Providing for Environmental Safeguards in the Development Loans Given by the World Bank Group to the Developing Countries

I. Introduction

The overall state of development within the less developed countries (LDCs) is unacceptable. The LDCs are plagued with problems including hunger and malnutrition, disease, rural-urban imbalance, overpopulation, insufficient


3 Lee Speeches Nos. 1, 3, & 4, supra note 2; McNamara Speech, supra note 1.

4 A "favorable environment" for disease has been unwittingly fostered by many LDCs who have attempted to combat hunger by increasing agricultural growth without adequately allowing for environmental considerations. For example, agricultural growth involves construction of irrigation and drainage systems, clearing of forests, and adoption of monoculture practices which can lead to misuse of fertilizers and pesticides, creation of new transmission routes, and establishment of human settlement patterns. See Lee Speech No. 1, supra note 2. Bilharziasis and schistosomiasis are often spread by irrigation projects which fail to take environmental and health considerations into account. See World Bank, Environmental, Health, and Human Ecologic Considerations in Economic Development Projects 52 (1974) [hereinafter cited as Ecologic Considerations]; McNamara Speech, supra note 1.

5 Environmental Economics, supra note 2, at 324. The trend toward urbanization in the LDCs has upset their traditional rural-urban balance. Since this trend has not been accompanied by adequate economic development, it has resulted in unemployment, which has further impoverished the rural environment and further contributed to the drift to the cities. See Lee Speech No. 1, supra note 2; Sadove, Urban Needs of Developing Countries, Finance & Development, June 1973, at 26; Smith, Financing Cities in Developing Countries, 21 Int'l Monetary Fund Staff Papers 329 (1974) [hereinafter cited as Financing Cities]. Principle 15 of the Declaration of the United Nations Conference on the Human Environment states that "[p]lanning must be applied to human settlements and urbanization with a view to avoiding adverse effects on the environment and obtaining maximum social, economic and environmental benefits for all." Declaration of the United Nations Conference on the Human Environment, art. II, prin. 15, U.N. Doc. A/CONF.48/14 (1972) [hereinafter cited as Environment Declaration].

6 When the population increases faster than the economy can develop, per capita food supply and per capita product decrease, and hunger, disease, and unemployment increase. See Lee Speech No. 1, supra note 2. See also Sankaran, Population and the World Bank, Finance &
capital, and unemployment. The apparent solution to these problems is economic growth via rapid industrial development. Unfortunately, economic de-

DEVELOPMENT, Dec. 1973, at 18. "Demographic policies ... should be applied in those regions where the rate of population growth or excessive population concentrations are likely to have adverse effects on the environment or development . . . ." Environment Declaration, supra note 5, art. II, prin. 16. See generally INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, WORLD BANK ATLAS 4-15 (1973); Lee Speeches Nos. 1, 2, 3, & 4, supra note 2; McNamara Speech, supra note 1.

A complicated problem facing LDCs is the scarcity of domestic capital in relation to the size of investment required to achieve high rates of growth of national and per capita income. See Chandavarkar, Some Aspects of Interest Rate Policies in Less Developed Economies, 18 INT'L MONETARY FUND STAFF PAPERS 48 (1971) [hereinafter cited as Interest Rate Policies]; Kahn, The Law Applicable to Foreign Investments: The Contribution of the World Bank Convention on the Settlement of Investment Disputes, 44 IND. L.J. 1, 2 (1968); Meier, The Bretton Woods Agreement—Twenty-five Years After, 23 STAN. L. REV. 235, 255-56 (1971) [hereinafter cited as Bretton Woods]. "Although the accumulation of capital is not the prime determinant of economic growth, its role as a necessary, even if not a sufficient, condition in the economic development of the less developed countries is widely recognized." Interest Rate Policies, supra at 48.

Since capital accumulation is crucial, the price of capital as measured by the level and structure of interest rates is important. However, positive interest rate policies have been conspicuously lacking and analyses have been directed more toward the structure, behavior, and determinants of interest rates. See Bottomley, Monopoly Profit as a Determinant of Interest Rates in Underdeveloped Rural Areas, 16 OXFORD ECON. PAPERS, (n.s.) 431 (1964); Bottomley, The Premium for Risk as a Determinant of Interest Rates in Underdeveloped Rural Areas, 77 Q.J. ECON. 637 (1963); Chandavarkar, The Premium for Risk as a Determinant of Interest Rates in Underdeveloped Rural Areas: Comment, 79 Q.J. ECON. 322 (1965); U Tun Wai, Interest Rates in the Organized Money Markets of Underdeveloped Countries, 5 INT'L MONETARY FUND STAFF PAPERS 249 (1956); U Tun Wai, Interest Rates Outside the Organized Money Markets of Underdeveloped Countries, 6 INT'L MONETARY FUND STAFF PAPERS 80 (1957); cf. G. MYRDAL, 3 ASIAN DRAMA 2087-96 (1968).

