see, P Peters et al, "Permanent Sovereignty, Foreign Investment and State Practice", 88-143, in Kamal Hossain (ed), Permanent Sovereignty over Natura Resources in International Law. Frances Pinter, London (1984).

CHAPTER FIVE

SPECIFIC IMPACT OF BANK ACTIVITIES ON THE POLITICAL SYSTEM OF BORROWERS.

In the recent past, the Bank has moved away from its traditional economic conditionality, and started requiring its LDC borrowers to introduce, beside the economic criteria, political changes in their system of governance. The Bank change in attitude is not the result of an internal planned policy or resolution, but seems rather dictated by a combination of external as well as internal factors. It is therefore essential to look, albeit briefly, at the nature of these factors.

I- Recent Change in the International Environment.

At the end of the 1980's, the world economic and political outlook changed dramatically. On the economic front, Third World economies were on the verge of bankruptcy as their foreign debt reached alarming proportions. The flow of capital became reversed, and more money was fleeing from the developed rich North to the underdeveloped poor South in debt repayment. The confrontation between debtors and creditors increased, thus reducing sharply the flow of private investment to the LDCs. And all that at a time when the LDCs themselves required net resources inflow to sustain their development efforts.(1)

On the political front, the end of the 1980's saw also their upheavals with the spectacular and rapid disintegration of the communist regimes, and the emergence of new democracies in Eastern and Central Europe. The dismantling of the Soviet Union and later on its replacement by the Commonwealth of Independent States (CIS), remains, from a geopolitical point of view, amongst the most salient feature of the end of this century.

In the midst of these changes,the Western world emerged as a politically and economically reliable system to which the newly democratised states turned for assistance. Knowing in advance their economic superiority, Western leaders expressed their readiness to help the former communist regimes on condition that these latter undertake major political reform in their system of governance, and opt for an open market economy. Opening an OECD conference on the economic problems of Eastern and Central Europe, the Chairman of the DAC stated that:

> There is a vital connection between open , democratic and accountable political systems, individual rights and the effective and equitable operation of economic systems with substantial reductions in poverty.(2)

The consequences of such a (Western) policy have a double effect on the economic development of most of the LDCs. On the one hand, Western donors attention to Eastern European aid needs and their introduction of democratisation as a condition for further support is troubling many LDCs who fear similar treatment, or a possible aid disengagement from the South to East.(3) Despite assurance from Western donors trying to convince LDC leaders that the flow of international resources toward Eastern Europe will not be at the expense of assistance for the Third World countries, this does not seem to be the the case.(4) Doubts about these assurances were hardened when Western countries extended their conditionality of democratisation to Third World countries and linked their financial aid to political reform.(5) On the other hand, this new shift in official aid policy has also extended to the World Bank which seems to follow its main suppliers' path by requiring from its borrowers good governance as a new criteria for its future loans. It is therefore essential to look first at the reasons behind the DCs shift in aid policy, before considering at some length the Bank's new attitude.

A)- New Trends in Western Aid Policy.

In the past, the West has always tied its aid, whether concessional or non-concessional, to the Third World.(6) This tied aid was basically justified on three main grounds:economic, political and ideological (or strategic). Economically, the West granted aid to LDCs on condition that the loan be spent on the purchase of goods and equipment from the donor country. This was by far the most common type of tied aid. Examples of this type are countless and the literature is abundant.(7) Politically, Western countries gave financial aid to LDCs in order to gain some extra votes on crucial issues in international fora such as the UN. For instance, US aid to Morocco to back America's stand against the admission of China (before 1980) to the UN fits perfectly in this category of aid. Ideologically, the West was specially generous towards some LDCs because they were vital to counter what the US used to call "the communist threat". On the grounds of such a policy, the Americans financed projects as far apart as Africa (Kenya, Liberia), South Asia (The Philippines), and Latin America (Honduras, El Salvador, Panama), on condition that the loans should be used to develop capitalist oriented economies (and therefore stop the spread of socialism).(8)

By the end of the 1980s and the beginning of the 1990s, none of the reasons justifying Western aid to LDCs remained. The democratisation of Eastern Europe and especially the crumbling of the "hobbled giant", the Soviet Union, marked a new turn in East-West relations. The Cold War which pushed the superpowers to gain some Third World friends in every corner of the planet has ended. The Eastern countries headed by the Soviet Union, emerged completely devastated by more than forty years of communism. Financially bankrupt, they turned to the West for assistance, while knocking at the door of the IMF and the World Bank; some asking for more money (Yugoslavia, Romania), others applying for membership (former USSR, Bulgaria, Czechoslovakia).[9] For the West, the economies of the East presented an enormous market for its goods, technology and services. It was only a question of time and money. These latter will be taken from the LDCs and reoriented to the newly democratic states of Eastern Europe as will be discussed in the forthcoming section. In the meantime, the process of disengagement has already started both at regional and national levels of the Western countries.

a) Collective Western Action.

Regionally, the tone was officially given in 1989/90, when the OECD was approached informally by the governments of several Central and Eastern European countries which were embarking on the transition from centrally planned to more market oriented economies, and which were seeking advice on a wide range of possible economic reforms.[10] The OECD responded by setting up the Centre for Cooperation with European Economies in Transition, which specialises in problems of transition from a centrally planned economy to a market oriented system.[11] Further steps were taken at the Houston economic summit in July 1990 when the heads of states of the seven major industrial countries (G7), requested the World Bank, the IMF, the OECD, and the President designate of the EBRD, to undertake a detailed study of the Soviet economy, to make recommendations for its reforms, and to establish the conditions for western economic assistance to support such reforms effectively. The study was carried out collectively and submitted as planned at the end of 1990.[12] In the following Western economic summit's of the G7 in London, July 1991, the aid deliberations focussed once again on the Eastern bloc and notably the Soviet Union. This expected move was followed by a series of packages of aid from the EEC, including food and medicines to countries such as Poland, Romania, East Germany and the USSR. In short, what used to be the lot for Ethiopia, Sudan and Bangladesh, has simply been diverted to Warsaw, Bucharest and Moscow.(13)

The West extended its generosity to the East when it announced the first ever debt write off for a group of Eastern countries including Poland.(14) Western solidarity reached its peak in April 1991 when the DCs leaders gathered in London for the inauguration of the European Bank for Reconstruction and Development (EBRD), which many observers regard as a new Marshall Plan for the Eastern and Central European countries.(15) In sum, the political detente between East and West has overshadowed the economic problems of the LDCs who have been since then accorded a lower priority.(16)

b) Individual State Action.

At the level of individual countries, the process of withdrawal has also started in the main Western capitals as DCs launched an unprecedented attack on LDCs economic failure.(17) Senior officials as well the media have been regularly focussing on LDC policies and a lack of democratisation as the principal causes for the Third World crisis, without acknowledging its severely disadvantaged position in the global economy. Slowly but gradually Western countries started to withdraw their official aid to LDCs on the ground that their political regimes were undemocratic.

France, once one of the most outspoken nations on Third World grievances has suddenly started to alter its line by pulling out its investments from many countries in Africa. According to statistics, in the space of two years almost one-third of French private and public businesses in Africa have closed down.(18) At a recent meeting with Francophone heads of states, French President, F. Mitterand said that in the future, the country would be far more enthusiastic about extending financial assistance to countries which embarked on programmes of democratisation than those which did not.(19)

In the UK, the British government is sending out similar signals.(20) At a recent conference in London entitled "The Prospects for Africa in the 1990s", British foreign secretary Mr.D.Hurd told participants that:

> Governments which persist with repressive policies with corrupt management, or with wasteful and discredited economic systems should not expect us to support their folly with scarce aid resources.(21)

Other donors have made pronouncements in surprisingly similar vein. The German economic cooperation Minister Jurgen Warnke told the Bundestag on May 10th 1990 of the tying of aid by his country to political conditionality.(22) A few months later, the new aid German policy was confirmed by Federal Chancellor Helmut Kohl. In his government statement on January 30th 1991, the Chancellor stressed that for an efficient use of the funds Germany will provide there would be some prerequisites, namely:

- Respect for Human Rights.
- Democratic government.
- Economic development instead of piling up armaments.
- Priority to the development of the private sector.(23)

In 1990, the Japanese Foreign Ministry's white papers for the first time linked aid to political value. Without determining the content or the nature of the political conditions envisaged, the papers specified in a general fashion that "countries efforts to democratise will be taken into account more than before."(24)

Even the Scandinavian countries which are known for their sympathy towards the LDCs, have changed their position. Traditionally the most generous donors in terms of untied aid to the Third World countries, they have recently announced substantial changes in the form of development assistance.[25]

a) The Kenyan Experiment.

The government of Kenya represents the first concrete western action in tying aid to political reform. It is seen by most observers as a test for both the DCs and the LDCs for any future development assistance from the former to the latter.[26] In November 1991, the EEC and the USA launched a virulent campaign against the regime of Arap Moi of Kenya, accusing the President of kleptocracy, tribalism, mismanagement, and of stifling the press and spurning demands for multiparty elections, and threatening to "brush his opponents aside like rats."[27] During the meeting of the Paris Club, a group of rich western governments, to which Kenya owes $6 billion as foreign debt, it was made clear by the donors that they would lend no money to a government rendered unstable by corruption and authoritarian rule. The Paris Club put off for six months a decision on Kenya's debt, hoping for progress in economic and social reforms, which, according to the Economist, meant "ending extortion and autocracy."[28]

What is more relevant in the context of this thesis is the Bank's attendance at the Paris Club meeting. The Bank representative joined the Club's aid boycott, and warned that the institution would not continue to lend to Kenya unless economic and social (understand political) changes were introduced. Yet, not so long ago, the same institution praised the same government for its economic reforms, and described Kenya as a "successful story of structural adjustment strategies."[29] The government of Kenya responded by referring to an international plot to destabilise its country. The President accused Western countries and particularly the US of undue interference and provocation and said that Kenya had the right to choose its own political system and not engage in copying alien models.[30] However, under continuous international pressure President Arap Moi announced a month later, in December 1991, the introduction of multipartism and promised free elections in the near future.(31)

How successful western policy in tying aid to political reform will be, and how often Western governments and international institutions such as the Bank, are prepared to repeat the Kenyan experiment, remains to be seen. For the time being, it seems that the West's attempt to tie aid to democratic reform has been overshadowed by more important events taking place within Europe. On the one hand, the Yugoslavian civil war, the confusing situation that still prevails in the former USSR and the pending issue of the former Soviet nuclear arsenal, are more important issues for western security than the fate of the Third World undemocratic regimes.

The Kenyan experiment and the Harare Declaration are still in their debut, and it may be premature, to draw any conclusion. Probably the question worth asking at this stage is whether political change could be the solution to the economic problems of the developing countries.

C)- The Opportunity of Political Conditionality.

