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COMMITTEE ON ECONOMIC AFFAIRS AND DEVELOPMENT

THE ACTIVITIES OF THE BRETTON WOODS INSTITUTIONS (WORLD BANK AND INTERNATIONAL MONETARY FUND)

Draft Report

(Rapporteur: Mrs Verspaget, The Netherlands, Socialist Group)

Summary:

On the occasion of the 50th anniversary of the Bretton Woods institution (World Bank and International Monetary Fund), the Assembly provides a summary and a critical analysis of the achievements of these publicly supported bodies. The aim is to ensure greater accountability as regards their work, and to let social, human rights, democracy and environmental aspects play a more important role in their operations.

In recent years, parliamentarians, Governments and non-governmental organisations have placed these two Bretton Woods bodies under intense scrutiny. This has resulted in a number of reforms, leading to improved effectiveness of their policies and programmes. Nevertheless, they both have to continue their efforts to enhance transparency, public participation and accountability, and they should be allowed to modify their lending policies vis-à-vis regimes guilty of gross violations of human rights. The Assembly should strengthen its co-operation with the World Bank and International Monetary Fund, and monitor their actions and policies.

I. Draft Resolution

1. The Assembly congratulates the Bretton Woods institutions - the International Monetary Fund and the World Bank, both created in 1944, on their 50th anniversary and recognises the considerable contribution they have made to greater economic stability and development in large parts of the world.

2. This anniversary offers an appropriate occasion to start a critical analysis of these publicly supported institutions as regards their functioning and policies, in order to achieve greater public accountability of their operations and to have social, human rights and environmental considerations taken into greater account.

3. Accordingly, the Assembly welcomes the creation of an Inspection Panel at the World Bank, and considers it an important step toward greater transparency, public participation and accountability. It also supports the creation of an independent auditing department within the International Monetary Fund for assessing the social and environmental impact of its programmes, and for measuring IMF programmes against objectives.

4. The Assembly invites the Bretton Woods institutions:

(i) to support in the first instance projects in countries which:

- demonstrate respect for human rights and progress toward democracy;
- initiate economic and social reform essential to the creation of a "civil society";
- avoid excessive military spending and;
- show a willingness to protect the environment;

(ii) to intensify their cooperation with other United Nations development agencies and international organisations on the issues referred to in paragraph 2 above.

(iii) to devise a more streamlined organisational structure, and to observe strict standards of cost-effectiveness in their internal administration.

5. Furthermore, the Assembly encourages the World Bank Group:

(i) to invite shareholders to reconsider the Articles of Agreement, in order to allow the Bank to modify its lending policies vis-à-vis governments guilty of gross, systematic and persistent violations of human rights;

(ii) to further increase the share of World Bank lending directly aimed at poverty alleviation, environmental protection, voluntary family planning, human development, emancipation of women, indigenous ethnic groups and marginalised communities, and in general toward supporting the principles for sustainable development contained in "Agenda 21" and other conclusions of the United Nations Conference on Environment and Development;

(iii) to concentrate its resources more intensively on low-income countries and economies in transition that lack ready access to international capital markets;

(iv) to develop criteria for judging the environmental and social sustainability of loans and projects;

(v) to pay adequate attention also to non-economic determinants of development, and to broaden the concept of "good governance", in particular as regards the institutional and legal framework for development;

(vi) to enhance the Bank's analytical capacity by enhancing the input of social scientists, and to accentuate the multilateral character of the institution through the recruitment of more nationals from Europe and the developing countries;

(vii) to pursue decentralisation of the Bank's organisational structure, and to increase its local presence so as to enable it to deepen its understanding of socio-cultural factors and the political economy of recipient countries;

(viii) to enhance the participation of local populations both at the design and implementation stages of projects, to give greater consideration to the consequences for the poor of structural adjustment programmes, and to encourage greater efficiency and accountability on the part of state officials and public institutions in recipient countries.

7. Furthermore, the Assembly encourages the International Monetary Fund:

(i) to extend the use of the Fund's temporary Systemic Transformation Facility in order to help transition countries in the development of market-oriented economies;

(ii) to lay greater emphasis on individually tailored, country-by-country reform strategies that take into better account particular characteristics and needs, and which build on dialogue with local civil organisations, governments and the competent UN agencies;

(iii) to pay greater attention to the social and ecological consequences of its structural adjustment programmes, and to improve the integration of technical assistance into programme design;

(iv) to ensure that its activities become more open and transparent, so as to allow affected communities and local experts a voice in the shaping of programmes;

(v) to avoid any duplication of effort vis-à-vis the World Bank, notably by limiting the Fund's involvement in efforts at long-term development, and instead to focus on the establishment of a more efficient international monetary system.

8. Since a large part of the funding of the Bretton Woods institutions comes from the Council of Europe member States, the Assembly wishes to strengthen its cooperation with them and to monitor their activities and policies, and for this purpose invites its Committee on Economic Affairs and Development to report on this subject at regular intervals.

II. Explanatory Memorandum

by **Mrs Verspaget**

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A Introduction

1. In its Resolution 952 (1990) on OECD activities, the Assembly called on OECD member countries to "equip the World Bank and the International Monetary Fund with parliamentary observer institutions which can monitor their activities and policies..."

2. The motion for a resolution presented by Mr Holtz and others in December 1993 (Doc. 6982), stresses that "such a parliamentary role is all the more called for since it is the parliaments of participating countries which approve funding of the institutions in question - a large part coming from Council of Europe member States - without, however, having any direct say, except through Executive Directors, over policy. The 50th anniversary, in 1994, of the creation of the two Bretton Woods institutions in question forms a suitable occasion to start the above process..." Referring to its already good cooperation with the two Bretton Woods institutions in question, the motion called for its significant extension on behalf of Europe's citizens and in the continent's political interest.