The problems of unemployment and underemployment have been getting progressively worse in the developing countries in the years since World War II. Bhagwati, Main Features of the Employment Problem in Developing Countries, 20 INT'L MONETARY FUND STAFF PAPERS 78 (1973) [hereinafter cited as Employment Problem]; Friedman, Dilemmas of the Developing Countries: The Sword of Damocles, FINANCE & DEVELOPMENT, March 1973, at 12, 14. See also Environmental Economics, supra note 2, at 324-27. At present, two-thirds of the labor force and the bulk of the disguised unemployed are in the rural/agricultural sector of the LDCs. The proportion of the labor force in this sector cannot be reduced by any feasible acceleration during the next decade in the productive absorption of labor by the urban/modern sector. Population growth will increase the numbers in both categories. Therefore, many economists now say that priority should be given to increasing the productivity of labor in the rural/agricultural sector, because as it reduced unemployment, it would help alleviate food problems, city health problems, and urban drift. Employment Problem, supra at 98. See also Lee Speeches Nos. 1, 3, & 4, supra note 2; McNamara Speech, supra note 1.

"The achievement of a level of life in accord with fundamental human dignity for the world's two and three-quarter billion poor is simply not possible without the continued economic growth of the developing nations, and the developed nations as well." McNamara Speech, supra note 1; see Lee Speeches Nos. 1, 3, & 4, supra note 2. "Without economic growth a poor country can only remain poor." McNamara Speech, supra note 1; see Lee Speeches Nos. 1, 3, & 4, supra note 2. Without economic growth a rich country must reduce its concessionary aid and capital investments. See generally Kahn, The Law Applicable to Foreign Investments: The Contribution of the World
velopment necessarily affects the environment, and if it is not regulated properly, it can intensify instead of solve the problems of the LDCs.10

Most nations now recognize that the "protection and improvement of the human environment is a major issue which affects the well-being of peoples and economic development throughout the world . . . ."11 Environmental protection involves political, technical, social, economic, legal, and institutional disciplines.12 The extent to which any one of these disciplines predominates in any one country is determined by a number of factors:13

Among these factors are those relating to the conditions of nature with regard to the quantity, quality and degree of exploitation of the available natural resources, to the level of economic development, to the financial means available, to social needs, to the population growth and to its standard of living, to the level reached by science, technology, industrialization and urbanization and to the characteristics of its legal and institutional framework.14

The Founex report15 states that the kinds of environmental problems that exist in a given country depend on these factors and on the country's overall "relative level of development."

Dr. Paul Ehrlich believes that the major problems which have arisen in the LDCs can all be traced to one source: too many people.17 Accordingly, he has developed a formula which coordinates several factors to indicate the level of pollution. "Pollution can be said to be the result of multiplying three factors: population size, per capita consumption and an 'environmental impact' index that measures in part, how wisely we apply the technology that goes with consumption."18 Dr. Ehrlich believes that rapid population growth is the underlying cause of the other problems and therefore the key to solutions. In any event, rapid population growth tends to intensify the problems of the LDCs, because it serves to nullify their "economic progress, cruelly frustrating their hopes for development."20

In order to develop, the LDCs need to decrease their population growth rates.

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Bank Convention on the Settlement of Investment Disputes, 44 IND. L.J. 1, 2 (1968). Thus, in both the developing and developed countries, "[e]conomic and social development is essential for ensuring a favorable living and working environment . . . ." Environment Declaration, supra note 5, art. II, prin. 8.

10 McNamara Speech, supra note 1; see Lee Speeches Nos. 1, 3, & 4, supra note 2.

11 Environment Declaration, supra note 5, art. I, para. 2.

12 Caponera, Towards a New Methodological Approach in Environmental Law, 12 NATURAL RESOURCES J. 133 (1972).

13 Id.

14 Id.


20 Lee Speech No. 1, supra note 2.
and attract large amounts of capital investment.\textsuperscript{21} Capital investment by foreign governments,\textsuperscript{22} international organizations,\textsuperscript{23} and private interests\textsuperscript{24} will help the LDCs develop. However, even though the LDCs need to attract capital investment, they must not fail to enact environmental standards to do so. This is difficult for the LDCs, because many things hinge on capital investment, especially a nation’s “international comparative advantage.”\textsuperscript{25} Since investment is so important domestically and internationally, the LDCs hesitate to invest in nonproductive projects; \textit{i.e.}, environmental projects. This is understandable because “[e]nvironmental control absorbs productive factors by using capital and technology to reduce the negative externalities\textsuperscript{26} of existing patterns of economic activity . . . .”\textsuperscript{27} However, the position of the LDCs on this matter is going to harm them in the long run:

To the extent that these [environmental] losses occur or go unmeasured, the level of development is inflated. Often the difference has to be paid at a higher price and at a later stage of development. Higher costs of future remedial action may be avoided by prudent planning and early preventive measures.\textsuperscript{28}