The question which is raised and debated in the media, in policy discussion with Western governments and in public documents by international economic institutions is whether aid should be linked to political reform. A corollary to this question is whether democratisation in LDCs is a solution to their economic difficulties.(32) The question has been raised as a result of the recent changes in Eastern and Central Europe and the West's response for economic help by providing some money and promising more on condition of their help in continuing political liberalisation. No definite answer can be given for lack of past experience. However, from current experiences in some LDCs who are presently trying a combination of Glasnost and Perestroika, it may be possible to draw at least some general -and very limited- observations.(32a)

As attractive as it may be, the idea of democratic reform has not been without problems in many Third World countries. First of all, there are potential dangers, that in most cases, the introduction of democracy may centre on ethnic, regional or religious cleavages. In Algeria, for instance, religious leaders took advantage of open competition to envisage an Islamic state based on Sharia' law. The street violence and social unrest that followed, in preparation for the general elections, prompted the army to intervene and declare martial law for a period of four months. At the same time, the Islamic Front leaders and many of their followers were arrested and tried before courts martial.(33) Further attempts were made to put the democratic process on the right footing, but in vain. By January 1992, Algeria was left without a parliament (constitutionally dissolved at the eve of the general elections), without a President (who resigned following his party defeat in the December 1991 general elections), and only a transitional government (which was set up temporarily in July 1991 to prepare for the general elections). A five member Council of State , heavily backed by the army was sworn in to take in charge the country's affairs until the end of 1993.(34)

In the newly democratised states of the former communist regimes, the early euphoria when these countries opened for democracy soon evaporated, leaving room for public disillusion and resentment. In some of these countries, the democratic process seems to have fallen short of meeting peoples'expectations. In Poland, nearly half of the population were disappointed at Lech Walesa's economic promises.(35) In the first free election in Albania, the communists defeated the new democratic reformers and remained in power.(36) In Bulgaria, the reformers were nearly beaten at the first free general elections by the previous communist party.(37) In Russia, Boris Yeltsin was disavowed by a certain section of the population, after only few months in office.(38)

In others countries, the transition from a single to a multiparty system has been accompanied with violence and internal civil war. In Yugoslavia, the Slovenian and Croatian republics took the opportunity of an open democratic system to desert the

Federation and proclaim themselves independent entities from the central government of Belgrade. There too, the federal army had to intervene "to protect and preserve the unity of the Federation".(39) The conflict took an international dimension with the involvement of the United Nations and the Security Council. It became even more complex when the twelve members of the EEC decided to recognise Slovenia and Croatia as separate and independent states.(40) In the newly created republic of Georgia, the newly elected President Gamsakhurdia was forced out by an armed opposition.(41)

In most African countries open democracy is synonymous with ethnic and tribal rivalries which lead to violence and bloodshed, as happened in Nigeria, Gabon and Kenya.(42) Realising the danger of such an undertaking President R. Mugabe said that a multiparty system is not necessarily what the majority of Africans want, staking his argument on the fact that tradition extols a strong centralised leadership and that a multiparty system will only fuel ethnic dissent. He was supported by many African leaders such as Arap Moi of Kenya and Keneth Kauanda of Zambia.(43) These two Presidents were particularly active and mounted personal crusades against the multiparty system, calling its supporters names like tribalists, subversives and terrorists, manipulated from abroad.(44)

For most Third World countries, it was in fact the fear of such ethnically based politics which were the justifications of the one party system at independence. To Professor T. Bamesa (Zaire), the single party corresponds to an essential feature of the African society, namely the search for unanimity in a community arrangement.(45) Professor B. Olofio goes even further and asks whether the single party has not played a positive role in the shaping of many African modern states.(46)

In sum in most of the LDCs and to some extent the Eastern European countries, undertaking political reforms at the West's request and on the western model of democracy, there is a growing concern at the potential use of force. This point has been officially debated during the World Bank/OECD conference, when some of the participants raised the possibility that certain governments may soon have the unavoidable choice of facing being swept aside, or having to resort to force to maintain power and perhaps law and order.[47] "The stark choice facing Western governments and international economic organisation", says one participant, "is Marshall Plan or martial law."[48]

In the light of the foregoing experiences, it seems that the population of the countries concerned took the opportunity of political openness to rebel against the economic reforms, which the West and the Bank made concessional on good governance. Whether it is a problem of political immaturity is outside the scope of the present study. What seems clear, however, at least for the present, is that the Western linking of financial assistance to political reform is misplaced. By so doing, Western donors are deliberately adding to the economic crisis of LDCs another crisis of a political dimension this time. What seems, however, more disturbing for many LDCs, is that the World Bank is heading in the same direction as Western donors; something quite normal since they are its main capital suppliers.

II- The World Bank's Political Conditionality.

Before considering the reasons for the Bank's new shift in its lending policy, it may be necessary to clarify the concept of political conditionality.

A- Meaning and Scope.

In the Bank's understanding, the criterion of political conditionality is closely linked to the notion of good governance, which one senior Bank official describes as " the exercise of political power to manage a nation's affairs."[49] In the recent past, the notion of good governance has been increasingly identified by the Bank's management as a critical determinant of the economic performance of developing countries. The upsurge of the Bank's interest in governance is reflected by two main reasons:

a) SAL Failure.

After a decade of the structural adjustment policy, the Bank realised that in the vast majority of LDCs in which SALs have been implemented success has been very limited. This verdict was recalled recently by the Zambian Minister of State, who was talking on behalf of the African Community at a meeting of the UNECA. He said:

> It is now widely accepted that the 1980's generation of structural adjustments have been deficient, because they were very short term in character...(50)

Indeed, in many of these countries, investment remained among the lowest in the world and disinvestment in industry increased, as inefficient firms collapsed in the face of import competition facilitated by the open market laws directed by the SALs policy. For example, in Africa, between 1980 and 1990 over thirty countries had a structural adjustment programme with the Bank; only two countries are cited by the institution as being successful.(51) In fact, the Bank already knew in 1985, when its staff carried out the first report on the evolution and evaluation of early SALs, that these programmes were meeting considerable difficulties in their implementation. The introduction in 1987 of SAPs is clear evidence of such difficulties.(52)

This failure has also been been recognised by a Bank report "From Crisis to sustainable Growth in Sub Sahara Africa" which encompassed a wide range of concerns such as the effectiveness of the state's institutional arrangements, decision making process, policy formulation, and the relationship between rulers and the ruled.(53) After having put all the blame for economic failure on the governments, the report concluded that "Africa stands little chance in the 1990s if there is no move towards an accountable and participatory form of government".(54)

Thus for the Bank the failure of the SALs was due mainly to problems of governance. That is to say the existence of inappropriate politics at the domestic level. To adequately address the question of economic development, the Bank made it necessary to consider an additional dimension to its lending, namely political reform to ensure good governance. In so doing the Bank has been considerably influenced by events taking place in the former communist regimes.

b) The Eastern Syndrome.

In its 1990 annual report, the World Bank confirmed LDCs fears indirectly by rejecting any responsibility in the present East-West "warming" relationship. The report stated:

> A central concern of the developing economies has been the degree to which their needs for external financing investment and trade will be "crowded out" by Eastern and Central European demand. While the World Bank has emphasised that its assistance to Eastern and Central Europe will not be provided at the expense of other developing countries, it is likely that some private capital flows will be diverted to Eastern and Central Europe.(55)

The whole process that was taking place in Eastern and Central Europe was not alien to the recent change in the Bank's attitude. Under the pressure of its main capital suppliers, the Bank was under an obligation to accord its lending policy with that of its Western donors. Under no circumstances, could the Bank have taken a different step from the rich industrial countries. The Bank seems to have been particularly seduced by the view held by many western economists and politicians that economic reforms cannot succeed without radical political changes.

B- The Conditionality of Governance in the Bank Practice.

In the Bank's view, economic criteria alone cannot improve the development of LDCs without an improvement in governance. For the Bank's officials, behind problems of economic mismanagement and corruption, there are problems of political leadership. It is therefore, essential that these problems should be dealt with adequately and simultaneously with the traditional economic criteria. In practice, the conditionality of governance means that if, for instance, Algeria, requested a loan from the Bank to build a dam, she would first of all agree to introduce political reform before getting the funds. The content of this new form of conditionality of governance has not been defined with precision nor has it been formally adopted by formal provisions (Statutes/ BOG interpretation). It seems to have been left for the time being to the discretion of the Bank's officials.

a) The Abuja Declaration.

The first formal evidence of the Bank's "linkage" between politics and its loans has been prompted in a recent address by the institution's President B. Conable to the African heads of states and governments gathered in Abuja (Nigeria) for a meeting of the OAU.(56) While emphasising an increased level in the Bank's lending to help the continent, Conable said that "all will be to no avail unless the quality of governance in Africa improve".(57) He went on to elaborate on the need to allow the African people to participate freely and openly in economic life. Referring to Eastern Europe, he noted that people all over the world were demanding such participation. In the context of Africa, he argued that the founding fathers of the continent's independence had also fought for this kind of freedom. He said:

> Freedom of speech, of thought, of association; freedom from arbitrary arrest and oppression; freedom to participate in the development of their nations. The voices of freedom are once again being heard in Africa; and I urge you as Africa's leaders not to ignore them.(58)

In concluding his speech, Conable eloquently stated that he did not come to the OAU summit to give African leaders a lesson in politics, and that the World Bank had no intention of introducing political conditionalities in its work. However, he did underline that:

> The Bank would be intensifying its scrutiny of those aspects of governance which directly affect development, accountability, transparency and adherence to the rule of law.(59)

b) Institutional Implications for LDC Borrowers.

The recent call by the Bank for radical political reforms in exchange for economic assistance has far reaching consequences on the borrowers' institutions. The main purpose for the Bank is to create the right political environment which is, in the Bank's opinion, essential for the implementation if not the success of the economic reforms.

In his Abuja speech, former President B. Conable did not elaborate on any specific kind of political system, but it was clear from his address that the Bank would eventually favour a democratic system on the western model, where people can participate in the political and economic decision making of the nation. Further details on the kind of institutional changes that the Bank wished to promote have been discussed by L. Noel and I. Serageldine in the semi official publication of the World Bank- Finance and Development.(60) While recognising the complexities in identifying what constitute good governance, the authors refer to certain characteristics which according to them are "generally agreed upon". One of these characteristics is political accountability.In the authors' opinion:

> the classic mechanisms for ensuring political accountability is to subject the political leadership at all levels of government (national, provincial, local), to a credible electoral process, with limited period in office.(61)

For the LDCs, the task is not merely to dismantle the discarded political system, but to fashion -virtually from scratch- the overall structure and core component of a modern democratic society. These massive reforms often must be carried out at the same time as countries huge economic problems, and heavy debt burden. This raises serious questions about how to best set up the necessary institutions which would manage the transition. At issue are the speed, the combination and the adequacy of the measures that could lead to a strong political system. The ultimate goal of these institutional changes is not to fulfill specific popular demands, or install a genuine democracy, but to respond to the Bank's requirement in building a market oriented economy. It is only then, that the long term development issues- the prime concern of the Bank- will be tackled.

C)- Criticism of the Bank's Conditionality of Governance.

After having preached for a decade that the answer to the economic problems of the LDCs is structural adjustment, the World Bank has discovered recently that more is necessary to achieve sustainable development, namely that economic and political reforms go hand in hand. The Bank's argument that political reform should be tied to its lending policy is open to criticism from two sides: one statutory or theoretical, the other practical.

a) **Statutory Limitations.**

Theoretically, the Bank is not allowed by its Statutes to interfere in the politics of the borrowing countries. Article IV section 10 is very clear on this point:

> The Bank and its Officers should not interfere in the political affairs of any member, nor shall they be influenced in their decision by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions...

Yet, the new criteria of governance introduced recently by the Bank fall expressly into the category of politics. The Bank claims that its motivation is economic in essence; namely, that good governance implies good economic management. The issue of political interference has been raised countlessly in the past and the Bank has always managed to escape criticism.(62) However, in its recent call for political reform, it may be hard for the Bank's officials to deny political interference. From the legal point of view, the Bank's meddling with its borrowers politics is tantamount to a violation of its Statutes. Whatever justification the Bank's officials may give, they are simply acting outside the institution's legal framework.

It was seen, for example, in the case of privatisation that the Bank defended its action on the grounds of statutory provisions, namely Article 1, which directed the Bank to enhance the private sector. Again, when the Bank introduced in its early years of operations the fact-finding missions, it said that it was part of its Articles to act with care and due diligence in the use of its monies. In these and other similar situations the Bank has stretched the interpretation of its Articles beyond their legal limits, and has thus avoided touching on the political boundaries of its borrowers. In the present case of political conditionality, such an extensive interpretation is not only irrelevant, but it is expressly prohibited unless the Bank's management has decided to amend the Bank's Statutes, so as to allow explicitly the Bank to indulge in politics. This hypothesis seems, however, unlikely in view of the opposition by the Western members of the Bank to amending the Institution's Statutes, on the ground that "it may open the floodgates to a cataract of proposed amendments."(63) The Bank management cannot certainly continue to carry out its business on improvisation, or as in the case of political conditionality, by reacting to specific conjunctural events.

Finally, although the problem of governance exists in many LDCs, it is not the role of the Bank to address such an important issue. The Bank was not established for that purpose. Its main objective is development assistance. It is not equipped for such an undertaking, for its main think tank is composed of economists and financial experts. It is not prepared to venture in such an area, because its overall structure and institutional framework has nothing to do with politics *per se*.Last but not least, using loans for political change is meddling in LDC politics: It could damage the already fragile stance of the political neutrality and, to be successful, it would require political skills which the Bank does not possess.

b) Practical Limitations.