3. Indeed, members of parliament of the wider Europe have a particular interest in holding regular exchanges of views with these institutions on matters of common interest in the socio-economic and related fields - such as the need for sustained, socially just and environmentally sound development in the world's poorer countries based on democracy and human rights; and the direction of economic reform and the strengthening of human rights and democracy in post-communist Central and Eastern Europe.

4. The aim of the present report is to present current activities and concerns of these institutions in the field of development policy, as well as their role in helping economic reform in Central and Eastern Europe. It draws not only on various documentation, but also on exchanges of views with officials of the IMF and the World Bank, as well as on a Hearing with Non-Governmental Organisations on the theme "Activities of the Bretton Woods Institutions and the Changing North-South Relationship" - organised by the Committee on Economic Affairs and Development in Geneva in December 1994. (A summary of the results of the Hearing is appended to this report).

B The World Bank and its operations

(i) Institutional structure

The " World Bank " is a group of four multilateral financial institutions:

(a) the International Bank for Reconstruction and Development (IBRD);

(b) the International Development Association (IDA);

(c) the International Finance Corporation (IFC); and

(d) the Multilateral Investment Guarantee Agency (MIGA).

While all four organisations are often referred to collectively as the "World Bank Group", it is generally the IBRD which is referred to as "The World Bank".

5. The World Bank was established as a result of series of meetings held by the Allied Powers during World War II to devise a new and more stable international financial structure for the post-war era. These meetings, collectively known as the Bretton Woods Conference, resulted in the establishment of the World Bank as a multilateral financial institution whose chief goal was to help financing the reconstruction and development of war-ravaged Europe. In contrast to the International Monetary Fund (IMF), which was also established at Bretton Woods to promote international monetary cooperation and exchange rate stability, the mission of IBRD was to make available longer-term funds for investment in order to improve economic productivity and foster economic growth.

6. The World Bank's work with respect to the reconstruction and development of the European areas destroyed during the Second World War was successfully completed decades ago. Accordingly, most of the Bank's focus in recent times has been on the development of the large group of former colonies during the 1950s and 1960s. While 32 of the 45 founding members of the IBRD in 1946 were European or Latin American countries, the subsequent influx of Asian and African states has swelled the World Bank's membership to a present total of 177. Nowadays nearly all countries of the world are members of the World Bank. The demise of communism in Central and Eastern Europe and the former Soviet Union has not only brought a new wave of membership applications to the IBRD, but it also means that the World Bank will need to extend its possibilities to further development in the transition economies.

7. Created in 1960, the International Development Association (IDA) was designed to provide assistance for the same purposes as the IBRD, but primarily to poor developing countries. IDA assistance is therefore concentrated on the least developed countries (LDCs) - those with an annual per capita gross national product of US$ 610 or less. More than 40 countries (mostly in Africa) are eligible for IDA assistance under this criterion. Whereas money distributed by the IBRD is deemed a "loan", funds paid out by the IDA are called soft loans.

8. IDA credits are made only to governments, and they are nominally loans that must be repaid, but with a low or without interest. Unlike the IBRD the IDA needs frequent infusions of new contributions from donor governments, and is extremely vulnerable to shifts in the political climate for aid. The Bank holds IDA replenishment discussions approximately every three years. In 1992, the IDA committed a total of US$ 6,550 million in credits.

9. The other two institutions in the World Bank group are the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency. The IFC was established in 1956 in order to assist the economic development of less developed countries, by promoting growth in the private sector and helping to mobilise domestic and foreign capital for this purpose. Membership in the IBRD is a prerequisite for membership for the IFC, which encompasses 146 countries. The MIGA was established in 1988 in order to encourage equity investment and other direct investment flows to developing countries.

(ii) Charter prohibition against consideration of non-economic factors in the Bank's decision-making

10. One of the characteristics of the World Bank is that it observes a less explicit "policy conditionality" than, say, the recently created European Bank for Reconstruction and Development. The World Bank has traditionally refused to consider human rights issues in its loan and grant of aid determinations. This refusal is grounded specifically in the provisions of the Bank's Articles of Agreement, which prohibit the Bank from considering "non-economic factors" in its decision-making.

11. From its inception to the mid-1970s the Bank officially maintained a strict separation between economics and politics, but these spheres were of course interrelated in the sense that economic decisions always have an impact on the political situation. This attitude stemmed from a concern to establish the Bank's credibility as a multilateral institution based on the equal treatment of sovereign states. Hence, in the Articles of Agreement establishing the IBRD loans are to be made "with due consideration given to economy and efficiency, and without regard to political or other non-economic influences" (Article III, Section 5 b). Similarly, the Bank and its officers "shall not interfere in the political affairs of any member; nor shall they be influenced by the political character by the member or members concerned. Only economic considerations shall be relevant to their decisions, and these shall be weighed impartially... " (Article IV, Section 10)

12. Article IV of the Bank's Charter was originally designed to restrain the Bank from interfering in the political affairs of member States, and to prevent members from using financial assistance to advance their own political goals. The political prohibition also applied when the UN General Assembly called on the Bank not to lend to South-Africa or Portugal on the basis of human rights considerations. By the late 1980s, however, there was a growing consensus among member countries as to the legitimate use of "political conditionality", so much so that the Bank now pays great attention in its operations to "good governance".