It is in the interests of the LDCs to recognize environmental concerns early and to provide for them accordingly. Being latecomers in the development process, “they are in a position to avoid some of the more costly and needless mistakes

\begin{itemize}
  \item \textsuperscript{21} The LDCs “need substantial amounts of capital to provide decent standards of living for their populations.” Kahn, \textit{The Law Applicable to Foreign Investments: The Contribution of the World Bank Convention on the Settlement of Investment Disputes}, 44 \textit{Ind. L.J.} 1, 2 (1968).
  \item \textsuperscript{22} The LDCs have renewed their efforts to obtain assistance from developed countries. At the U.N. Conference on the Human Environment held in Stockholm, Sweden, on June 5-16, 1972, they succeeded in including a statement in the Conference’s Declaration to the effect that “[e]nvironmental deficiencies generated by the conditions of underdevelopment . . . can best be remedied by accelerated development through the transfer of substantial quantities of financial and technological assistance as a supplement to the domestic effort of the developing countries . . . .” Environment Declaration, supra note 5, art. II, prin. 9.
  \item \textsuperscript{24} The LDCs realize that “private capital might contribute considerably as a means of financing economic development,” and they are trying to attract private capital by enacting appropriate safeguards. Pinto, \textit{Settlement of Investment Disputes: The World Bank’s Convention}, 13 \textit{How. L.J.} 337 (1967).
  \item \textsuperscript{25} For the formula and explanation of international comparative advantage see \textit{Environmental Economics}, supra note 2, at 303-10. The author states that “[i]nternational comparative advantage is based on a variety of factors, including availability of natural resources, labor, investment in physical capital, investment in human capital, investment in technology, and so forth . . . .”
  \item \textsuperscript{26} In domestic and international economics, “the theory of externalities in welfare economics, as applied to the environmental issue, is well advanced and appears to be progressing rapidly.” \textit{Id.} at 332.
  \item \textsuperscript{27} \textit{Id.} at 301.
  \item \textsuperscript{28} \textit{Preface to Ecologic Considerations}, supra note 4, at iii; \textit{see} Blair, \textit{The Environmental Crisis in the Third World}, 1972 \textit{Intereconomics} 50.
\end{itemize}
the developed countries made in the past."^29

To help them take advantage of this opportunity, the World Bank established an Office of Environmental Affairs in 1970. The World Bank office reviews loan applications from the LDCs and decides whether or not the project adequately provides for environmental safeguards. The office has established guidelines for projects in the areas of agriculture, industry, transportation, utilities, and public health. The World Bank Group is divided into three branches: the International Bank for Reconstruction and Development, the International Development Association, and the International Finance Corporation. Each branch has different loan policies and criteria. First, this Note will examine those policies and criteria from the standpoint of financing environmental safeguards for proposed projects. Secondly, the current policy of the World Bank in this regard will be reviewed. These developments are important to international law, because the establishment of the World Bank's Environmental Office is the first attempt by an international organization to effectively deal with environmental concerns.

II. THE DILEMMA OF ECONOMIC GROWTH VERSUS THE ENVIRONMENT

The tendency of the LDCs is to sacrifice the environment to rapid economic development. This is because it is politically expedient to do so:^33

[T]he reactions of political leaders in developing countries to pressures for environmental protection is predictable: within the social welfare function that faces them, ecological questions generally assume a subordinate role. Under present conditions, they simply cannot afford to forego maximum possible economic growth and generally must reject out of hand anything which may interfere materially with this objective. They cannot concern themselves with the fine points of industrial location, water pollution, or despoliation of the land, and a certain degree of environmental degradation is accepted as a necessary cost of the otherwise efficient achievement of their primary objectives. To them, ecological balance is often a luxury at this stage of their development, although it is generally recognized that excessive postponement of concern with this issue may give rise to major problems at a later stage.^34

Another reason that the leadership in the LDCs tends to ignore environmental issues is that the effects of pollution are frequently less marked. LDCs generally possess a high assimilative capacity which renders pollution unnoticeable

^29 McNamara Speech, supra note 1; see Lee Speech No. 1, supra note 2.
^30 See McNamara Speech, supra note 1.
^31 See Lee Speech No. 1, supra note 2; McNamara Speech, supra note 1.
^32 See ECOLOGIC CONSIDERATIONS, supra note 4.
^33 The "polluter pays principle" as it relates to the "go-slow" approach of political units is discussed in Environmental Economics, supra note 2, at 298.
^34 Id. at 324-25.
^35 Id. at 325.
for a long period of time.36

This position of the LDCs surfaced at the U.N. Conference on the Human Environment (hereinafter referred to as U.N. Conference), which was held at Stockholm, Sweden, in June 1972:37

Statements were reported that maintained that pollution was exclusively a problem created by developed countries, and that it was exclusively up to them to solve it. It was also asserted that the environment “problem” was no more than a gambit of the rich to provide a political umbrella under which to keep themselves rich, and the poor poor.38

The developed countries naturally came to believe that the LDCs would be “unwilling to divert capital resources and trained personnel from environmentally harmful industry and development projects promising quick returns at lowest cost.”39 The overall tenor of the Declaration of the United Nations Conference on the Human Environment (hereinafter referred to as Environment Declaration)40 supports this interpretation,41 and it appears that the current economic situation is going to reinforce the position of the LDCs.