In practice, the Bank's conditionality of democratisation is also disputable. For the implementation of the Bank's economic reforms in general, and SAL in particular, most of the time generate variable degrees of public resentment. Depending on individual countries, this may start from minor street skirmishes to major social upheavals leading to political instability because of the unpopularity of the measures that structural adjustments carry with them. The question which arises here is how it is possible to ask governments to carry out painful IMF/World Bank programmes -which are by definition unpopular- in a democratic fashion. In the logic of democracy, unpopular actions have greater chances of being removed by democratic means (vote of no confidence in the government, anticipated general elections, demonstrations, or strikes.). "Indeed", wrote the Indian economist A. Sen:

> there is even a basic contradiction in seeing both (economic and political reforms) as fundamental requirements. If there is democracy, then it is up to the people to determine whether or not (and to what extent), to use markets. It would be contradictory to leave the choice of institutions to the people and at the same time to pre-close that choice by insisting that the market form of organisation be in fact chosen.(64)

Yet, in the recent past the Bank has been helping many LDCs whose regimes were "undemocratic" in the Western sense of the term, and quite often these regimes have eventually succeeded in bringing about noticeable economic changes. South Korea, Taiwan, Indonesia and Hong Kong are often cited as nations which have experienced decades of sustained economic expansion under highly authoritarian systems which allowed them to graduate eventually to the status of New Industrialised Countries (NICs).(65) This does not mean that a dictator or a military regime must be appointed in each country undertaking comprehensive economic reforms. But the NICs experience may be worthwhile trying as an economic model of development, because of the similarities that exist between the LDCs and the NICs. In fact such an option is not alien to the Bank. It has been largely debated during the OECD/World Bank conference referred to earlier.(66) Some of the participants did indeed refer to the NICs success story as a possible formula for the Third World economic development instead of imposing political changes on the western model, in order to set in motion economic reforms(67)

c) What Form of Democracy for the LDCs ?

As it was asked previously what kind of liberal system (especially in the case of privatisation), the LDCs should adopt, it may be equally important to raise the same concern in relation to political changes. Generally speaking, there seems to be no evidence that the democratisation rules of Western Europe fit all kinds of society. The type of society in Western countries is different from those in Asia and Africa. Almost all recent experiences in democracy building in the LDCs have run into some sort of inextricable problems. For example in Togo, only a few months after the establishment of a democratic system, there were three attempted *coups* in the first week of October 1991. According to the Economist, "each (*coup*) designed to restore the *ancien* (undemocratic ?) regime" (68) In Venezuela, the failed coup *d'etat* (February 1992), against a democratically elected government, was seen by many observers as a reaction to economic discontent, rather than a classical overthrow of a political dictator.(69) Again, recent events in Russia show that President Yeltsin is under severe opposition from former nostalgic communists and from his own entourage.(70) Less than one year after the economic reforms, the Institute of World Economy and International Relations (formerly part of the Russian Academy of Sciences), sent a report to B. Yeltsin. It calls for a "softly-softly" approach to the economic reforms and more particularly privatisation. The report advised the Russian leader to "retain a strong executive (ie. governmental) role and a relatively high level of centralism during the process of warring the country on to a market economy." "This", adds the report, "should involve postponing privatisation until well after next year, and that Russia must avoid copying traditional privatisation methods used by Western countries."(71) Should one conclude from this that open democracy is a threat to open economy?

Algeria is perhaps the best illustration which shows that the concept of democracy that the Bank and the West try to promote is not always the one they liked. Thus, the rise of Islamic fundamentalism through democratic means in Algeria has paradoxically upset many western democracies such as the US, UK, and France which welcomed the disguised *coup d'etat* to prevent the Islamic Front from taking power which, it must be recalled, it was almost certain to win through the ballot box i.e democratically. The massive arrests of Islamic leaders and their followers passed almost unnoticed in the

Western world, which customarily react vigorously by accusing the newly set up regime of human rights violations.

In similar situations of blatant undemocratic behaviour, the West usually reacts by taking action against the accused regime. The most common sanctions are either diplomatic or economic sanctions, or both. As was the case in the Kenya, the West started by cutting all diplomatic links, before suspending its economic aid at a later stage. It should be also recalled, that in most cases, regional and international organisations follow suit by applying the apprropriate sanctions on the incriminated state. Nothing of that sort happened in Algeria and the new army backed Council of State, still enjoyed financial support from the Bretton Institutions in particular, and the West in general, which has exceptionally stepped up its financial assistance to rescue the new regime.(72)

The Algerian democratic experience demonstrates clearly that the Western World is sometimes mistaken in its judgements on Third World specificities. It is a relevant story of the risk of copying foreign models, and a clear signal to the the Bank's adventure into the field of the internal politics of its borrowers, and the kind of potential problems that may arise as a result of such action. For what is good for Europe will not necessarily work for Asia and Africa. This is a very fundamental issue in which sociology may be of valuable guidance and which, at the present time, the West in general and the Bank in particular seems to underestimate. Furthermore, this new conditionality of democratisation, although necessary, is not an urgent necessity. It does not seem appropriate - at least for the time being -in many Third World countries, namely those of Sub Sahara Africa and South Asia. In these parts of the world, there are more urgent priorities for governments to tackle such as poverty, deseases and above all, illiteracy, which is probably the cornestone of any democratic culture.

Addressing the UN conference on Third World debt, the Deputy General Secretary of the Organisation of African States (OAE) Mr. Bronson Dede, said "La democratie ne pousse pas sur un desert de pierres", meaning that democracy does not grow in a desert of stones.(73) In the same context C.L. Morna said "Democracy is a luxury."(74) The sad reality is that at present many LDCs cannot offer such a luxury. For his part, Richard Joseph does not seem to be convinced that democracy will necessarily entail economic welfare. He writes on Africa saying:

> Nevertheless, we must avoid the seductive notion that democracy or "multipartism" will rescue Africa from its distress. Democracy while a prerequisite for Africa's economic revival, will not by itself guarantee such an outcome.(75)

The concept of democracy is non quantifiable. It cannot be measured by economic indicators alone. It is a long process which depends on a variety of factors among which intellectual consciousness is the most important. Democratic values, notes President Nyerere, form an inherent part of the cultural heritage of modern society. It is not a spontaneous movement, or a foreseeable social phenomenon. It may be possible for economists to predict, on the basis of scientific data and various indicators, certain economic events such as for example the rate of inflation,or the GNP growth. But no government can predict, for the reasons stated earlier, that by next year its country will be a democratic nation by the mere signature of a governmental decree, or upon the recommendation of an international organisation. Democracy needs time. It is a long process. At the extreme, people will be more ready to support undemocratic regimes then starvation. In that respect, democracy may be described as a long term socio-political demand, whereas starvation is a biological need which cannot be postponed indefinitely. In hungry Russia, people reacted angrily to the price rises, and called for the resignation of their leader and democratic promoter B. Yeltsin.(76) The current experiences in democracy building that are taking place in Eastern Europe and many parts of Africa and Asia demonstrate that democracy is a relative concept whose contours are not precisely shaped. Even in a country such as the United Kingdom where democratic foundations were laid centuries ago, there are still today in Britain voices which claim that the UK. is not a democratic country.

The other side of the coin is also true, namely that good governance implies eventually good economic performance. But the problem with many LDCs is that the issue of governance is limited to one or a handful of persons. And it is precisely that governing minority which the Bank makes responsible for the mismanagement of the country. The Bank now insists that this kind of regime must be removed, so the people can participate in the economic decision making (participatory development). The question, however, which the Bank seems to ignore or to underestimate is whether all people in the Third World are ready and able to participate in the decision making process, whether political or economic. This is not sure for the time being. What seems to motivate the Bank, at least on the surface, is the existence of an urban elite in many LDCs which very often looks "westernised" and which the Bank wants to use to foster its dynamic of market oriented philosophy.

By moving into an area as sensitive as domestic politics, the Bank is undoubtedly venturing into the unknown. For political governance cannot be "recommended" from outside, especially by a group of states or a particular institution which have not been so helpful in the past. For most LDC governments are not ready to forget the fierce opposition by the developed world to the establishment of a New International Economic Order (NIEO).(77) Similarly, the Bank has never taken into account Third World conceptions of development and has always taken a negative attitude in refusing to lend in order to promote certain principles and policies favoured by the LDCs.(78) On the contrary, every step the Bank took was in favour of the developed world. The creation of the IFC, the ICSID and the MIGA as discussed previously, were more valuable to the First than to the Third world. From this aspect, neither the developed western world, nor the World Bank are in a good position to advise changes as important as internal political reforms. But, if the West and the Bank link their economic assistance to political reforms, as seems to be the case, than the whole issue becomes a matter of outside pressure, in short, an issue of sovereignty.

III- The Position of International Law on Outside Pressure (or Domestic Interference)

In the previous Chapters, it was pointed out that the Bank has always made its lending conditional on certain economic criteria whose implementation had a substantial effect on the legal and institutional structure of the borrowing countries. For many LDC governments, in so doing, the Bank was exceeding its statutory powers and unduly interfering in their domestic affairs. This is by far the most common and frequent claim that the LDCs have been raising for decades. Thus, the conflict between the Bank and its main clients is essentially one of national sovereignty.

A- The Issue of Sovereignty in General

Text books refer to sovereignty as the very basis of international law.(79) As opposed to other subjects, the concept of sovereignty is not static, in the sense that it has been open to many alterations since its enunciation in Article 2 § 1 of the UN Charter in 1945.(80) As enshrined in the Charter, sovereignty is traditionally defined through its political rather than its economic aspects. But as ICJ Judge, M. Bedjaoui remarked:

> The inadequacy of this definition is plain. The Charter was only able to condemn breeches of the political sovereignty of States, and the sanctions it prescribed are linked only to the transgression of political obligations, not of economic duties.(81)

However, since the sixties, especially with the accession of many Third World countries to independence, the concept of sovereignty has been closely linked with economic considerations. Perhaps the best illustrations in this context are the Law of the Sea and the principle of Permanent Sovereignty over Natural Resources, where economic interests and national sovereignty proved sometimes difficult to reconcile.(82)

a) Economic Sovereignty.

In the field of economics, the issue of sovereignty has a different meaning for the developed and the developing world. For the former, there is no such an absolute sovereignty in the conduct of the economic affairs between countries. To the concept of national economic sovereignty, the West proposes the notion of economic interdependence, i.e. that no country can live in isolation and that economic cooperation between states is an essential ingredient to the survival of nations.(83)

For the LDCs, the principle of economic sovereignty is closely linked to that of political sovereignty. They equate interdependence with the opening up of economies to international trade and private capital flow. Instead the LDCs suggest that in the economic field, priority should be given to self reliance as the only way of preserving their real sovereignty. The principle of self reliance was developed in the early seventies, at the height of the discussions on the NIEO that were taking place between the North and the South.(84) Because of such a divergency of views on the concept of sovereignty, clashes between the DCs and LDCs occurred frequently and led many times to an impasse in negotiations between the developed and the developing world. The same clashes came to light in the LDCs dealing with international economic organisations such as the IMF and the World Bank, which by imposing political and economic changes were accused by the Third World members of interfering with their domestic affairs and thus infringing their national sovereignty.

B) The Bank's Arguments on Domestic Interference.

The issue of interference by the Bank in the internal affairs of its borrowers is usually met by a set of four arguments. The first one is that by adhering to an international organisation, states hand over, *de facto*, some aspects of their sovereignty to the institution.(85) Proponents of this theory, such as J. Gold, argue in the particular context of the Bretton Woods institutions, that as states have willingly accepted to join the Bank and the IMF, they have implicitly committed themselves to relinquish some of their sovereign rights to the benefit of these institutions. For the author, it seems that there is no limit to the degree of interference and that:

> members cannot refuse to furnish information on their economies to the Bank and the IMF, even on reliance on the ground that such information would be incompatible with their national security.(86)

The classical argument is that international law is perceived as consisting of rules of *ius dispositivium*, from which states can depart at will.(87) There is no provision in international law which forces states to join an international organisation against their will. Likewise, nothing in international law prevents states from withdrawing from an institution if they do not agree with its policy. Put crudely, this principle means that if the LDCs do not like the Bretton Woods institutions, nothing prevents them from quitting them.

The second argument is the so called complementarity of goals between the Bank and its borrowing members. The core of the argument is that the borrowers and the Bank share the same objectives, therefore there is no conflict of interest but "cooperation" between the two parties. Action by the Bank in the borrowing country is a manifestation of such a cooperation.

The third argument is that Bank action would have not been possible without the consent of the borrowing state. As A Fatouros writes:

> No action by a state, or any other entity, could be deemed unlawful, if the state affected had consented to it.(88)

In other words, since the borrowing government has agreed to the conditions set up in the loan agreement, that accord suffices to remove any taint of improper or unlawful interference.

The fourth argument is that the Bank activities are mainly technical. They are limited to providing, in addition to funds, a wide range of expertise to borrowers in order to make better use of scarce resources.

a) The Irrelevance of the Bank's Arguments.

Bank justifications for its policy of domestic interference are open to criticism in many respects. To begin with, the argument that adherence to an international organisation implies relinquishing some degree of sovereignty to the institution is, in the case in hand, a one sided argument. For it applies only to the LDC members who are the main users of the Bank funds. More importantly, the minority of the developed countries, which are not concerned by such concessions, exercise a great control over the institution to the point where this latter has to "trade" its own internal sovereignty, to please the desirata of such a minority.