13. The Bank has traditionally refused to accept restrictions as to whom might be permitted to bid on contracts. In some situations, this approach can be be defended. However, when it is applied to stop governments from requiring, as they ought to, that e.g. only companies prepared to sign "no bribery" pledges and undertakings to disclose (on a confdential basis if need be) the commissions paid to third parties and the size of any "performance-related" bonuses to staff, then clearly such a rule of the Bank can no longer be justified. The Rapporteur firmly believes that the Bank should be encouraged to support such "anti-coruption" pledges, and to foster them positively throughout the developing world. For it to do so would be wholly consistent with its evolving stance on encouraging "good governance".

(iii) 'Good governance' and human rights

14. There are at least four aspects of the Bank's activity that have human rights implications:

(a) the social dimensions of structural adjustment programmes (such as "social safety nets" for the poorest);

(b) the human and ecological implications of large Bank-sponsored projects;

(c) popular participation in the design and implementation of Bank projects; and

(d) civil and political rights as a component of " good governance" .

15. The Bank's current preoccupation with 'good governance' (i.e. increased transparency and accountability in government, adherence to the rule of law) emerged alongside a shift in the 1980s to more policy-based lending in its "Structural Adjustment Programmes" (SAP). While the "good governance" agenda makes no presumption about the political form of government, there is an assumption that the success or failure in achieving sustainable economic development is dependent on the quality of governance. The debate today focuses on how far the governance agenda should be widened to include civil and political rights, or whether it should focus solely on social and economic rights.

16. In June 1994 the Committee held an exchange of views with representatives of the World Bank and the International Monetary Fund. The World Bank representative on that occasion said that the Bank had identified three aspects of governance:

(i) the form of the political regime;

(ii) the process by which authority was exercised in the management of a country's economic and social resources for development; and

(iii) the capacity of a government to design, formulate and implement policies, and discharge functions.

The first aspect is deemed outside the Bank's mandate. Thus it is focusing on the second and third aspects, related to the quality of governance.

17. The Bank is now addressing issues such as the popular participation in the design and implementation of projects, providing social safety nets for poor communities adversely affected by structural adjustment programmes, and strengthening the efficiency and accountability of state officials and structures. However, the Bank will not add concern for civil and political rights to its development mandate, except in circumstances where non-respect of these rights have profound and unequivocal economic effects. In this respect, the General Counsel of the Bank has judged that "the Bank should not allow political factors or events ... to influence its decisions unless... it is established that they have direct and obvious economic effects relevant to its work. For these to be taken into account, such economic effects have to be preponderant". Civil and political rights are nevertheless considered "off limits" because their consideration is seen by some countries as amounting to political interference.

18. The lists of countries receiving World Bank loans or credits in which governments consistently and systematically violate fundamental human rights is long. For instance, despite its bleak human rights record, Indonesia is second only to India in the amount of IBRD loans it receives (15,855 million). A similar case is China where already more than US$ 1000 million has been invested by the Bank. Abuses of civil and political rights are not appropriate "triggers" of the Bank's conditionality, except in rare circumstances. At present there appear to be four such circumstances :

(a) when the Bank must respect binding decisions of the UN Security Council not to lend a particular country for reasons of international peace and security ;

(b) when international sanctions affect the economic prospects of a potential borrowing country;

(c) when an escalation of armed conflict affects the viability of Bank projects;

(d) where it can be unequivocally demonstrated that political phenomena have adverse economic consequences.

19. There are indeed calls for amending the Bank's charter to allow it to consider human rights criteria. (Altering the World Bank's Articles of Agreement requires the assent of 85% of the Bank's voting shares and three-fifths of its members.) In fact, in the 50 years since the establishment of the Bretton Woods institutions the international political and economic situation has undergone major changes, including as regards the relations between developing and developed countries.

20. The World Bank cannot be and is not immune from the momentous upheavals in the international landscape. These include:

(a) the global appeal of human rights and democracy;

(b) the "demonstration effect" when donor countries link human rights with foreign aid in their bilateral development cooperation;

(c) the reference to human rights and democracy in the charter of the European Bank for Reconstruction and Development;

(d) the growing insight that development must concentrate on "human development" capacity to be sustainable.

21. Accordingly, the Rapporteur considers that the Bank's articles of agreement should be revised so as to include the principle of sustainable development and, as a minimum, the respect of internationally recognised human rights, as well as a commitment to eliminate the vicious cycle of poverty, environmental degradation and runaway population growth. The charter of the European Bank for Reconstruction and Development (EBRD) could serve as a useful example guide in this respect.

22. The Rapporteur in addition believes there are several practical steps that can be taken to ensure that human rights considerations are added to the Bank's project criteria and policies. For instance, the Bank should broaden its conception of "good governance",

as regards in particular the legal framework for development. Moreover, the Bank should begin to develop a comprehensive human rights policy, containing the following elements:

(a) promoting social, economic, civil and political rights, especially where these are shown to enhance economic efficiency ;

(b) preparing guidelines for temporary freezes on new policy lending where gross human rights violations have occurred;

(c) providing human rights impact assessments of Bank-funded project proposals; and

(d) adding human rights standards to project loan agreements between the Bank and borrower governments.

23. As a UN Specialised Agency, the Bank should also deepen its cooperation and dialogue with other UN development agencies and with UN human rights bodies, on issues such as governance, human rights and democratic development. this would be in accordance with the appeal of the 1993 World Human Rights Conference, which called on "prominent international and regional finance and development institutions to...assess the impact of their policies and programmes on the enjoyment of human rights".

(iv) Poverty reduction

24. The declared, fundamental objective of the World Bank is to support the reduction of poverty in its member countries. The World Development Report 1990 on Poverty outlined a strategy for reducing this phenomenon based on experiences from developing countries across the world. It reached two primary conclusions:

(i) policies that encourage labour-intensive forms of economic growth should be supported;

(ii) investments in basic social services, including primary education, family planning, and primary health care should be stepped up. Where necessary, these measures should be supported by social safety nets to protect those unable to take advantage of growth, or those who might be adversely affected by macro-economic adjustment processes.