Recent changes in the world economy will tempt the LDCs to ignore environ-

36 [T]he effects of environmental pollution are frequently less marked in developing countries because their environmental assimilative capacity may be quite high. Hot, dry climates tend to minimize the impact of certain effluents of production processes. High rainfall levels reduce the impact on air quality of some types of emissions. Low population densities reduce the effects of other types of pollution, and large undeveloped tracts of land render marginal encroachment by industry of minor significance. And the people themselves may operate under entirely different conceptions of the quality of life; they are concerned more with elementary survival, nutritional adequacy, and health than the environmental side-effects of the means of achieving these very fundamental goals.

Environmental Economics, supra note 2, at 325.


39 Id.


41 Article I, paragraph 4, of the Environment Declaration states:

In the developing countries most of the environmental problems are caused by under-development. Millions continue to live far below the minimum levels required for a decent human existence, deprived of adequate food and clothing, shelter and education, health and sanitation. Therefore, the developing countries must direct their efforts to development, bearing in mind their priorities and the need to safeguard and improve the environment. For the same purpose, the industrialized countries should make efforts to reduce the gap between themselves and the developing countries. In the industrialized countries, environmental problems are generally related to industrialization and technological development.

Environment Declaration, supra note 5, art. 1, para. 4.
mental considerations.\textsuperscript{42} Rapidly rising commodity prices are making it difficult for the LDCs to pay for imports of food and fertilizer.\textsuperscript{43} Growth rates in the developed countries are expected to continue to decline.\textsuperscript{44} This will diminish the prospects for growth of developing country exports and for increases in concessionary aid from the developed countries.\textsuperscript{45}

Last year flows of official development assistance fell from the earlier cited figure of 0.35 percent of the GNP to 0.31 percent, and by 1975 the rate is likely to fall even further. But—even if the richer nations were to maintain their concessionary assistance at 1973 levels—at anticipated rates of inflation, this objective will require an increase in disbursements, in current prices, from $12 billion in 1973, to $18 billion in 1976 and $30 billion in 1980.\textsuperscript{46}

In 1972 the goal of the United Nations was to increase concessionary aid from 0.35 percent to 0.7 percent of GNP.\textsuperscript{47} It now appears that the 0.7 percent goal will not be reached as soon as anticipated. This decrease in aid to the LDCs should not be used as an excuse to ignore environmental safeguards.

Contrary to the majority view, Robert McNamara believes that the LDCs are concerned with the environment:\textsuperscript{48}

It is unfair to suggest that the poor countries are indifferent to the environmental issue, and simply dismiss it out of hand as a rich nation’s problem. They do not.

What they are concerned about, and justly so, is that some of the rich—under the influence of doomsday alarmism—may be tempted to impose unilateral and unreasonable roadblocks on the poor countries’ desperate need to develop.

The poor nations, after all, have no desire to see their own environment contaminated or wantonly abused. But they also have no desire to remain caught in the permanent contamination of poverty.\textsuperscript{49}

The LDCs may be concerned with their environment, but they are definitely more concerned with economic growth. They must be made to realize that there is not necessarily a conflict between the two goals. At the U.N. Conference McNamara stated that:

The question is not whether there should be continued economic growth. There must be. Nor is the question whether the impact on the environment

\textsuperscript{43} See 1974 WORLD BANK ANN. REP. 6-12; Lee Speech No. 3, supra note 2.
\textsuperscript{44} See 1974 WORLD BANK ANN. REP. 12; Lee Speech No. 1, supra note 2.
\textsuperscript{45} See 1974 WORLD BANK ANN. REP. 6-7; Lee Speech No. 1, supra note 2.
\textsuperscript{46} Lee Speech No. 3, supra note 2; see 1974 WORLD BANK ANN. REP. 6-7.
\textsuperscript{47} See McNamara Speech, supra note 1.
\textsuperscript{48} Id.
\textsuperscript{49} Id.
must be respected. It has to be. Nor—least of all—is it a question of whether these two considerations are interlocked. They are.

The solution of the dilemma revolves clearly not about whether, but about how.50

Within the confines of the World Bank, McNamara pioneered a solution to the conundrum of the reconciliation of economic growth and environmental protection. While principle 25 of the Environment Declaration propounded the abstract statement that "[s]tates shall ensure that international organizations play a co-ordinated, efficient and dynamic role for the protection and improvement of the environment,"51 McNamara’s "international organization" had already established an Office of Environmental Affairs 2 years earlier.

III. THE WORLD BANK’S OFFICE OF ENVIRONMENTAL AFFAIRS

In 1970 McNamara established the position of Environmental Advisor to review investment projects of the World Bank from the standpoint of their potential impact on the environment.52 Later, the position was expanded, until it emerged as the Office of Environmental Affairs.53 Its current director is Dr. James A. Lee, and its current role is to examine potential projects for their possible environmental, health, and sociocultural impacts.54 "Identification and analysis of these potential problems often involve field studies by multidisciplined teams operating under carefully tailored terms of reference."55

The process of analysis now begins with project officers who are thoroughly briefed on the World Bank’s environmental criteria.56 Potential borrowers meet with the project officers and the environmental considerations are discussed.57 Then the Environmental Office makes a careful in-house study of the ecological components.58 "If the project warrants it, an on-site 'ecological reconnaissance' study is commissioned by the Bank with the use of qualified consultants."59 If more serious problems are uncovered, a second and more intensive on-site evaluation is undertaken.60 As a general rule, the guidelines promulgated by the Environmental Office take into account not only physical and health-related factors, but also cultural factors:

The fact is that the environmental criteria we have established in the Bank encompass the entire spectrum of development. They consist as a comprehen-
sive checklist of questions designed to insure that foreseeable and injurious environmental consequences are carefully considered from the initial concept of a project, through its design stage, its actual construction, and into its ongoing operations.\footnote{Id.}

The Environmental Office has developed guidelines for agriculture, industry, transportation, utilities, and public health.\footnote{Id.} In these five areas the following topics are considered:

a. environmental resource linkages,
b. project design and construction,
c. operations,
d. sociocultural factors,
e. health impacts, and
f. long-term considerations.\footnote{Id.}

Thus, the examination given any project is detailed and thorough. In the 30-month period between July 1, 1971, and December 31, 1973, the Environmental Office was called upon to review 434 loans and credits from an environmental standpoint.\footnote{Id.} Of the total 434 projects, 275 revealed no apparent potential problems.\footnote{Id.} In 135 projects, the environmental problems were handled by the Bank staff; the remaining 24 projects required special studies by outside consultants.\footnote{Id.} To date, the incremental cost necessary to finance environmental controls has not exceeded 3 percent of the total project cost;\footnote{Id.} however, costs may increase as environmental controls become stricter and as they become incorporated in the kind of technology chosen for the project.\footnote{Id.} If a borrower refused to pay the costs or was unwilling to take reasonable measures in his own interest, the Bank could refuse a loan on environmental grounds.\footnote{Id.} Refusal of a loan could also occur if environmental problems were so severe that adequate safeguards could not be applied.\footnote{Id.} However, no such case has yet arisen, and no loans have been refused on environmental grounds.\footnote{Id.} In fact, McNamara states that ““[s]ince initiating our environmental review, we have found that in every instance the recommended safeguards can and have been successfully negotiated and implemented.”\footnote{Id.}
IV. THE WORLD BANK GROUP

The "World Bank Group" consists of the World Bank itself, formally designated as the International Bank for Reconstruction and Development (IBRD), and its two affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC).73 "The World Bank was created, along with the International Monetary Fund (IMF), at the Bretton Woods Conference of 1944 to meet international financial problems that were envisaged for the postwar period."74 The purpose of the IMF was to finance temporary balance-of-payments deficits, while the Bank was to provide long-term finance for the reconstruction of economies damaged by the war and for the development of the LDCs.75 Thus, the IMF dealt with problems of international liquidity and short-term credit, while the Bank handled the flow of long-term capital for investment purposes across national boundaries.76

Initially, the Bank's lending policy was governed by two conditions. The loan had to be for a specific project, and the Bank could only finance the foreign exchange component of the project.77 However, the Bank has now liberalized its project approach and helps fund many different types of stabilization programs within the LDCs.78 The delegates at Bretton Woods envisioned the Bank as operating mainly to guarantee loans by private investors, rather than making direct loans from its own capital.79 However, from the outset the Bank has emphasized its other purpose, as stated in its Articles of Agreement, "to supplement private investment by providing on suitable conditions finance for productive purposes out of its own capital, funds raised by it, and other resources."80 The Bank now makes loans to the LDCs in the areas of agriculture, industry, and transportation. "Since the Bank obtains most of its funds on commercial terms, it must charge its own borrowers a commensurate rate of

74 International Aid, supra note 73, at 90.
75 Id.; World Bank, World Bank and IDA 3 (1974).
76 Bretton Woods, supra note 7, at 235, 241.
77 The Bank's charter specifies that loans must be:
   a. made for specific projects (except in "special circumstances"),
   b. made for productive purposes,
   c. guaranteed by the government concerned,
   d. granted without prejudice as to country,
   e. made only if there exist reasonable prospects for repayment, and
   f. granted only if there is no other available source.

World Bank, World Bank and IDA 3 (1974); Bretton Woods, supra note 7, at 242.
78 Bretton Woods, supra note 7, at 242.
interest." On the average, Bank loans are repaid over approximately 20 years, and the current rate of interest is 7.25 percent.

Since the Bank's major resources for lending came from private capital markets, it had to fix its terms accordingly. Consequently, the IDA was founded in 1960 to "to provide development financing to less developed countries on terms more flexible and bearing less heavily on their balance of payments than those of the World Bank . . . ." Only members of the World Bank can join the IDA; consequently, all members of the IDA are members of the Bank. Unlike the Bank, the IDA gets virtually all its funds in the form of contributions. "This makes it possible for the Bank Group to help countries that are too poor to borrow from the Bank at all, and to ease the average terms of lending to others that can afford to borrow only a part of their legitimate needs on conventional terms." Nearly all IDA "credits," as they are called, have been given with a repayment period of 50 years. The first 10 years are a grace period; during the second 10 years, 1 percent of the principle is amortized per year; and during the remaining 30 years, 3 percent of the principle is amortized per year. The IDA charges no interest rate but does have a "service charge" to defray administrative expenses, which has uniformly amounted to 0.75 percent per year. Therefore, IDA loans are termed "soft loans"; whereas, IBRD loans, which must charge 7.25 percent, are termed "hard loans":