Furthermore, the argument that state consent nullifies, therefore legitimises, Bank interference in the domestic affairs of the borrower is irrelevant, because of the "special circumstances" under which the consenting party ,ie the state, acted.(89) This situation is to some extent, comparable to the notion of duress in private law, where the party acting under duress is generally said to be irresponsible for his acts. That is to say, he does not have a free choice, as seems the case in hand, where the borrower is left with two alternatives: either he accepts the loan, and surrender part of his sovereignty, or loses the loan and accordingly reduces his development capacity. This element of coercion is also recognised by A Fatouros who considers that in such circumstances:

> there are various kinds of pressure short of the use of "force", whose presence vitiates any expression of consent.(90)

Furthermore, the vigorous denunciations of the Bank policies by many LDC governments, and the unpopularity of such policies within the LDC population are also relevant indications that state consent to the Bank policy was not always "cogent."

Finally, to say that the Bank's efforts are not political is no longer a sustainable argument. Although such an argument has been refuted by the LDCs in the past, the Bank has constantly refused the LDCs view for the reasons discussed previously. With the recent introduction of political conditionality, the non political characteristic of the Bank has not only became obsolete but also controversial. Since the issue of political conditionality seems to be on the agenda of the current debate on development assistance to the LDCs, it may be appropriate to explore the position of present international law on that particular issue.

C) The Ambiguity of International Law on Political Conditionality.

The recommendation of political conditionality raises in international law the following question: Is support for political reforms from outside legitimate politically and in terms of international law? In short, should one interfere? Whereas recipient countries had already refused in the past to accept economic interference in their internal affairs -in the framework of structural adjustment- it remains improbable that they would accept it on the political level. Formally, political and economic conditions are no problem in terms of international law if the recipient country accepts them. In cases where conditions are enforced with inadmissible pressure, or through violence,the country concerned can invoke the Vienna Convention on the Law of Treaties which declares such unequal treaties between states null and void.(91) The question which arises here is whether political conditionality falls in any of the categories of treaties foreseen by the Vienna convention. The Convention leaves open what conditions encroach on sovereignty and from what point is pressure from outside so severe that it invalidates the treaty. For a long time any interference from outside -even if it aimed to benefit the country- was branded in academic discussions as imperialism. The principle of non-interference has been until very recently one of the most rigid concepts in contemporary international law.(92)

In the case of the Bank, Western interference through political conditionality has been legitimised on the ground that most regimes in the Third World do not derive their legitimacy from the approval of their own people. The Bank and the West justify their support for political reforms from outside on the following arguments:

- The political regimes in most of the Third World countries are a hindrance to socio-economic development.
- In most of these countries there is no respect for basic human rights,or the rule of law.
- Transformation of these regimes requires both economic policy reforms and political reforms.
- These economic and political reforms can only succeed if they are supported from outside.
- The personalisation of power around a military leader and the presumption that such authoritarian regimes are economically inefficient because of corruption, favouritism, clientelism, and patronage.

Although the present thesis does not dispute the veracity of such claims, nonetheless any state action on the ground of such claims has no justification whatsoever in present international law. In fact such intervention contravene the UN Charter of Economic Rights and Duties of States and more specifically the provisions of Article 1 which reads:

> Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural systems in accordance with the will of its people, without outside interference, coerciion or threat in any form whatsoever.

Therefore any attempt by a state to interfere, or influence, directly or indirectly, the course of events, and *a fortiori*, political events of another sovereign state, is an inadmissible act.

D) Some Attempted Suggestions.

There are still some questions which are left unanswered. Is it really important that the Bank should impose stringent conditions on the ground that it does not want to sign a blank cheque? Why should borrowers make concessions by altering their legal, institutional economic and political systems "for a handful of Dollars"? Finally who is the real beneficiary from the whole business of the Bank lending policy? Certainly not the LDC borrowers, since the Bank never guarantees the success of the project, which it has approved, but which does insist on the loan being repaid in order to keep its credibility *vis a vis* its creditors intact.

Yet, there are other reasonable and realistic options, that the Bank and the rich western countries can accept, without having to interfere with the LDCs sovereignty, or impose undue conditions whose results are hypothetical. The following are some suggestions which, although unpopular amidst the rich countries, are certainly within their reach and material possibilities. The first suggestion is of a general nature and is directed more to the Western developed world than to the Bank. It has already been voiced by many Western leaders, but it applies fully to the LDCs reality in the present world economic circumstances. This suggestion consists in telling the Western countries to start "cleaning their houses", before telling LDCs to clean theirs. As Hans W. Singer wrote:

> With proper adjustment in the developed countries, the mutual interest will prevail, and hence the developed countries should support the developing countries.(93)

In the first place, DCs must refrain from indirectly impairing LDCs economic development through irresponsible behaviour in the conduct of the international economy. Quite often, economic distortions in the European continent, or across the Atlantic, such as inflation, exchange rates or devaluation of the US Dollar have serious repercussions in Asia, Africa and Latin America. To paraphrase an eminent US politician, "When America sneezes, the rest of the world catches cold". Despite rhetoric from certain western capitals "to do something", the various recommendations made in that sense have never been put into effect. As this call from the Managing Director of the IMF witnesses:

> What is needed now is the political will on the part of the membership to carry forward their commitments into policy decisions and concrete actions. This applies of course with particular force to the major industrialised countries who have been outside the reach of conditionality, yet whose policy actions have such a decisive influence in shaping the world economic environment.(94)

So far the DCs have avoided adjustment which they perceive as a difficult and conflicting process which may threaten their internal stability.(95)

Secondly, the developed world must remove existing barriers to allow Third World economies to expand. In trade for instance, more supple and flexible rules would certainly increase LDCs penetration to Western markets.(96) In finance, a solution (eg. cancelling) of the Third World external debt may also inject a breathing space in LDCs economies.(97) Similarly, a new code of investment, which would protect investors and recipient countries alike, is necessary to build trust and confidence among the LDC borrowers and the international financial community at large.(98) Again, a fairer and more just commodity price agreement may also be an effective stimulant to enhance LDCs hard currency reserves to sustain their development efforts.(99)

The third and equally important suggestion is directed to the World Bank and more precisely to its role in development as a development agency. As an international actor , with explicit law making capacity, the Bank is well placed to play a key role in the shaping of rules of an international law that would be oriented to issues of development.(100) This could be eventually achieved through the drafting of, and participation in, international conventions as it did in its early practice with the establishment of the IFC, ICSID, and MIGA. But instead of being too attentive to its main suppliers' concern, the Bank should give more consideration to the Third world propositions and suggestions on development issues and how to tackle them.(101)

To say that the LDCs are looking for blank cheques, and accordingly overload them with stringent conditions is a misleading judgement. The Third World countries oppose the present form of assistance that is channeled to them for solid reasons, which may be summarised in the stringency of economic and political conditionalities. For these countries, the conditions that the Bank (and the West) impose on them are, as they stand, inappropriate and in blatant contradiction with Article 5 of the UN Charter which calls for:

> [T]he promotion of higher standards of living, full employment and condition of economic progress and development.

At the same time, the Third World countries have proposed through various UN channels (UNCTAD, UNGA), intersting proposals such as the New International Economic Order, as it is embodied in the Charter of Economic Rights and Duties of States, to help them out of their present state of underdevelopment.(102)

In one of his writings Professor M. Bedjaoui said, had the West consented to an application of a third of the NIEO Charter, a third of the LDCs problems could be resolved.(103) It may be then said, by extension to Bedjaoui's remark, that if all the NIEO proposals are taken into account, a large portion of Third World economic problems may perhaps find adequate solutions. Then the Bank will hardly have to force changes nor would it have to sign blank cheques.

Conclusion to Chapter Five.

In spite of the move towards democracy, the political systems of the Third World countries are not well developed for managing simultaneously economic crisis. Reform programmes on the Bank pattern generally call for hardship and economic austerity. For the Bank to call for open democracy at this particular time is somehow "putting the cart before the horse".

It is an undisputed fact that, in a democratic society economic and political decision making is subject to a greater transparency than in a close undemocratic system of governance. The issue at stake is not whether or not to introduce political reforms. What is argued in the foregoing Chapter is the timing and the "linkeage" of development and democracy, especially by making the latter *a sine qua non* for the acquisition of public international aid. Western donors and the international financial institutions, both public and private, must devise another less burdening formula for the LDCs. One such a devise could be postponing democratic reforms, while keeping LDCs political regimes under a close surveillance in sensitive areas such as human rights violations for example. As discussed in the case of the NICs experiences, economic austerity may have greater chances of yielding to conclusive results if accompanied by "political austerity". For as it has been shown, in all transitional economies there is a lack of public understanding of the unavoidable costs of systemic changes. More generally, there is a deep unwillingness on the part of the population to accept too much pain. This underlying lack of well founded consensus endangers the positions of many reformed governments and may threaten the longevity and sustainbility of reform. At the same time, it is important to point out that many new governments were thrust into their position without having had time to prepare for the immense task ahead and without the benefit of experience.

The current concerted action (World Bank-Western world), to tie aid to political conditions does not seem at least for the time being attractive for many LDC governments. It looks in the eyes of these latter like a return to neo-colonialism, rather than a way of rejuvenating development assistance, or as the Egyptian economist, F. Ramzi, put it "colonisation without force. "They are conscious of the already high cost benefit so far achieved by tied aid to economic policy conditionality, and are worried about western influence in their political life as the only way to obtain aid for development. Furthermore, by imposing a certain model of governance, the Bank and the West take a double risk, of which the LDCs alone will eventually pay the consequences.

In the first place, there is a serious problem of rejection of transplantation which may arise as a result of copying from alien types of democracies. In that respect, the Algerian experience is among many others relevant to the danger of any blind borrowing.

Secondly, by imposing democratic systems from outside there is a clear problem of direct interference in the domestic affairs of the LDCs. An issue where present international Law does not seem to provide adequate answer(s). For the present Thesis, it is precisely this vacuum of legal norms specific to development issues that are at the origin of the Bank's obstinacy in "learning by improvising" on Third World misery.

Notes to Chapter Five.

1 According to C. Payer, the Third World countries have been paying since 1982 their creditors an average of $ 30 billion more each year than they received in new lending. See C. Payer, Lent and Lost, Foreign Credit and Third World Development. Zed Books, London (1991), at IX. According to The Guardian (16/7/1991, at 19), the figure is between $ 40 and $50 billion, if profit repatriation is included.

2 See A. R. Love, "Participatory Development", 173, The OECD Observer, Dec-Jan 1992, at 5-7.

3 See I. R. Krugmann, "Cooperation Is more Imperative than Ever", 6, Dev. & Coop. 1990, at 16-18.

4 On this point, see a series of articles in 5, Africa Recovery, Dec. 1991 and especially at 8-9.

5 *Cf.* Title XVII on Development and Cooperation of the (EEC) Maastricht Political Treaty, and namely draft Article A which states that:
"Community policy in this area (development and cooperation), shall contribute to the general objectives of development and consolidating democracy and the rule of law, and to that of respecting human rights and fundamental freedoms."

6 A succinct analysis of aid to LDCs is to be found in Nelson M. Joan, Aid Influence and Foreign Policy, Mc Millan, London, (1968).

7 Id. See also eg., Raymond F. Mikesell, The Economics of Foreign Aid, London (1968), especially the last Chapter.

8 Supra note 6.

9 Russia is already given the status of Associate Member of the IMF before full membership which will be decided by the Board of Governors. This status enables Moscow to benefit from technical assistance viz, expertise, counselling..., but no financial disbursement. See the Guardian 13/6/1991, at 18 and Le Monde 12/10/1991, at 13. However, in the recent conference on aid to the former republics of the Soviet Union, the US pledged immediate full membership for all CIS in the Bretton Woods institutions, so that they can benefit from technical as well as financial assistance from the IMF and the

World Bank in particular and the Western (public/private) aid in general, See The Economist Jan. 25-31,1992, at 14.

10 P. Marer, "The Transition to a Market Economy in Central and Eastern Europe", 169 The OECD Observer, Apr-May, 1991, at 7.

11 The aim of the Center which works under the responsibility of the Secretary General of the OECD is:
"to design and implement a coherent programme of activities that draws on the diverse multidisciplinary experience and intellectual resources of the OECD to help Central and Eastern reformers address specific problems in the transition to a market economy." Ibid., at 7.

12 Unnamed article, "Radical Reform for the Soviet Union: A Joint Study by the IMF, the World Bank, the OECD and the EBRD, 169 The OECD Observer, Apr-May 1991, at 11-15.