25. Following this report, the Bank accelerated its efforts to make detailed poverty assessments by country: by 1993, 20 such assessments had been completed for 19 countries, containing two thirds of the developing world population (and most of the world's poor), with 68 more scheduled to be completed by mid-1996. The next step will be to incorporate these findings into future assistance strategies - a process that needs to move forward more quickly.

26. All the same, many shareholders perceive the Bank as a primarily financial institution, which should make decisions on financial grounds and led by economic rates of return. Others, particularly in the industrial countries, consider it as an instrument for the propagation of the blessings of the free market and the private sector. Others again claim that it is and should be, predominantly, a development institution. Notwithstanding declarations by the Bank's management that poverty reduction is the overarching

objective, its shareholders, through the Board, are seen as sometimes sending ambiguous messages to staff about what should be the Bank's objectives.

27. One obstacle to transforming the World Bank is the place the institution has come to occupy, at the very centre of the international financial system. To prevent defaults on its own and private bank loans, the Bank has often pursued a strategy of lending still more money. This distracts from its central mission as a development institution, where the quality of projects should matter more than the quantity of funds dispersed. And it may also be counter-productive in that it could compound future debt burdens - creating a vicious circle in which countries are forced to over exploit natural resources in order to generate the foreign exchange needed to pay the loans back.

28. In view of this, recent achievements towards poverty reduction are nevertheless remarkable:

(i) the World Bank Development Report on Poverty has been translated into policies and operational directives;

(ii) lending for supporting investments in people (basic health, education, nutrition), as a share of World Bank (IBRD and IDA) lending, has tripled since the early 1980s, amounting, in 1991-93, to 15 percent of the total. (Lending for human resources development as a share of IDA lending has more than tripled during the same period, and now accounts for 26 percent of all IDA lending.);

(iii) adjustment programmes proposed and financed by the Bank increasingly address social costs, encompass safety nets, and are accompanied by public expenditure reviews in order to protect social spending; in addition, the taboo on military expenditure has been lifted.

29. The Rapporteur believes a number of things have to be done. Firstly, shareholders should confirm poverty reduction as being the overriding mandate and objective of the Bank, and they should commit themselves to monitoring its implementation. Secondly, if the Bank is to become an institution that promotes sustainable development, it will also need to revise the criteria by which it judges success. Projects should be measured by their development impact, not exclusively by their financial rate of return. Therefore, indicators of sustainable development should be developed that take adequate account of social and environmental goals. Attention to these indicators must figure prominently in the ratings that Bank staff assign to projects to measure success.

30. Thirdly, the World Bank Group would be well advised to concentrate its assistance onto those countries where the need is the greatest. This means a more determined "policy of differentiation" for both the IDA and the Bank as a whole. IDA resources should be devoted exclusively to the poorest and least-developed countries, the institutional and technical capacity of which is the weakest. Bank resources should be concentrated more on lower-income countries and economies in transition, both of which normally lack ready access to international capital markets.

31. Finally, some "intellectual gaps" should be addressed by the Bank such as: (a) the impact of macroeconomic policies at the micro level; (b) non-economic determinants of development; (c) the possibilities of tying economic growth more closely with labour-intensive activities. The best way to realise these goals would be for the Bank to improve

its "skill mix", by including more social scientists in its work. In addition, "participatory approaches" should be strengthened by involving NGO's, parliaments and others with a stake in policy dialogue, design, and the implementation of programmes and projects. To achieve this the "project cycle" of any given investment should be redefined, and social impact assessments (impact on poverty) included as a matter of routine - as is already the case for environmental impact assessments.

(v) Lending and project financing issues

32. The Bank's "governance" agenda stems in part from concern about the poor rate of return of many projects. But good governance should also apply to the Bank itself. An absence of transparency and accountability in the Bank's decision-making has contributed to the poor performance of many projects. An internal review (the so-called Wapenhans Report) in 1992 found that world-wide, 39% of borrowing countries are experiencing problems with more than 25% of their Bank-funded projects. As regards the management of the Bank's portfolio, the Committee at its June 1994 meeting was informed by the Bank that there was a direct link between the worsening of global economic conditions in the 1980s and the rate at which projects had failed. In addition, he said, too many projects had simply been too complex, and there was a need to shift the Bank's institutional culture toward greater emphasis on the management of operations under implementation.

33. In recent years the Bank has been the target of growing criticism by groups protesting projects which uproot and resettle communities and destroy fragile environments in the Bank's countries of operation. The Sardar Sarovar Dam in India is considered no more than the tip of an iceberg of complaint. On the question of resettlement of communities, the Committee was informed that while some 10 million people were displaced annually in developing countries as a result of infrastructure projects, those financed by the World Bank affected less than 3% of those moved. The Bank's resettlement policy guidelines call for measures to at least restore the living standards of those resettled, and preferably to improve them. In April 1994 the Bank published a review of projects involving involuntary resettlement between 1986 and 1993. It includes proposals for improving its policies in this area, and for rectifying any unwanted effects of earlier projects.

34. Another recent criticism voiced by environmental groups concerns the Bank's energy loans. These groups maintain that the Bank continues to support energy-inefficient projects based on fossil fuels that contribute to global climatic change. Such projects could severely undermine the International Climate Treaty (which entered into force in March 1994), and are claimed to represent a departure from the Bank's own energy policy guidelines. However, the Rapporteur questions the implication that energy projects based on fossil fuel are inevitably inefficient and automatically contribute to global climate change. We must not deny developing countries the chance to increase energy supplies as long as this can be done efficiently and with proper environmental safeguards. At its June 1994 meeting the Committee was informed that the Bank made twenty-four energy sector loans (ie one in ten loans) in 1993. Each of them included improved efficiency - both on the demand and the supply side - among its objectives.