81 WORLD BANK, WORLD BANK AND IDA 3-4 (1974).
82 Id. at 4.
83 INTERNATIONAL AID, supra note 73, at 91.
85 INTERNATIONAL AID, supra note 73, at 91. Article I of the Articles of Agreement of the International Development Association states that:

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


86 INTERNATIONAL AID, supra note 73, at 91-92.
87 WORLD BANK, WORLD BANK AND IDA 4 (1974). Since 1964 the IDA has received a substantial amount of the World Bank's net earnings to use for IDA loans to the LDCs. See INTERNATIONAL AID, supra note 73, at 95-98. Otherwise, the majority of funds come from the contributions of IDA members under replenishment agreements. The United States has already consented to pay its share. See, e.g., S. Rep. No. 834, 93d Cong., 2d Sess. (1974).
89 Id.; INTERNATIONAL AID, supra note 73, at 104-05.
90 INTERNATIONAL AID, supra note 73, at 104-05.
91 Id.
The soft terms of IDA are granted only to governments. They are not intended to subsidize revenue-producing projects, either in the public or the private sector. Whenever IDA loans are re-lent by governments to such projects, IDA insists that conventional terms of finance be applied in the sub-loans.92

IDA funds are carefully screened and rationed for use in the poorer countries. In order to borrow from the IDA, a country must meet four main criteria:93

a. It must be very poor. Though the "poverty ceiling" varies due to changing circumstances, it is roughly $375 a year of income per capita.94
b. It must have sufficient economic, financial, and political stability to warrant long-term development loans.
c. It must have an unusually difficult balance-of-payments problem and be unable to borrow all it needs on conventional terms.
d. It must have a commitment to development which is reflected in its policies.95

By lending to governments, the IBRD and the IDA are the main avenues for channeling development capital to the LDCs; however, the IFC also contributes by mobilizing private investment.96 Under a provision of the Bank's charter, loans made by the Bank, if not made to governments, required a government guarantee, and this limited the extent to which the Bank could work with the private sector.97 Therefore, the IFC was established in 1956 to supplement the Bank's activities by providing risk capital and financing projects in the private sector without government guarantees.98 The "IFC does not make conventional loans or charge uniform interest rates; the conditions vary with the individual project."99 Most investments have been made at 7 percent per year plus other features, such as additional interest contingent on profits.100 "The usual loan term is from about seven to fifteen years, with serial maturities after an initial grace period."101 "Because of the Bank's position at the center of the world development arena, it is able to focus for the benefit of each member country the knowledge and experience of all."102 IBRD and IDA loans are usually used in a common

92 Id. at 105.
93 WORLD BANK, WORLD BANK AND IDA 5 (1974).
94 This figure was calculated for the WORLD BANK ATLAS for 1972. The 1973 figures for each country and section of the world may be found in INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, WORLD BANK ATLAS (1973).
95 WORLD BANK, WORLD BANK AND IDA 5 (1974).
96 See 1974 WORLD BANK ANN. REP.
97 INTERNATIONAL AID, supra note 73, at 112.
98 Id. at 91.
99 Id.
100 Id. at 112.
101 Id.
102 Id.
103 WORLD BANK, WORLD BANK AND IDA 9 (1974).
package to help an LDC. This is because they can only be made to governments, as distinguished from IFC loans, which are usually made to private sectors. Consequently, projects to help an LDC develop are viewed from the standpoint of IBRD and IDA loans, and most World Bank "analyses" tend to concentrate on the IBRD and IDA.

The World Bank must carefully consider not only how it finances development in the LDCs, but also how it provides for the incremental cost of environmental controls. Ecological safeguards are a prime directive in today's world:

The ever-increasing concern with our ecology has developed into one of the prime objectives of public policy in recent years. Whenever the need for capital investment on a large scale arises, banks and lending institutions generally cannot extricate themselves from these developments. They must be prepared to participate, usually quite extensively, in the financing aspects of business ventures based on the aims of public concern.

One criticism of the World Bank Group has been that it is biased toward the developed countries. "The LDCs complain that the operation of the Bretton Woods system has been biased in favor of the rich countries and that the Fund and GATT must be reformed to promote a transfer of resources from rich to poor countries and to expand the trade of the developing countries." This is an unwarranted criticism which the Bank must refute by continuing to provide as much capital as possible to the LDCs and by perhaps modifying its policy with regard to the funding of environmental costs in its projects. The latter problem is examined in the next section.