13 See The Financial Times. 16/4/1991, at 2; See more recently, the proceedings of the UN conference on Aid to the Former Soviet Union, supra note 9.

14 "...Then in Waltzer Poland, fresh out of communism and with Lech Walesa elected as president, western governments, immediately forgave half of the official debts. LDCs felt like wallflowers: why should they not get the same favour?" The Economist, 13-19/1991, at 20.

15 The idea of a European Bank for the Eastern and Central countries of Europe was launched by President Mitterand of France a few weeks after the historical fall of the Berlin Wall in November 1989. It was followed by a summit meeting of the EEC in Paris in April 1990 which completed the Statutes of the new institution. One year later, on April 15th, 1991, the EBRD was formally inaugurated, and soon after began its operations; *Cf.* ILM 29: 1077, Sept 1990 for the Agreements establishing EBRD.

16 Supra note 13.

17 To counter criticism from domestic public opinion, many DCs have launched, since December 1989 a score of articles in the press, radio and television. The thrust of this campaign is that LDC leaders are carrying out catastrophic pillages, and that western aid has reached the ultimate point of perversion. See The Guardian, 5/11/1991.

18 Unnamed article, "France Reassessed Record Aid on Africa", 35 Africa Report, May-Jun 1990, at 11.

19 Commenting on the President's speech the Paris magazine Jeune Afrique wrote that since the dramatic changes in Eastern Europe, Africa has become synonymous with corruption, venality, dictatorship and pernicious maladies. According to the magazine, The real reason is that lured by prospect of investing in Eastern Europe, France is in the process of making hard choices, and Africa is clearly not on the cards." 1953, Jeune Afrique , Feb/1990, at 92.

20 See Colleen L. Morna, "Pluralism in Africa: A Luxury no more", 35, Africa Report, Nov/Dec. 1990, at 34.

21 See Douglas Hurd speech at the House of Commons Foreign Affairs Committee in June 6th, 1990 when he emphasised on the link between the supply of aid and the movement towards democracy.

22 A. Hewiff, "Aid Without Power", 9 Development Policy Review, Jun 1991, at 217.

23 Id.

24 Ibid, at 219.

25 Id., at 221.
For example, in May 1991, Norway recalled her ambassador in Nairobi (Kenya), because of the government violation of Human Rights. The Norwegian's move denotes Norway's intention to link assistance to Human Rights issues.

26 See, A. Oyowe, Kenya: Democracy Winning the Hearts and Minds of Wananchi. 130, The Courier , Nov-Dec 1991, at 11 - 13.

27 The Guardian 6/11/ 1991, at 22.
The Guardian 25/11/ 1991, at 24.

28 The Economist 30/11 - 6/12 1991, at 76.

29 The Economist 16 - 12 /11/ 1991, at 8.

30 Supra note 26, at 12.

31 Id.

32 See D. Brauer, "Tying Aid to Democracy", 3 Dev.&Coop. 1990, at 32; Also, C. Lancaster, "Reform or Else"?, 35 Africa Report, Jul-Aug 1990, at 45-47; and Salim Lorne, "Challenging Conditionality", 35 Africa Report Sept-Oct 1990, at 32.

32a See the proceedings of the 28th Comnmonwealth Summit in Harare (october 1991), in, 28 African Research Bulletin, Oct. 1991, at 10291-93. In Harare the core of the debate included issues of democracy and economic liberalisation. On the first issue, the Conference insisted on the need:
"...to protect and promote democracy, democratic process and institutions ...the rule of law, and a just and honest government..." On the economic issues, the Conference, at the insistence of Britain, emphasised the need for:
"...sound economic management" and recognition of "the central role of the market economy".

33 For an account of the events see, The Sunday Times 20/1/1992; and Le Nouvel Observateur, 28/1/1992, 12.

34 A succinct analysis of the political changes in Algeria since the *coup d'etat* is found in the Weekly US magazine Time International (Time Magazine), 27/1/1992, at 28-29.

35 The Guardian, 12/1/1992, at 24.

36 See, The Economist, March, 1991, at. 17.

37 The Guardian 14/1/1992, at 6.

38 See, Time Magazine, 30/12/1991, at 14-15.
________________, 13/1/ 1992, at 6-8.
________________, 27/1/ 1992, at 33.

39 The Economist, March 2-8, 1991, at 51.

40 The Economist, Jan.18-24, 1992, at 48

41 The Economist, Jan.11-17, 1992, at 46.

42 See Collen L. Morna, "Pluralism in Africa: A Luxury no More" 35 Africa Report, Nov-Dec 1990, at 34.

43 Ibid, at 35.

44 Peter. P. Walker, "Helping by interfering" ? 6, Dev.&Coop. 1990, at 22-23.

45 D. Bombote, "Democracy in Africa: Which Form it Will Take?" 2 Dev.&Coop. 1991, at 8-9.

46 Id. Professor B. Olofio maintains that:
"The African one-party system deserves credit for setting up unique centres of authority with a view to creating an acceptable idea of the State, or indeed of the nation. The Consciousness of N'krumuh and Authenticity of Mobutu have quite often upset Europeans, who have not hesitated to incriminate the African one-party system, Ibid 7.

47 Supra note 10, at 8.

48 Id.

49 See P. Landell-Mills and I. Serageldine, "Governance and the Development Process", 28 Fin. & Dev., Sept., 1991, at 14.

50 Supra note 4, at 25.

51 These two countries are Mauritius and Botswana. However, even these two successful countries have been contested by some critics who point out that Botswana eg. could be much lower in the league without its diamond windfall. See, Colleen L. Morna, supra note 14, at 34.

52 Supra notes 155-158{Chapter Three.}

53 World Bank, Sub Saharan Africa: From Crisis to Sustainable Growth, Washington DC., October 1989. For a summary of the report, see The World Bank Annual Report, 1990, at 42 et ss.

54 Id.
However, this does not seem the conclusion of the London Symposium which states that:
"While it is true that Africa has more than its share of economic

mismanagement, this does not mean the foreign factors have no role in the African predicament. The fact is that many of the policies like import substitution, export of raw materials, green revolutions etc... that African countries have been pressing were recommended by the IMF and the World Bank."; *Cf.* The proceedings of the London Symposium on "The Impact of IMF/WB Policies on the Peoples of Africa", held by the Institute for African Alternatives, London 7-10 June 1987, at 6.

55 World Bank Annual Report 1990, at 27. For an insight of the Bank activities in Eastern and Central Europe, See, W. Wapenhans, "The Challenge of Economic Reform in Eastern Europe" 27, Fin.& Dev. Dec. 1990, at 2-5; and J. Schweitzer, "Transition in Eastern Europe. The Social Dimension" Ibid, at 6-8.

56 OAU summit, Abidjan-Nigeria, June 4-6, 1991.

57 Extracts from President B. Conable's speech are found in World Bank News, Vol. 10, N° 23, June, 6th, 1991.

58 Ibid, at 4.

59 Ibid, at 5. For a commentary on Conable's speeches; see, The Financial Times, 5/6/1991, at 4.

60 Supra note 49.

61 Ibid, at 15.

62 The Bank's stance on politics has been and still is a fertile ground for the institution's critics. See especially D. Baldwin, The IBRD in Political Perspective, 18, World Politics, 1965; C. Payer, The World Bank: A Critical Analysis, Monthly Press Review, London (1982). For a more recent critic, see Batram S. Brown, The US and the Politization of the World Bank, The Graduate Institute of International Studies, Geneva, (1991).

63 One of the most vociferous opponents to the amendment of the Articles of the Bretton Woods institutions is J. Gold. Writing on the Fund, he said:
"In the early decades of the Fund,the idea of amendment of the Articles was not entertained and even a casual mention of it produced shudders. If amendments were undertaken too frequently or too lightheartedly, the effects would be a loss of respect for the Articles as a constitution. It was feared also that a proposal

for the amendment of a provision would open the floodgates to a cataract of proposed amendments." See, J. Gold, Some impressions of the early Fund, in, 21, Fin. & Dev., March 1984, at 3.

64 A. Sen, Socialism, Markets and Democracy, 37 Indian Economic Journal, Apr-Jun 1990, at 1.

65 Supra notes 1, at 112-115.

66 Supra note 10.

67 Ibid, at 8.

68 See, The Economist, Oct. 26-Nov. 1, 1992, at 16.

69 "Venezuelan Reform may be victim of failed *coup*", writes The Financial Times, 6/2/1992, at 5.

70 The Financial Times, 10/2/1992, at 6.

71 The Guardian, 15/1/1992, at 9.

72 According to Le Monde dated 18/2/1992, the EEC was considering an urgent meeting to study a new financial aid package to Algeria.

73 Le Monde 13/11/1991, at 22.

74 Supra note 42.

75 J. Richard, "Partnership not Patronship", 35 Africa Report Sept-Oct. 1990, at 30.

76 Supra note 70.

77 The literature on the NIEO is abundant both from the legal and economic point of view. See among others, Bhagwati, The New International Economic Order, in Pradip k. Ghosh, (ed.), New International Economic Order, Greenwood Press, London,(1984); M. Bedjaoui, Pour un Nouvel Ordre Economique Mondial, UNESCO, Paris, (1979).

78 The position of the Bank on the NIEO has been amply discussed by Richard W.

Edwards, Jr. Responses of the International Monetary Fund and the World Bank to the Call for a New International Economic Order: Separating Substance from Rhetoric; Symposium on the NIEO: Development or Dependence, held at The Law School, St. Louis University (USA), in Public Law Forum, v ol.3A, 1984

79 B. Stern, Un Nouvel Ordre Economique International ?, Economica, Paris (1980), at LXX.

80 Id.

81 M. Bedjaoui, "Some Unorthodox Reflexions on the Right to Development", in F. Snyder & P. Slinn (eds), International Law of Development: Comparative Perspectives, Professional Books, London, 1987, at 102.

82 I. Seidl-Hohenveldern, Economic International Law, Martinus Nijhoff, London 1989, at 21 et ss.

83 See eg. the Preamble of the OECD Charter.

84 *Cf.* the G77 Mexico Conference on Economic Cooperation Among Developing Countries, Mexico, 13-22 Sept. 1976. On the principle of economic self reliance, see Samir Amin, "The Principle of Self Reliant Development". in, S. Grassman, (ed), The World Economic Order- Past and Prospects. McMillan, London, (1981).

85 Supra note 82, at 112.

86 J. Gold, "Some Legal Aspects of the IMF Activities in Relation to International Trade, 36 Osterv. Z. Off R. U. VR 1986, at 213. Also, D. Carreau, "Les Moyens de Pression Economique au Regard du FMI, du GATT et de l' OCDE", 18, RBDI 1984-1985, at 31.

87 A. Fatouros, The World Bank's Impact on International Law of Cooperation, in Jus et Societas, Essays in Tribute to Wolfgang Friedmann, Martinus Nijjhoff, London (1979), at 70.

88 Id.

89 Id.

90 Id.

91 J. Sztucki, Jus Cogent and The Vienna Convention on The Law of Treaties: A Critical Appraisal. Wien, Springer (1974).

92 Since the Gulf War, French legal diplomacy has been very active in the elaboration of a new *Droit d'ingerence*, (Right to intervene-duty of meddling-duty of intrusion), which could pose a serious challenge to the traditional principle of non interference. See M. Bettati, Un Droit d'ingerence ? 95, RGDPI, (3) 1991, at 639.

93 Hans. W. Singer, "North-South and South-South Cooperation", 3 Dev.& Peace, Spring 1982, at 5.

94 IMF Survey, 10 Dec. 1984; reported also in K. Khan, "The Law of International Economic Institutions and the Principle of Universality in the Contemporary International Legal Order, in W. E. Butter, Perestroika and International Law. Martinus Nijhoff, The Netherlands, (1990), at 227-243.

95 Supra note 93.

96 See C. Raghhavan, Recolonization. The GATT, the Uruguay Round and the Third World, Zed Books, London 1990, especially at Chapter 14; See also C. Morrison, "More trade, Less Poverty" 162, The OECD Observer, Feb-March 1990, at 4-6.

97 C. Payer, Lent and Lost: Foreign Credit and Third World Development, Zed Books, London (1991).

98 J.G. Zorn and P. Bayne, (eds), Foreign Investment, International Law and National Development: Papers presented at the 7th Waigani Seminar, Papua New Guinea, Apr-May, 1973, Sydney (1975).

99 K. Khan, The Law and Organisation of International Commodity Agreements, The Hague, London, 1982.

100 The capacity of the Bank as an international law maker is amply discussed by A. Fatouros, supra note 87.

101 On the Right to Development, see a series of Articles in F. Sydner & P. Slinn

(eds), International Law of Development: Comparative Perspectives. Professional Books, London, (1987); also, K. Khan, "International Right to Development, Legal Basis and Measures for its Development" in 7, Sciences, Technology and Development, Apr. 1984, at 1-20.