35. The United Nations Conference on Environment and Development (UNCED) in Rio de Janeiro in 1992 reconfirmed that the central concerns of developing countries are now the acceleration of socio-economic development and the eradication of poverty. Increased

awareness of environmental concerns has put the "environment-poverty" nexus back on the development policy agenda. Growth cannot be sustained for long if it is accompanied by depletion of natural resources or degradation of the environment. However, environmental protection requires major investments in new technology. Developing countries for this reason emphasise the need for additional resources for the implementation of Agenda 21.

36. One of the basic decisions of UNCED was to designate a Global Environmental Facility (GEF), by which additional funding can be channelled to developing countries for the implementation of the Climate Change and Biodiversity Conventions. Under the GEF, countries with a per capita income of $4,000 or less are entitled to special grants. GEF projects are to go into three areas: tackling emissions of greenhouse gas or ozone-destroying chemicals; protecting biodiversity; and reducing pollution of international waters.

37. Two-thirds of the GEF money is allocated to the World Bank, while the rest is administered by the United Nations Development Programme. In its pilot phase, the GEF was seen by many observers as being excessively in the hands of the World Bank, and as not providing sufficient access to information and participation for NGOs and affected local communities. In addition, environmental groups argued, since some 85% of the Bank's GEF projects are in the "large" category, GEF money will only serve to "green" the Bank's overall operations considered environmentally destructive. The Rapporteur considers that the Bank should give serious consideration to remedy these shortcomings.

(vi) Public accountability

38. As an organisation owned by governments, the Bank is fully accountable for its stewardship of public money, and has an obligation to be responsive to the questions and concerns of its shareholders. Most loan documents are considered the property of borrowing governments, and the Bank is not allowed to release these or any other documents while projects are under negotiations. However, this lack of openness often makes it difficult for the public to assess a project until late in the project planning process, when there is little opportunity to have an impact. Non-governmental organisations have therefore advocated important institutional reforms in order to provide greater accountability and "objectivity" in Bank lending practices.

39. The recent creation of a three-person inspection panel within the Bank - which may be called upon when Bank loans are seen to violate its own procedural guidelines and directives and which may report to the Board of Directors - may serve as a starting point in this context. The Rapporteur was heartened to learn that the Bank has recently adopted a new policy on the disclosure of information, by which it will broaden the range of information about its activities that it makes available to the public. At the same time the Bank encourages borrower governments to release as much information as possible on its projects and programmes in an effort to increase local participation in decision-making.

40. Similarly, the Bank has gradually increased the share of its projects that involve collaboration by NGOs, increasing this figure to 30 percent in 1993. It has adopted new operational directives on ways to involve NGOs in Bank-supported activities, and has begun a "learning process" on participatory development, in which 20 existing projects will

be carefully studied to determine the feasibility of introducing participatory approaches more widely.

C The changing role and mission of the IMF

41. The International Monetary Fund was the centrepiece of the Bretton Woods system of fixed exchange rates based on the gold-exchange standard. In 1973, when the system collapsed, the IMF seemed to have lost much of its original mission. However, in reaction to the first oil shock and the resulting widespread balance-of-payment problems its duties were expanded, and in subsequent years the Fund also began to make longer-term loans in addition to its short-term credits.

42. Each member of the IMF has a quota, expressed in Special Drawing Rights (SDR), that is equal to its subscription to the Fund. The quota, reflecting the size of the member's economy, is the most fundamental element in its financial and organisational relations with the IMF (voting power, access to financial resources, etc.) With the demise of communism, the IMF has also become a genuinely world-wide body, as its founders intended. At present the IMF has 179 member countries, and total quotas provided for under the Ninth General Review of Quotas amount to SDR 146 thousand million (US$ 210 thousand million).

43. In this respect, the possibility of a new allocation of Special Drawing Rights (SDRs) - the IMF's instrument for supplementing the currency reserves of its members - is high on the agenda. As repeatedly stressed by Mr Camdessus, Managing Director of the IMF, there has not been a single SDR allocation since 1981, and a pressing need is felt to resort to this instrument in order to bolster international reserves. Not only are reserve levels too low for many developing nations and countries in transition, but 36 of these countries have never received an SDR allocation as they joined the Fund after 1981. However, at the annual meeting of the Bretton Woods institutions in Madrid in October 1994, the Group of Seven industrial countries rejected the plea by developing countries to issue 36,000 million new SDRs, on the grounds that it would create serious inflationary risks. In a rare flexing of their muscles the developing states rejected an offer by the industrial world that would have given them only half of what they wanted, leaving the issue to be resolved at a later date.

44. Another task of the Fund is to assist in the elimination of foreign exchange restrictions in member countries. Despite the immense progress made in the past fifty years in this field, to date only 98 out of the Fund's membership of 179 countries have committed themselves to convertibility of their current accounts, by accepting obligations under the Fund's Article VIII. This Article is a hallmark of the regime of multilateral exchange relations that the Fund was founded to promote: the free convertibility of currencies for transactions of goods and services. In 1993, 11 countries moved to "Article VIII status" (this is more than in any corresponding period since 1961 when most countries in Western Europe accepted Article VIII.)