V. FINANCING THE ENVIRONMENTAL COST INCREMENT IN WORLD BANK PROJECTS

The policy of the World Bank and the Office of Environmental Affairs has been to examine environmental concerns on a project-by-project basis. Since the Environmental Office was started in 1970, no loan has been refused because a borrowing country would not comply with the Bank's environmental recommendations or because the environmental problems were too large or too expensive to be handled. The Bank's standard procedure has been to increase the amount of the loan, whether it be an IBRD or IDA loan, to accommodate the cost of environmental safeguards. To date, the incremental cost necessary to finance environmental controls has not exceeded 3 percent of the total project cost. Since the incremental cost has been low and since the LDCs

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104 Id. at 6.
105 See INTERNATIONAL AID, supra note 73, at 112-13.
106 See 1974 WORLD BANK ANN. REP.
108 Bretton Woods, supra note 7, at 254.
110 See McNamara Speech, supra note 1.
111 See generally id.
112 WORLD BANK, ENVIRONMENT AND DEVELOPMENT 3, 11-12 (1975).
have been so desperate to alleviate the problems of hunger and malnutrition, disease, rural-urban imbalance, overpopulation, insufficient capital, and unemployment, they have consented to loan increases to provide for environmental safeguards. However, these environmental costs are going to rise as environmental controls become stricter and as they become incorporated in the kind of technology chosen for the project. Worldwide inflation and recession are also going to contribute to the rise in costs of environmental safeguards. As investment capital becomes harder to procure, the LDCs are going to be tempted to reduce their own environmental standards. They are also going to resist increasing their indebtedness to the World Bank for environmental controls and paying conventional interest rates of 7.25 percent on that increment.

Since the money market is going to tighten and since the problems facing the LDCs are so overwhelming, the World Bank can insist that the LDCs continue with the Bank’s present policy, but the LDCs are going to resent it. This year’s reduction in concessionary aid from 0.35 percent to 0.31 percent of GNP has backed the LDCs into an economic corner. The World Bank is one of the few places to which they can still turn for capital. If the Bank does not change its policy regarding the financing of environmental controls, it will soon have a confrontation with the LDCs, or even worse, the LDCs will be forced to lower their own environmental standards or use “backdoor” methods of avoiding environmental expenditures. Since the Bank has worked so diligently to have the LDCs accept incorporation of environmental safeguards into projects, it would be tragic for the Bank to lose its initiative now. The Bank cannot allow its current policy of financing environmental costs to be criticized as being a hindrance to development in the LDCs or as favoring the developed countries.

The solution is for the Bank to make financing of environmental safeguards easier, not harder. Regardless of whether the initial loan is from the IBRD or the IDA, the increment in total project cost necessary to incorporate environmental safeguards should be financed as an IDA loan. In IDA projects there is no divergence from the current policy, because the current policy allows for environmental costs by increasing the amount of the “original loan.” Similarly, IFC projects should still be financed to conform to current policy, because the loans involved go to the private sector. There is no reason to give private investors an advantage over their competitors, who must still comply with and pay for environmental safeguards at conventional rates. In any event, the total number of IFC projects with which the Environmental Office has had to deal is comparatively small. Out of the 434 loans and credits reviewed by the Envi-

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113 Id. at 11-12.
115 See authorities cited note 114 supra.
116 1974 WORLD BANK ANN. REP. 6-7; Lee Speech No. 3, supra note 2.
117 See Bretton Woods, supra note 7, at 254.
ronmental Office between July 1, 1971, and December 31, 1973, only 58 were IFC loans. Of the 58, thirty projects revealed no apparent potential problems; 26 were dealt with by the Bank staff; and only two required special studies.

Therefore, IBRD loans would be the only type of loans affected by the proposed solution. The original cost of the project should still be financed as a conventional IBRD loan at 7.25 percent interest, but the incremental cost of environmental safeguards should be financed as an IDA loan. This would encourage the LDCs to maintain and perhaps improve their environmental standards. It would alleviate or avoid any potential confrontation with the LDCs over the means of financing environmental costs, because in essence it is a grant of money. For the same reason, it would alleviate the problems caused when the costs of environmental safeguards finally rise above 3 percent of the total project cost. It will also help to maintain the liquidity of the LDCs. One of the prerequisites for obtaining an IDA loan is that the LDC must "have an unusually difficult balance of payments problem, and little prospect of earning enough foreign exchange to justify borrowing all it needs on conventional terms." As the money market tightens, the LDCs will definitely have problems borrowing money on any terms. During the current economic situation, international liquidity is going to be affected with resultant effects on credit tranche positions, special drawing rights (SDRs), and stand-by arrangements. The LDCs are going to need capital, and since the IDA already has standards to channel its funds to poor countries, the LDCs will be assured of being the beneficiaries. Another benefit is that the "soft loan" financing of a project's environmental safeguards is almost equivalent to a grant because of its easy terms. Thus, its economic effects can be profitably compared with those of other intergovernmental grants. The "[b]asic forms of grants are the functional grants that are allocated for a specific purpose and the unconditional grants that the local authorities may use as they see fit." Unconditional grants have been used more sparingly than functional grants in the developing countries, and because their distribution is usually not based on good criteria, they are often wasted. On the other hand, "[e]vidence generally supports the

119 Id.
See generally J. Gold, Stand-By Arrangements 147-49 (1970); Bretton Woods, supra note 7, at 267-68; Polak & Argy, Credit Policy and the Balance of Payments, 18 Int'l Monetary Fund Staff Papers 1 (1971).
See H. Aufricht, The International Monetary Fund 64-65 (1964); J. Gold, Stand-By Arrangements 147-49 (1970).
The requirements necessary to qualify for IDA funds were listed in section IV on the World Bank.
See Financing Cities, supra note 5, at 376.
Id. at 377.
belief that functional grants lead to increased local expenditure in the aided categories".127