102 The legal aspects of the NIEO have been the subject of considerable scholarship and research by the Committee established for that purpose by the International Law Association. The seminal documents of the NIEO, particularly the Charter of Economic rights and Duties of States, are, from a legal point of view, hybrid in their juristic nature. They contain declarations of existing legal rights and political principles as well as programmes of action for the future. Although some documents have been adopted by the UN General Assembly without a vote, this has generally been over objections and reservations, including the most persistent objector, the USA. It would be beyond the scope of this overview of financing to rule on this part of the NIEO where the debate still continues as to the juristic nature of certain provisions. Nevertheless, it is worth noting that while some portions of the NIEO are not accepted by many DCs as binding principles,they may be accepted as political principles or " legitimate political targets." On the legal nature of the NIEO, see J. Castaneda, "La Charte des Droits et Devoirs Economiques des Etats", in XX AFDI, Paris 1974, Kamal Hossein, (ed), Legal Aspects of the New International Economic Order, Francis Pinter, London (1980); C.N. Brower and J.B. Tepe, "The Charter of Economic Rights and Duties of States: A Reflexion or Rejection of International Law", in, 9, International Lawyer, 1975, at 295-318.

103 Supra note 77, at 56. See also Le Monde Diplomatique, May 1974.

CONCLUDING REMARKS.

The vehicles which the Bank chooses as means of changing the legal and institutional aspects of LDC governments are new neither in international finance nor in human relations more generally. It has always been the lender's concern to recover his money, and eventually, some extra money "for service rendered." Fear of default on repayment from the borrowers leads the lender to resort to various devices or threats to discourage this. The threat usually required from the private lender is to require the borrower, as a condition of the loan, to pledge a capital asset such as a house or a piece of land called collateral, to the lender. If repayment falls into arrears, or become impossible, the lender has the right to claim and the borrower is under an obligation to hand over the asset to the lender.

In international finance, and more precisely in the case of the World Bank, the motives for lending are different, and the range of threats available to the institution is limited, due to the status of the Bank as an international institution, and the quality of its customers who are sovereign states. On the one hand, the Bank cannot, by "international courtesy", treat its members in the same manner as a private banker treats his client by requiring security for its loans. In fact the Bank has considered this possibility in the past, but has formally ruled it out. On the other hand, an international institution cannot sue one of its members in an international court for failure to repay, not by courtesy this time, but simply because such a judicial body does not exist.

To contour the problem of physical security, the Bank has instead used different methods at different stages of its lending history. In its earlier loans, for instance, the

Bank linked the financing of a project to the implementation of particular measures, usually tied to the project. Thus in almost all water supply and electricity loans the Bank financed, there was a special provision in the agreement requiring the borrower to undertake a review of his tariffs and implement new legislation to that effect. On other occasions, the borrower was required to set up an autonomous entity to run the project which the Bank financed.

In the relatively recent past, the Bank has moved towards more stringent conditions, by making its lending conditional on the implementation of a certain policy under a structural adjustment programme. Unlike in the past, the Bank's funds were not tied to a specific project, but encompassed all the economic sectors of the borrower. At the heart of such a policy, public sector restructuring and the wholesale privatisation of the economy were the most common policies recommended by the institution.

More recently, however, the bank has moved further by making its loans, which are, by definition, legal and financial transactions, conditional on radical political - therefore non economic- reforms. According to this new policy, LDC governments would be eligible for Bank's funding only if they satisfy the institution that they are ready to implement democratic rules in their system of governance. Quite often the measures, whether economic or political, required by the Bank do not fit the borrowers' overall structure. Hence, the necessity for these latter to introduce some legal and institutional changes in order to accommodate the Bank's measures.

On the legal side, the implementation of most of the Bank's recommendations led to the modification, rewriting, or introduction of laws in the recipient countries. The legal areas involved vary in accordance with the importance of the loan. In an electricity project, for instance, the legal implications of the loan may be restricted to the enactment of new tariff law. In contrast, if the borrower opted for the implementation of a SAL programme, then the legal and institutional changes may be much wider, and in many cases involve reshaping several sectors of the economy simultaneously.

At the level of the national institutions of the borrower, the same phenomenon occurs, as governments are often required by the Bank to remove cumbersome and obsolete institutions and replace them with new and modern ones. In many instances, this policy has led to the emergence of new forms of ownership (autonomous/private entities), which were until then alien to the borrower's institutional arrangements. New forms of dealing have also appeared as a result of price liberalisation, privatisation and the open market economy in general.

In the political sphere, the debate is on the establishment of a multiparty system to replace the old one party formula of governance. New institutions such as multipartism and various elected bodies at different levels of the government are characteristic of the kind of institutional changes that Third World governments are being pressed for by the Bank. For the Bank's management, these changes, whether legal or institutional, are necessary for the successful implementation of the Bank's programmes, and, accordingly, the economic development of the borrowers.

For the recipient borrowers, the laws and institutions introduced as a result of Bank recommendations have not always met the LDCs expectations. On several occasions, a loan agreement has turned to a sour disagreement between the borrower and the Bank, especially since this latter became, like its sister the IMF, involved in the policy based lending business, through the unpopular SALs. Witness: the food riots as a result of SAL conditionality, government opposition to the Bank's measures on the ground of sovereignty infringement, the unexpected trends that democracy is taking in countries undertaking political reforms, to cite only these few examples. Several factors contributed to this amalgam.

In the first place, all measures recommended by the Bank and the subsequent changes that followed in the borrowing country are carried out by the borrower with a mixture of enthusiasm, hesitation and sometimes anxiety. In other words, the borrower is called upon to behave in a manner which he would have never chosen, had it not been for the loan. There is therefore in the borrower's attitude an impression of external pressure, or a pseudo coercion, "short of the use of force", to paraphrase A. Fatouros, and D. Carreau.

In such circumstances, experience has proved that conditions, or any other measures imposed from outside, usually do more harm than good. The Bank's measures are not an exception to this rule. Moreover, action taken by borrowers primarily because of externally imposed conditions rather than domestic conviction are unlikely to be sustained. This raises a fundamental issue in the present debate, which is that of transplantation, *viz*, borrowing different sets of laws and institutions from one country and implementing them in another one. The issue is equally valid for economic as well as political borrowings. For in both situations, the rejection has been sometimes brutal (food riots and civil disturbances as a result of moves towards democracy in many LDCs and Central and Eastern European countries).

It may be true that the legal and institutional arrangements have been successful in a particular environment, but this does not necessarily imply that the same arrangements will have the same result in a different surrounding. The domestic political, economic, social and cultural environment are fundamentally different. It is therefore more likely that the result will be different, and in many cases it has been so.

Several factors, some directly, others indirectly linked to the Bank, explain to a large extent the institution's hesitant policy in development issues. Firstly, there is a structural problem in the Articles of Agreement. Since their inception, nearly half a century ago, the Bank's Articles have remained practically untouched. Yet the circumstances surrounding their establishment have drastically changed. The Articles were set up at a time when the world was divided into two diametrically opposite systems: capitalism and socialism. Later on, the division increased to three worlds with the emergence in the late fifties of the Non Aligned Movement. The division then fell down to one system in the nineties, with the collapse of the socialist regimes, and the uncertain future of Third World Non Aligned Movement.

Another characteristic of the Bank's Articles is their rigidity and hostility towards any significant change. Despite being in a majority in the Bank, the LDCs have so far been unsuccessful in persuading the DCs minority to introduce some major changes in a few areas such as voting and decision making. A compromise on such vital issues, would have certainly given the Bank's efforts a different direction in the area of development assistance to the LDCs. Moreover, as they stand, the Articles do not even provide for proper legal means (amendment /revision) for the LDCs to use to bring about the desired changes in the institution's functioning. Like the US constitution, the Bank's Statutes were drafted on very broad principles whose interpretation and amendment was left to the Board of management. In view of the Western predominance over the Board, it is unlikely for the LDCs to have any substantial effect on the amendment or interpretation of the Bank's Articles.

Secondly, the Bank's reliance on western monies, determines the management conduct of the institution's business on the selection and implementation of western types of laws and institutions in the borrowing countries. The dilemma for the Bank is that without western capital especially the US contribution, the institution will not survive. Similarly, a Bank perceived to be nothing but an extension of the treasury of Western governments, loses its influence amongst its other (LDC) members. In such circumstances, it can only be expected that a "tied" Bank can make but only "tied" loans, as is explained below.

Thirdly, there are diverging views on the interpretation and conception of the notion of development between the Bank and its Third World members who are the major beneficiary of the loans. This factor is in fact a consequence of the previous one, if not its natural continuation. By placing their money in the Bank, Western donors are implicitly selling their economic ideology, including their economic model of development to the Third World borrowing countries. Therefore, it is only to be expected that all laws and institutions that are "recommended" by the Bank to the borrowers, should be on the Western, ie. capital oriented model.

Fourthly, there is a noticeable lack of dialogue between the Bank and its member borrowers. Although the Bank claims that it always deals with its members as partners, in reality it has developed instead a "take it or leave it" attitude, which has negated from the very beginning the establishment of a genuine partnership, based on reciprocal exchange and acceptance of views on development issues. The only dialogue possible was the one that the Bank imposed, conducted and required the borrower to implement the outcome of, if he wanted to benefit from the loan. The absence of a dialogue in sensitive areas such as the economic and political future of a nation cannot be decided by an injection of foreign patterns, without taking into account the views of the recipient country. Yet, there have been numerous proposals by the LDCs to fill the legal vacuum on development at the international level through the elaboration of a corpus of international law of development. By being full partners with the West (and the Bank) on such a "joint venture", the LDCs would certainly arrive at an original economic and political system, free from any outside pressure, interference or any particular taint.

In short, to say that the World Bank' efforts have been unfruitful is, with some reservations, a false statement.

It is false because it would be incorrect to underestimate the gigantic task of the Bank which is to address the economic problems of more than three quarters of the international community, some of which are in a desperate situation. To address such huge problems, the Bank has built through the years an immense reservoir of knowledge, skill, and expertise that cannot be ignored and which can be put to the benefit of the less privileged nations. In many respects, the Bank's diagnosis of the LDC economies revealed major loopholes and irregularities such as mismanagement, waste and blatant inefficiency that were at the origin of the borrowers' economic retardation. In that respect, it may be said that the Bank is more than indispensable for the economic development of its unfortunate members.

But, and this is the other side of the coin, the instruments used by the Bank, the method in approaching and dealing with the problems, the policies it has advocated and the legal and institutional arrangements that it has recommended, have not always been to the advantage of the borrowing countries. In that respect, it may be said that the Bank has fallen short in its mission. In sum, if the Bank has been able to discover the flaws of underdevelopment, it has so far been unable to address them properly.

For the time being, the Bank continues "to scratch where it does not itch" as the popular Algerian saying goes.

It would be difficult to summarise the message of this thesis more succinctly.

ANNEX {A}

The following Annex is an extract from the original copy of a World Bank structural adjustment to a developing country. The name of the country has been deliberately hidden to preserve the confidentiality of the report.

The Second Industrial and Trade Policy Adjustment Program (ITPA II)

1. The economic policy measures of the ITPA II program cover three main areas: continued export promotion and reform of protection, rationalization of the public investment program and public enterprises, and financial sector reform. We are convinced that these measures will permit to improve the efficiency of resource allocation and utilization in the economy, and realize the substantial existing potential for the development of exports, as well as for the growth of domestic savings, public and private.

I. Export Promotion and Reform of Protection

2. Export promotion is of special importance for generating foreign exchange to meet the needs of the economy and to service international debt, developing new industrial activities, and creating a significant source of employment.

3. Exchange Rate. We confirm that a flexible exchange rate policy will continue to be pursued in conformity with the agreement with the IMF, and with the objectives of maintaining and enhancing the competitivity of exports and supporting the program of import liberalization.

4. Export Certificates. In order to simplify export procedures, export certificates will be eliminated before end-1985 for hides and leather, and for mining products with the exception of barytine, unrefined lead, lead minerals and charcoal.

5. Food Products. The study of exports of fresh vegetables is expected to be completed by September 1985. This study is expected to yield recommendations aiming at increasing fresh vegetable exports; the agreed measures will be implemented after discussions with the World Bank during the last quarter of 1985.