45. One of the original functions of the IMF was to oversee a system of fixed but adjustable exchange rates. Following the collapse of this system in the 1970s, the IMF assumed as its chief responsibility the monitoring of its member countries' economic policies. (This role is often referred to as the IMF's surveillance function.) While many

organisations offer economic policy advice, there are at least three features which make the Fund unique in this regard:

(i) in accordance with the Fund's Article IV on what is known as the "consultation process", it offers advice to all 179 members - industrial and developing countries alike;

(ii) it provides such advice from a multilateral perspective, and tries to take into account the impact of policy actions by the subject country on the world economy and neighbouring countries; and

(iii) with its virtually universal membership, the Fund is uniquely placed to apply lessons learned in one country when formulating advice to others.

46. In this context the Rapporteur very much agrees with the recommendations of the so-called Commission on the Future of the Bretton Woods Institutions .The Commission's report "Bretton Woods:Looking to the Future", published in July 1994, recommends a "reform of international monetary arrangements and [of] the IMF, and a refocusing of development assistance and the World Bank Group." Because it is a well-established institution, the IMF is far better suited, according to the report, than the informal Group of Seven, to oversee the coordination of macroeconomic policies among the industrial countries.

47. The report therefore recommends that the IMF be given the central role in this activity, as well as in developing and implementing monetary reforms and, in time, monitoring the new central monetary system. In order to permit it to concentrate its energies on these missions, the IMF should, the report continues, "avoid duplicating the functions of the World Bank", limit its involvement in efforts at long-term development, and instead focus on the development of a more efficient international monetary system.

48. In providing resources to support short-term stabilization, however, the Fund should not relax the conditions it attaches to the use of its resources. These conditions - sound macroeconomic policies, a unified exchange rate, and an open payments system - are, according to the report, "exactly the issues on which the IMF should concentrate." In addition, if there is a move toward a centrally managed system of exchange rates, the Fund would have to play a central role, acting as a type of "custodian" over the process of reviewing exchange rates, and providing the mechanism to bring about changes when necessary. Unfortunately the Rapporteur must also add that the recommendations of the Bretton Woods Commission did not receive general support at the Conference on the Future of the Bretton Woods Institutions held in July 1994, nor subsequently from the Fund's shareholders.

(i) Balance-of-payment assistance, economic adjustment programmes

49. As regards financial assistance, the Fund is engaged in providing balance of payment assistance in order to strengthen foreign exchange reserve positions of member countries. For this purpose, a commitment is required from recipient countries to pursue sound economic policies. This commitment is often referred to as the IMF's economic and financial conditionality - expressed through quantitative and qualitative performance criteria (structural measures, interest rates, exchange rate policy) agreed upon before the

programme is undertaken. These measures are carefully tailored to each country's economic situation, and are designed to lend themselves to easy monitoring.

(ii) Special facilities

50. The SAF (Structural Adjustment Facility) was set up in March 1986 to provide loans to support structural adjustment in low-income countries; the ESAF (Enhanced Structural Adjustment Facility) was established in December 1987 to support particularly vigorous adjustment programmes with a higher level of access to IMF financing. Seventy-eight countries are eligible to use the ESAF. As of the end of July 1994, 34 countries had arrangements under the ESAF with total commitments of SDR 4.300 million. In May 1994 total disbursements under this facility amounted to SDR 2.900 million.

51. Under both facilities, adjustment is normally carried out in three successive annual programmes (although the ESAF now provides for a fourth-year arrangement in exceptional cases), which constitute the policy framework elaborated in a policy framework paper (PFP). The PFPs are designed jointly by the country authorities, the IMF, and the World Bank. They establish an agenda for mutually supporting macroeconomic adjustment and structural reforms, and may attract financial support from donors. (The interest rate on ESAF resources is 0.5% with a maturity of 10 years and a grace period of 5 1/2 years.)

52. An enlarged ESAF was initiated by the Executive Board of the Fund in February 1994. At the same time, they added Armenia, Cameroon, Georgia, the Kyrgyz Republic, Tajikistan, and the Former Yugoslav Republic of Macedonia to the list of IMF members eligible to receive loans under this facility. (It is interesting to note that about half of the contributors to the replenishment of this facility are developing countries that have successfully completed previous adjustment programmes promoted by the Fund). The terms and conditions under the new ESAF have remained the same: loans will be provided to low-income member countries that are undertaking three-year structural adjustment programmes to strengthen their balance of payments and improve their growth prospects. It is expected, however, that the programmes will henceforth pay greater attention to social safety nets, better integrate technical assistance into programme design, and also seek to strengthen the quality of public spending.

53. Your Rapporteur feels that in the past the IMF has not paid sufficient attention to the social and ecological consequences of its structural adjustment programmes (SAPs). In many cases (Ghana, Guyana, Cameroon) SAPs have led to an increased selling-off of natural resources and to a decreased monitoring of their management (owing to the uncontrolled operations of foreign companies) in areas such as forestry, mining and agriculture - with an often irreversible impact on nature and indigenous communities.

54. The IMF, however, has informed me that all project proposals now contain an analysis of the social and ecological implications of structural adjustment programmes, and that they pay particular attention to the need for social "safety nets" to protect vulnerable groups during the time the programmes are being implemented. The IMF also believes that it is only through good economic progress that poor countries will be able to attract the necessary financing for such safety nets.

55. Environmental aspects of structural adjustment programmes are of great importance. Admittedly, the IMF cannot be held responsible for all past shortcomings in such programmes from the social and environmental point of view. Your Rapporteur welcomes the greater attention paid now to such vital aspects of development and believes that such attention should become an even more important part of future IMF adjustment programmes.

56. The Fund's stabilisation policies, its insistence on market deregulation, import liberalisation and export growth have often undermined efforts to fight poverty. Another example in this respect are the "free-market revolutions" in Latin America. They have come to be regarded as a success story for the policies advocated by the IMF. However, critics say, these "revolutions" often have only widened already extreme income inequalities and worsened poverty, as they have failed to introduce measures for wealth distribution while doing nothing to protect basic social rights .