The extent to which functional aid leads to an increase in the aided categories depends on the "income elasticity" of demand for that function. Should the income elasticity be sufficiently great, the increase in expenditure could be greater than the grant, and budget distortion would occur as funds are drawn away from other expenditure. Income elasticities for the functions examined in the United States—education, health, highways, and public welfare—have generally been sufficiently low that grants have led to a freeing of resources for other purposes.128

Of course, functional grants to LDCs may not produce the same effect as those in the given United States example, but the general view is that grants have led to a freeing of resources for other purposes. In the case of an IDA loan, the moneys freed will be the difference between the 7.25 percent and 0.75 percent loan charges. Though this amount may seem insubstantial, it is not, because there are other benefits. The overall financial situations of the LDCs are improved. The LDCs become more liquid, and their balance-of-payments and credit positions are also enhanced.

It appears that the Bank has always assumed that LDCs would never look elsewhere for their loans. This is probably because it would not have been advantageous for them to do so, but with the tightening economic situation the LDCs may even be willing to enter into unfavorable arrangements. An LDC might refuse the World Bank's increase in an IBRD loan at 7.25 percent and look to concessionary aid for a loan to pay for the incremental cost of environmental controls. While a Western-bloc country might refuse to engage in such a transaction, a Soviet-bloc country might not. A 2.5 percent, 12-year concessionary loan from a Soviet-bloc country is much more attractive than a 7.25 percent loan from the World Bank.129 Though this type of concessionary Soviet-bloc aid is generally small,130 the amounts involved in financing environmental controls are also relatively small. Maximum goodwill could be obtained among the LDCs for relatively minor expenditure. "Soviet countries frequently arrange to accept repayment in the products of the projects assisted. This is attractive to the less developed countries in so far as it gives them an assured outlet for products which they might otherwise have difficulty in marketing abroad."131 Other advantages of this type of arrangement would include the increased liquidity of the LDCs and its resultant benefits.

One final consideration regarding environmental costs involves determining what standards to apply to the projects. Obviously, there are certain standards and technological safeguards which are more expensive than others. "Though

127 Id. at 378.
128 Id.
129 Id.
130 INTERNATIONAL AID, supra note 73, at 428.
131 Id.
the position may soon change, general international law (or customary law) contains no rules or standards related to the protection of the environment as such.132 The Environment Declaration133 is probably closest to a pronouncement of an international standard, but it is more of a subjective statement of principle than an objective standard. A comparison of the environmental standards of different nations shows that there is a wide variance in many instances.134 Many writers have proposed establishing an international environmental agency to set standards,135 including a proposal to create an international equivalent to the Environmental Protection Agency of the United States.136 Another proposal advocates the establishment in Japan of an international environmental center linked in a network to centers in Europe, Canada, the United States, and other countries.137

Thus, it is difficult to determine which standards to apply to a project in a country which has few or no environmental standards of its own. Probably the only reasonable solution is to compare the standards of those countries which are at a comparable stage of development, synthesize them, and apply them to the project country. The Environmental Office's checklists provide good guidelines in this regard.

VI. SUMMARY

The less developed countries have the task of developing their economies as quickly as possible to alleviate the problems of hunger and malnutrition, disease, rural-urban imbalance, overpopulation, insufficient capital, and unemployment. Since they view rapid industrialization as the remedy, they are attempting to do so without adequately considering or allowing for the pollution which necessarily accompanies such industrialization. At the United Nations Conference on the Human Environment, the LDCs demonstrated that they were prepared to sacrifice the environment to rapid industrialization.

133 See Environment Declaration, supra note 5.
135 Caponera, Towards a New Methodological Approach in Environmental Law, 12 NATURAL RESOURCES J. 133, 150-52 (1972); Environmental Economics, supra note 2, at 330.
The World Bank predicted and diagnosed this problem in 1970 and subsequently established an Office of Environmental Affairs. This office reviews loan applications from the LDCs and decides whether or not the project objectives of the loan adequately provide for environmental concerns. The office has set guidelines for projects in the areas of agriculture, industry, transportation, utilities, and public health. If environmental safeguards are inadequate, the World Bank increases the amount of the loan to finance pollution controls. To date, the additional costs of these safeguards have not exceeded 3 percent of the total project cost.

The World Bank grants two basic types of loans for projects. The main branch of the World Bank is the International Bank for Reconstruction and Development, which grants standard loans ("hard loans") to those countries which can repay them at 7.25 percent interest. The other type of loans ("soft loans") are financed through the International Development Association, which provides loans to LDCs on such easy terms that they are almost grants. Under current procedure the World Bank merely increases the amount of the loan to provide for a project's environmental costs. However, in those instances in which LDCs or semi-developed countries are granted "hard loans," the increment necessary for environmental safeguards should be on a "soft loan" or grant basis. This would encourage environmental action in the LDCs, and it would reduce claims by the LDCs that developed nations are trying to retard their industrialization by pressuring for environmental safeguards.

John Warren Kindt