6. Customs Regimes. In 1985, the temporary admission procedure (which permits exporters to import inputs free of tax and duties, without prior authorization), will be expended through modifying the negative list which was retained under the ITPA I program. This will be effected through the elimination from this list, before June 1985, of all products other than glass used for packaging and agricultural and fisheries products; the latter will be eliminated from the list immediately on their transfer from List B to List A. In addition, the Customs Directorate will decentralize the management of the procedure of "exportation préalable" (pre-exporting). As regards guarantees for customs duties payable by exporters, the Customs Directorate will accept global annual guarantees (bank guarantees or mutual guarantees of industries). A procedure will also be established to permit settlement *à posteriori* of customs claims, without blockage of customs clearance of

merchandise. In order to improve the access of industries to customs legislation, the Customs Code and the tariff list will be up-dated regularly. The average period between filing a customs declaration and the delivery of permission to lift the goods will be reduced in 1985 by 6 days from the time estimated at the beginning of the year of 12 days.

7. Global Approach to Simplification of Foreign Trade Procedures. After implementing a number of measures under the ITPA I program to simplify administrative procedures for foreign trade, the Government intends to complete and amplify these measures. It has realized that the complexity of administrative procedures and the slowness of movement of merchandise require a global and continuing approach over the medium-term to address the problem by successive stages of analysis and action. A Committee for Simplification of Foreign Trade Procedures will be established by end-1985, with respresentatives of different agencies concerned: the Customs Directorate, the agencies responsible for foreign trade, exchange control, and transport, the port authorities, the commercial banks, transit and maritime agents, importers and exporters, etc. This Committee will be responsible for the conception and follow-up of programs of analysis and folow-up of the implementation of specific measures resulting from these analyses concerning: (i) the rationalization of all international trade documentation; (ii) identification and elimination of delays due to procedures; and (iii) the preparation and publication of an annual compendium of foreign trade and exchange control rules. During 1985, an itinerary of export and import transactions will be prepared to provide a clear set of documentation on current foreign trade procedures. This would permit preparation of the first phase of their reform before June 1986.

8. Exchange Allocation to Exporters. From January 1985, an automatic allocation of foreign exchange is granted to exporters, up to a ceiling of 3% of annual export value, with the possibility of cumulating the allocation, in order to assist exporters to cover the expenses of export operations such as business trips and other incidental expenses.

9. Elimination of the Statistical Export Tax. The statistical export tax is currently levied on all exports at the rate of 0.5% of each transaction. In order to simplify the operating framework for exporters, this tax will be eliminated with effect from January 1986.

10. Export Code. So as to permit exporters to work in a clear and defined framework and confirm incentives for investment in export production, while recognizing the obligation of exporters to contribute to the Government an appropriate portion of the income from their activities, the Government is preparing a new Export Code.

11. Tariff Protection Policy. As it has already stated, the Government's objective is to encourage increased competitivity, improve the efficiency of investment and labor productivity. This objective will be realized through a gradual reduction of the level and dispersion of customs tariffs, so as to ensure by end-1988 a maximum rate of protection no greater than 25%.

12. Special Import Tax. To achieve the above-mentioned objective, the Government has reduced the Special Import Tax from 10 to 7.5% in January 1985. Subsequently, the Government will reduce the Special Import Tax from 7.5 to 5% in January 1986 and intends to eliminate it with effect from January 1987. No customs duty will be increased with a purely fiscal objective to compensate for the reduction of the special import tax and the elimination of the statistical export tax.

13. Maximum Rate of Customs Duty. The maximum rate of customs duty will be reduced to 45% by January 1986.

14. Rationalization of Tariff Structure and Customs Nomenclature. The Customs Directorate and the Ministry of Commerce and Industry have carried out preparatory work of rationalization to ensure that: i) similar products are taxed at the same rate; ii) the dispersion of customs duties is reduced; iii) the level of protection does not exceed 25% by end-1988; iv) the system is rendered simpler and clearer, including through the suppression of the stamp duty and/or its integration into customs duties. The new harmonized nomenclature will be introduced at the latest within a year after the definitive clarifications from the Customs Cooperation Council are received. This will be preceded by a restructuring, sector by sector, of the customs nomenclature, with duty rates to permit a definitive ceiling on the rate of protection of 25%, the whole system to become operational at the latest by January 1, 1989. A provisional structure of duty rates permitting a rate of protection not exceeding 25%, to be used in preparing the definitive structure, will be prepared in 1985, 86, and 87 according to a calendar and framework explained to the World Bank.

15. Non-Tariff Protection. The Government will continue to pursue the policy of import liberalization in the future so as to open up the economy further to increased foreign competition. Already in 1984 a large number of products were transferred from List B (requiring import licenses) to List A (free list). This process has been continued in 1985, and will be pursued according to a timetable explained to the World Bank. In addition, most products previously in List C (banned from imports) have been transferred from this list, either to List B, as an interim stage before their transfer to List A, or directly to List A. These import interdictions will be eliminated by stages by 1988. The timetable of this process has also been explained to the World Bank.

16. As regards protection policy for new investments, the Government has already explained in paragraph 16 of the letter of December 29, 1984 to the Bank in the context of the ITPA I loan the principles of granting special protection in an initial period (maximum of 3 years after completion of the project); the Government does not propose to grant such protection in the form of quantitative restrictions, except in exceptional, duly justified cases.

II. Public Investment Program and Public Enterprises

17. The main objective of policies and actions in this area is the improvement of the efficiency of resource utilization in the public sector. In order to harmonize budget expenditures with resource availability, the Government accords priority to the rationalization of public investments, increasing the return on these investments, and addressing the issue of Government and public enterprise arrears.

Public Investment Program

18. In the face of the continuing scarcity of financial resources, the public investment program was substantially reduced in 1983 and 1984 on the basis of a detailed analysis of investment priorities carried out in cooperation with the World Bank. Within the framework of the objectives of developing national resources and employment promotion, the criteria for project analysis have been: (i) the economic rate of return; (ii) the stage of physical execution of the project; (iii) the project gestation period; (iv) the project's contribution to export promotion and efficient import substitution; (v) the need for budgetary allocations. In function of this analysis and considerations of sectoral and inter-sectoral balance, public investment projects have been classified in three categories: (i) highest priority projects whose rapid completion would be desirable; (ii) projects whose implementation could be slowed down; (iii) projects to be postponed or cancelled. Following from this analysis, the Government cancelled DH 4.6 billion of credits in 1983 and DH 6 billion in 1984.

19. The rationalization of the public investment program is continuing in 1985. The global envelope of the investment budget was about DH 26.8 billion at the beginning of this year. After detailed analysis, the Government intends to cancel DH 4 billion. The control of the budget implies a practically total avoidance of inscriptions of new projects except if they would benefit from concessional financing. The Government proposes to use a significant portion of exceptional bilateral grant aid to reduce payment arrears. The Government also proposes to review with the World Bank in October/November 1985 the investment program for 1986 and subsequent years, so as to continue rationalization of the program with the application of the criteria mentioned in the preceding paragraph.

20. In addition to specific actions and increased control, as regards public investments, the Government is in the process of effecting a fundamental reform of the budgeting and planning system. This new planning system will involve an annually modifiable plan, with strict prior control by the Ministries of Finance and the Plan to ensure that only high priority projects in keeping with realistic global budget resource envelopes would be inscribed. Measures will also be taken to computerize project data, including estimates of total annual expenditure, amounts of credits available, commitments and payments, in order to improve follow-up of the financial implementation of projects and control of expenditures on the investment budget. The Government will request technical assistance from the World Bank to design and implement the new system of budgeting and planning investments,

according to a timetable discussed with the World Bank. The preparation of a program has already been initiated, and the functional design of the new system will be prepared during the second half of 1985. The implementation of the new system is expected before June 30, 1986.

Public Enterprises

21. The growing importance of public enterprises in the last decade has led the Government to consider carefully the financial and structural problems of this sector. After a major, in-depth study in 1979-80 which served as the basis for a series of actions and programs in this area, in 1984 the Government analyzed in detail the payables and receivables of the Government vis-à-vis public enterprises, in order to ascertain the magnitude of arrears. A program of measures has been prepared sector by sector, to resolve the structural causes of these arrears. The matrix of arrears as of December 31, 1983 has been completed for some 60 enterprises. Detailed analyses and sectoral action plans have also been developed for most sectors: energy, transport, water-supply, trade, mines, sugar, and agriculture. A study of local collectivities is in progress. An action plan has been designed and is being implemented to improve the situation of the enterprises and halt growth of arrears. Several decisions and specifications have been taken in the context of the sectoral rehabilitation programs. An Interministerial Committee chaired by the Prime Minister has been created to define a strategy for the public enterprise sector. A Vigilance Committee has also been created to propose reform measures, settle disputes, etc. and follow-up on their implementation.

22. The matrix of debts and receivables covering 80 enterprises shows a net deficit of the State to public enterprises of about DH 3.8 billion as of December 31, 1984. The Government expects to allocate in 1985 and 1986 a substantial sum to reduce arrears in the shortest possible period. While respecting the performance criteria of the IMF, the Government expects to reduce its net arrears to public enterprises by DH 1 billion by the end of 1985, and by DH 0.5 billion by June 30, 1986 (the arrears defined according to the methodology already established). The Government will furnish to the Bank in 1985 a detailed breakdown and timetable of settlement of the arrears. The Vigilance Committee will continue to be responsible for the implementation of the measures adopted (including revision of prices). The Government will avoide any fresh increase of these arrears in the future.

23. The Government also confirms its objective of reducing the overall amount of transfers to public enterprises. The amount of credits to public enterprises in the Finance Law has been limited (excluding operating subsidies) to DH 3.3 billion for investment subsidies and payments for services of public enterprises to the Government. The actual overall payments in these categories will be about DH 2.1 billion in 1985. In 1986, the Government expects to intensify the efforts undertaken in 1984 and 1985 to improve the performance of public enterprises so as to reduce their financial dependence on the Government, and to discuss with the Bank the measures to take in this connection.

24. The Government renews its request to the World Bank for assistance in introducing basic structural reforms in the sector of public enterprises, so as to improve the efficiency of these enterprises and achieve financial and structural rationalization of their relations with the State, collectivities, and the private sector. With this objective, the Government will prepare, in cooperation with the World Bank, a program to carry out: (i) structural reform of price, subsidy, and financing policies of the enterprises; (ii) administrative reforms permitting a better control of the efficiency of enterprise operations and greater enterpise autonomy; and (iii) financial or physical restructuring of a few key enterprises playing a vital role in the economy, which can serve as test-cases for the implementation of policy and administrative reforms in the sector. The Government has named a liaison and coordination group for these activities. The Government is endeavouring to progressively increase the proportion of self-financing by public enterprises of their investments.

25. Given the great importance throughout the economy of energy and power tariffs, the Government and the Bank have agreed to initiate a study in this area which will assist the preparation of a proposed Bank public enterprise sector loan.

III. Financial Sector Reform

26. The Government has prepared, in collaboration with the World Bank, a major reform of the financial sector, in order to promote domestic savings and improve the efficiency of resource allocation. This reform includes a series of measures aiming at simplifying and easing the regulatory framework, increased reliance on market mechanisms, encouragement of increased competition in the sector, progressive elimination of subsidies, reduction of fragmentation of the financial market and resulting distortions, strengthening the institutional system, and developing the money market. An important aspect of this reform, which supports the Government's overall adjustment policy, is increased recourse by the Treasury to the financial market. The most important measures of thius reform are summarized in the following paragraphs.

27. Interest Rate Policy. The Government is committed to greater flexibility of interest rates than in the past. With the exception of certain preferential rates, notably for export credits and cereal production, the Government recognizes the objective of maintaining interest rates at levels which are positive in real terms. Certain interest rates (notably, on deposits of maturity greater than 12 months) will be freed with effect from April 1, 1985. The other rates have been transformed into minima (in the case of deposit rates) and maxima (in the case of lending rates), and the system has been simplified through a reduction in the number of rates set by the authorities. The changes in interest rates effective April 1, 1985 are detailed in the table below.

Term Deposits	Former Rate	Change	New Rate[a]	Minima/ Maxima
3 months	6.5	+2	8.5	Min.
6 months	8.5	+2	10.5	Min.
12 months	10.0	+2	12.0	Min
Savings Deposits				
Caisse d'Epargne pass book accounts	8.0	+1	9.0	Min
Other pass book accounts	7.0	+1	8.0	Min
Lending Rates				
Overdraft	13.0	+1	14.0	Max
Rediscountable overdraft	10.0	+2	12.0	Max
Discount Rate	7.0	+1.5	8.5	Max
Medium-Term Rediscountable Loans	12.0	+1	13.0	Max
Long-Term Rediscountable Loans	14.0	+1	15.0	Max

a/ From April 1, 1985.