57. Again, the IMF does not quite see it this way. It views economic growth as a necessary, although not sufficient, condition for poverty alleviation, and maintains that rapid growth has consistently gone hand-in-hand with a reduction in poverty. The Fund also believes that in countries where market reform efforts were not pushed with sufficient vigor, the growth rate in the 1990s has been insufficient to prevent poverty from increasing further.

58. Important issues relating to the environment, including the composition of public expenditure and the regulatory framework, lie primarily in the area of the World Bank's expertise. Therefore, before imposing new SAPs the IMF should consult with the World Bank on the potential ecological and social impact of these programmes. Both ecological and social safety nets should be in place before SAPs are worked out. In line with Agenda 21 environmental NGOs should be consulted when an environmental policy framework is created with a view to ensuring long-term sustainability of the country's economy, and preventing it from becoming a permanent client of the IMF.

59. The Fund is already enhancing transparency by extending the range of documents which are available for the public. It should also ensure that its activities become more open and transparent, so as to allow affected communities and local experts a voice in the shaping of such programmes. In this regard, the Rapporteur is heartened to learn that the Fund is considering the creation of an independent audit department within the Fund, whose task would be to assess the social and environmental impacts of IMF programmes and conduct evaluations as to their success in reaching stated objectives. In addition, the IMF should encourage OECD countries to implement gradually a fair and ecologically sound trade regime, giving goods and services produced on a sustainable basis by developing countries free access to their markets.

(iii) The activities of the IMF in assisting the economies in transition

60. The main facilities of the Fund for this purpose are:

(a) the stand-by arrangements for supporting 1 to 2 year programmes;

(b) extended facilities provided for multi-year programmes (three years, with a possible fourth), agreed upon with Hungary and Poland (all the others have been standby arrangements);

(c) the compensatory and contingency financing facility (CCFF), provided for countries facing exceptional drops in exports. In general, CCF have not been considered appropriate for economies in transition as the decline in exports have been thought of as stemming from systemic factors and as not being of a temporary nature. These countries used the CCF mainly to import oil during the 1991 Middle East crisis. In the 1990-93 period the Fund disbursed approximatively 1,800 million US dollars under these facilities.

61. Under a new facility introduced in April 1993 and called the "Systemic Transformation Facility" (STF), the Fund provides extraordinary assistance to some member countries experiencing balance-of-payment difficulties as a result of their transformation from non-market-price trade to one based on world prices. The longer repayment terms of the STF recognise the protracted nature of the transition process and help address balance of payments problems stemming from deep-seated structural difficulties.

62. In 1993 disbursements under the STF of about 2,000 million US dollars were made to 11 countries: Belarus, Cambodia, Estonia, Kazakhstan, the Kyrgyz Republic, Latvia, Lithuania, Moldova, the Russian Federation, Slovakia and Vietnam. The Fund is also operating as a catalyst for encouraging financing from other sources. It has informed the Rapporteur that it carried out more than 250 missions of technical assistance in 1993 and 1994 to Central and East European countries - and about twice as many to the Newly Independent States. Many of the missions were in the fields of fiscal policy, banking and financial statistics.

63. The task of making sure that the various lending programmes are mutually consistent is all the harder in Central and Eastern Europe after a third institution - the European Bank for Reconstruction and Development (EBRD) - has entered the scene. The division of labour between the Fund and the World Bank in the transition economies is essentially the same as in its dealings with other members: the Fund is expected to concentrate on macroeconomic stabilisation, while the World Bank will finance either individual projects or investments associated with reforms in particular areas.

64. Some difficulties have nevertheless arisen in the carrying out of this division, in the sense that the Fund's short-term, stand-by lending appears ill-suited to the needs of the transition economies. Most of these countries are not in temporary balance-of-payments difficulties. In order to maintain a satisfactory flow of resources into the region, the Fund is obliged to lend more and for longer periods, as for instance to Russia ($1.5 thousand million) in early 1994. In addition, the separation of the "macro" and the "micro" perspective is difficult to maintain in the reforming economies of Central and Eastern Europe. Close collaboration between World Bank and Fund is therefore essential.

65. Indeed, one weakness in the Fund's policies has been the frequent absence of any linkage between the short-term and long-term effects of reform. Stand-by agreements usually concentrate on policy measures that aim at restoring economic balance within one to three years. This is alright, especially since the Rapporteur believes that the Fund, unlike the World Bank, should not pursue longer-term development projects. However, the Fund should not disregard the long-term implications of its short-term assistance, and thus work in close tandem with the World Bank. This is especially so since certain structural reforms necessary to achieve a stable macro-economic balance have a much longer maturation period - for instance in Central and Eastern Europe. In addition, the

Fund's approach to economic stabilisation has suffered from a certain failure to comprehend fully the economic consequences of a state's political bankruptcy.

66. To this comes the difficulty of managing change by governments inherently weakened by an inherited financial crisis, such as in certain countries in central and eastern Europe. It would be unfair, however, to demand too much of the Fund as it intervenes with host governments. For as the case of Russia has recently shown, not providing support may cause a country to collapse, while giving it too uncritically may lead to further delay by the country in introducing necessary reform. Needless to say, the Fund will never and can never take the place of governments.

67. While on the subject of Russia, it should be pointed out that the Fund's role has been controversial. Its support for the maintenance of the ruble zone, and its hesitation in providing loans, have all been points of friction. On the other hand, the invention of the so-called Systemic Transformation Facility shows the Fund's ability to adapt to unusual circumstances, and its technical assistance programme in Russia started even before the country became a member of the Fund.