28. The Government has created a Permanent Committee for Interest Rates, consisting of representatives of the Ministry of Finance, the Bank of and the Professional Association of banks, to follow up the evolution of rates and to ensure that, overall, the rates in force reflect the conclusions of an analysis of relevant factors, in particular, the current inflation rate, the liquidity situation, movements in exchange rates and the balance of payments, international inflation, etc. Each semester this Commission will prepare a report presenting its conclusions regarding this objective, and recommending, to the Minister of Finance, if need be, modification of the rates.

29. It is to be noted that the interest rates indicated in the table above, are considered net of taxes. In view of the proposed fiscal reform, and the introduction of a value added tax (see para. 38 below), lending rates will be increased by the amount of the value added tax deductible by borrowers

30. In parallel with the freeing of deposit rates, we have examined the freeing of lending rates, which also constitutes an objective of the Government's policy. The need for regulating credit through ceilings in 1985 will not permit us to free before the end of the year lending rates beyond the ceilings mentioned above. We would like to emphasize our intention to gradually liberalize lending rates at the same time as credit regulation is eased. Measures for deregulating credit allocation and liberalizing lending rates will be reviewed with the World Bank and the IMF before end-1985.

31. Gradual Elimination of Interest Rate Rebates. The Government intends to eliminate over the medium-term interest rate rebates on medium- and long-term credits in different sectors. As these rebates are granted under investment codes, their elimination will require passage of a law. The Government will study, in collaboration with the World Bank by end-1985 the measures to reach this objective, with a view to preparing in 1986, a program to apply the nominal rates to these different sectors benefiting from rebates.

32. Foreign Exchange Risk Coverage. Medium- and long-term loans of specialized financial institutions (BNDE, CNCA and CIH) are critical to ensure access to term resources for priority investments. A large part of these resources is mobilized abroad in foreign exchange, and the Government has assumed responsibility for covering the foreign exchange risks of these three institutions. The burden of this coverage weighs more and more heavily on the Treasury, and the Government has therefore decided to transfer a larger portion of the costs to ultimate borrrowers and the specialized institutions in order to lighten the burden on the Treasury. It would, however, be premature to transfer the entire risk to the ultimate borrowers. In function of these conclusions, the Government has decided to strengthen from June 1, 1985, the system of coverage of foreign exchange risks for foreign currency loans contracted by the specialized financial institutions, as follows.

(i) The specialized institutions will pay into a Foreign Exchange Risk Fund for credit of the Treasury at each of the institutions concerned, the difference between their lending rate, and the interest rate on new foreign borrowings, less a margin sufficient to assure them an adequate profitability;

(ii) The Foreign Exchange Risk Fund will receive funds from a commission of 1% on disbursements of new medium- and long-term credits of the specialized financial institutions, with the exception of loans for low-cost housing (HBM) and credits to small farmers (CLCA).

(iii) The specialized financial institutions will assume 2% (instead of 1.5%, till now) of all exchange losses on their foreign resources acquired after June 1, 1985. (In the case of exchange gains, the institutions will be credited with 2%).

These measures will be reviewed every six months, and may be modified by the Ministry of Finance. The Government will periodically consult with the World Bank to study the results of these measures, and propose, if need be, their improvement - the long-term objective being to reduce gradually, with a view to its eventual elimination, the charge to the Government of exchange-risk coverage.

33. The propositions mentioned above only deal with the foreign exchange risk on lending operations of the specialized financial institutions. The distortions which would arise from the implicit exchange risk on local currency loans of commercial banks to importers of equipment and investment goods have not been considered in the Government's program, for lack of a complete analysis of the situation. However, the possible impact of this distortion on public finances remains to be examined. The Government has therefore decided to initiate a study, by the end of 1985, with Bank support, on the importance of the implicit exchange risk for public finances, in order to specify the measures and the possible recommendations to transfer all or a part of the risk to importers benefiting from such loans.

34. Obligatory Placement Requirements and Reserve Requirements for Commercial Banks. In order to increase the margins of commercial banks on term-deposits, and hence encourage them to mobilize term-deposits with greater dynamism, the ratio for obligatory placements by the banks in Treasury bonds has been modified. The deposit base on which the rate of obligatory placement is applied was reduced in 1984 through the elimination, from the calculation of this base, of deposits with a term greater than 12 months. From April 1, 1985, all term deposits and certificates of deposit have been eliminated from the base of calculation of the obligatory placement requirement; the obligatory placement rate on sight deposits has been increased from 30 to 35%. In addition term deposits have also been excluded for purposes of calculation of the reserve requirements of commercial banks.

35. Allocation of Credit Ceilings to Commercial Banks. With the objective of encouraging commercial banks to mobilize savings, the system of determining credit ceilings will be modified effective June 1, 1985, to take account of the effort by the banks to mobilize savings.

36. Bank Commissions. The monetary authorities have set themselves the objective of simplifying, clarifying and up-dating bank commissions which have been in effect since 1975. A detailed study of commissions will be carried out, in collaboration with concerned institutions, by September 30, 1985, and communicated to the Bank for analysis and comments; this study would have as an objective the selection of commissions which would be expressed as maxima; it will take into account, as much as possible, the cost of operations. The reform of bank commissions will be effected, at the latest, by January, 1986.

37. Specific Measures to Encourage Competition Between Specialized Financial Institutions and the Commercial Banks. In order to strengthen competition between the banks and the specialized financial institutions, it would seem appropriate to permit the latter to receive deposits from the public. The Government's General Secretary has been requested to provide a legal opinion on whether it would be necessary to amend the laws to achieve this objective. This opinion will be furnished by end-September 1985. If CIH and BNDE can be authorized to receive deposits through administrative measures, the Government will take steps to effect this authorization, at

the latest by January 1986. In any case, the monetary authorities will take all appropriate steps to permit the specialized financial institutions to receive funds from the public through the issue of certificates of deposit. In case the law governing specialized financial institutions needs to be modified, the Bank will be informed before end-1985 of the next steps which could be expected. Besides, in order to grant the banks a greater degree of responsibility and a more important role in medium-term lending, the monetary authorities have already granted BMCE the right to affix the third signature on credits. The monetary authorities are also studying the possibility of permitting other banks to provide the third signature necessary for rediscounting medium-term loans at the Bank of This study will be reviewed with the World Bank with a view to its implementation effective January, 1986.

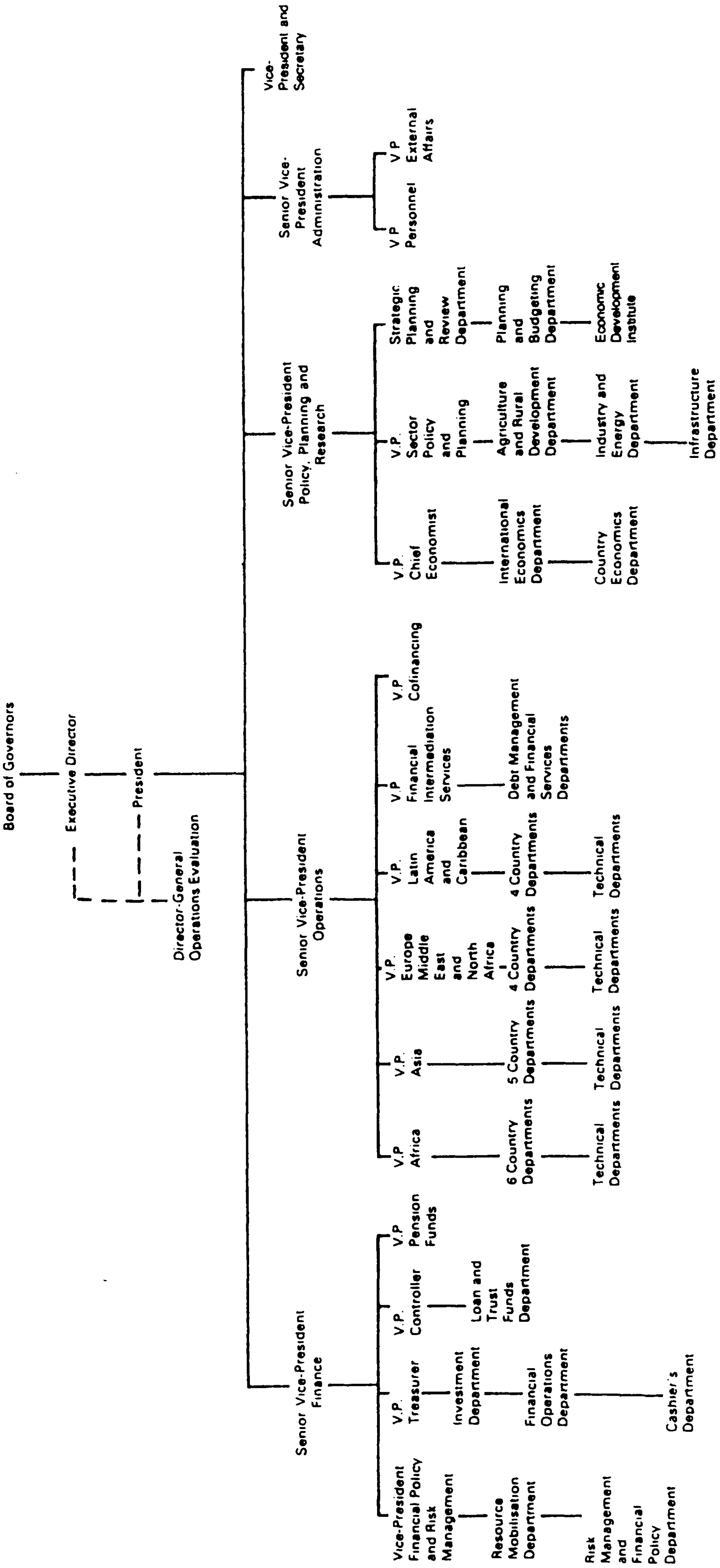
38. Reform of Taxation Affecting the Financial Sector. There has already been a clarification of the conditions under which provisions for risk can be established by commercial banks, and a reduction of the registration fee on capital increases of companies whose shares are traded on the stock exchange. The fiscal reform, whose presentation to Parliament is expected by mid-1985, includes important measures concerning the financial sector: (i) the tax on banking services will be replaced by a value added tax, with, as a result, the possibility for a commercial enterprise to deduct this tax from its expenses; (ii) enterprises will have the possibility of re-valuing their assets, which could lighten their tax burden and increase their self-financing.

39. Development of the Money Market. Since 1983, a growing proportion of the Treasury's financing needs have been met through borrowing on the money market at market rates. Also, the proportion of refinancing by the Banque du at flexible interest rates has continued to increase. In the future, these trends will be strengthened, in order to develop the money market and increase the participation of the Treasury in this market. In addition, the Treasury is seeking to mobilize supplementing resources on the financial market through the issue of bonds to the general public. In this regard, an issue in March 1985 for a sum of DH 100 million resulted in subscriptions of over DH 400 million, and the Treasury intends to repeat this experiment in 1985.

40. Reform of the Caisse Centrale de Garantie (CCG). To strengthen the credit guarantee system, there is need to redefine the role of CCG, and for a fundamental reform of its financial and organizational structure, including the procedures and principles of risk coverage by this organization. The Government is committed to study these issues by end-1985. A consultant will be appointed by the Government to carry out this study by September 1, 1985, and the study will be completed and its recommendations implemented during 1986, after discussions with the World Bank.

Monitoring and Progress Reporting

41. Progress in implementing the program described above will be monitored by the interministerial committee, established in the context of the ITPA I program, which will meet regularly to review progress and decide on appropriate actions to ensure timely implementation of the program. Two progress reports, summarizing the status of implementation of the program will be prepared and furnished to the World Bank, the first in early January 1986 and the second in early June 1986.



ANNEX B   World Bank organisation chart since 1987 reorganisation

SELECTED READINGS AND REFERENCE MATERIALS.

A great deal of the readings and reference materials used in this thesis come from original sources, most notably on publications of the World Bank designed to provide information about its activities These include:

- **Internal Documents**

  Annual Reports which are published every July.
  Summary Proceedings of Annual Meetings. which are published just after the joint Annual Meeting in September of the Board of Governors of the Bank, IFC, and IDA.
  Loan Agreements which are printed for loans made to borrowers (white cover).
  Loan Agreements which are confidential (grey reports).

- **Informational Publications**.

  Finance and Development which is a quarterly publication of the IMF and the World Bank, has been extensively used.
  World Development Report.
  Basic explanatory pamphlets and booklets issued by the Bank.
  Various informational documents, such as Country Economic Study, Reports and Discussion Papers, Occasional Papers, Staff Working Papers and World Bank News.

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