D Conclusions

68. The IMF and the World Bank are leading international institutions with significant influence on the economic and political development of developing countries and the transition economies. In addition, they are now the largest source of public development aid for many countries: in 1992 IMF, IBRD and IDA commitments together amounted to nearly US$ 31 thousand million. The policies and programmes of these institutions have an enormous impact on aid recipients, not only through the direct aid given, but also indirectly as models for the aid policies and programmes of governments and regional financial institutions.

69. The main challenge in the coming years will be for both institutions to adapt to a radically different world. Over the past half-century the world has moved from fixed to floating exchange rates, and the industrial countries have long stopped seeking loans from these institutions, preferring private capital markets instead. The emphasis of development philosophy has shifted from government aid to private investment. Now formerly developing countries, especially in Asia, are fast graduating into the "industrial league", and the balance of world economic power is much less concentrated on the powers that dominated the postwar era. These developments have had the effect of changing the Bretton Woods institutions' role. The IMF much less fulfils its original mission of stabilising exchange rates, and pays more attention to structural adjustment. Its clients are now largely identical to those of the World Bank, namely low- and middle-income countries.

70. Under these circumstances the new, basic operational role of the institutions in question can best be defined as one of assisting countries which are, for one reason or another, unable to prosper in the global market system. In that spirit, they should be able to play a decisive role in extending the process of global integration both to the least successful developing countries and to countries engaged in the switch from state planning to the market economy. As a country prospers, however, and improves its links with the global economy, the role of these institutions should diminish, as has been the case historically with Western Europe.

71. Developing countries have long reproached the IMF for setting excessively harsh conditions for its loans and lacking political sensitivity. Criticism against the Fund's conditionality policy has nevertheless subsided in recent years, especially as structural adjustment programmes supported by the Fund have been shown to work in various instances and contribute to progress in countries that have implemented them.

72. On the other hand, the World Bank's adoption of policy-based, structural adjustment lending has led to a growing appreciation that economic reforms may not succeed without taking into account the political climate in which they are undertaken. The Rapporteur believes that the Bank should broaden its understanding of the "good governance" concept, in particular as concerns the legal framework for development. In addition to its core interests in issues such as human resource development, institution-building and economic regulation, the World Bank should pay more attention to subjects such as (excessive) military expenditure, or basic economic and social rights. These are issues that private lenders and investors by their very nature cannot address effectively.

73. The World Bank must maintain its role as a *"financier of development"*, by providing resources and by helping to mobilise other resources - public and private. At the same time, it should strengthen its role as an *"adviser on development"*, and do more to share and apply its global experience. The combination of these roles is what gives the Bank its comparative advantage. The Bank's performance should be primarily judged by the development impact of its projects. A key element in this regard is to increase the participation on the part of those affected by the Bank's operations.

74. At any rate, the traditional project-financing role of the World Bank is rapidly becoming obsolete, as the Bank's own "World Development Report" indicates this year. It rightly points out that world capital markets are mobilising project finance of a kind that was unthinkable a few years ago. Many countries are turning away from the Bank's project loans because private ones are cheaper. Increasingly, such projects will have to be viewed as a sort of aid and, as such, restricted to the poorest countries.

75. Even if the Bank shifts its focus to the least developed countries (and the transition economies), the way ahead is fraught with risk. Large scale aid should be provided only to those countries ready to improve their governance through political and economic liberalisation.

76. In addition, the intense criticism from various quarters of the allegedly harmful human impact of many Bank projects could be channelled through independent inspection panels who would report directly to the executive directors of the Bank and systematically examine the human impact of all Bank projects and policies.

APPENDIX

Main results of the Hearing with Non-Governmental Organisations on the Bretton Woods Institutions (World Bank and International Monetary Fund), and on the Changing North-South Relationship, Geneva 20 December 1994

Representatives of Non-Governmental Organisations Participating:

Dr Ulrich **DUCHROW**, KAIROS - Europa, Heidelberg

Mr Peter **EIGEN,** Director, Transparency International, Berlin

Mr Wouter **VEENING**, President, Environment and Development Resource Centre - EDRC, Bruxelles

Mr Ted **van HEES**, EURODAD, Bruxelles

Ms Susan **GEORGE**, Transnational Institute, Amsterdam

Mr Philip **POTTER,** Former Secretary General of the World Council of Churches, Stuttgart

The NGO participants in the Hearing expressed their general agreement with the contents of the Committee's report. In addition, a number of the representatives made certain more specific comments regarding the Bretton Woods institutions. These are summarised below:

Mrs Susan George, Transnational Institute, Co-Author of the book "Faith and Credit. The World Bank's Secular Empire" (London, 1994):

1. The World Bank is filling a gap left by the near-total absence of a coherent North-South strategy formulated by anybody else. Thus, whether by accident or design, attribution or default, the policy the Bank chooses to apply in its borrowing countries becomes the *de facto* dominant one. The end of the Cold War has given rise to a mixture of indifference and confusion on the part of the rich, industrialised nations towards the South, and towards much of the East as well.

2. The Bank's "hegemony" in defining development and correct policy, its legitimacy in interpreting the world for others and the deference it commands are signs of this state of affairs.

3. This supranational, non-democratic institution functions very much like the Church, or more precisely the medieval Church. It has a doctrine, a rigidly structured hierarchy preaching and imposing this doctrine, and a quasi-religious mode of self-justification.

4. The Bank can be seen as an institution which began marked for a great destiny, but which is now tragically behind the times: one which craves 'intellectual leadership', but cannot necessarily recognise it even in-house; which seems condemned to reproducing a worn-out, bankrupt development paradigm, and thus to do much harm, occasionally responding to criticism but unable to pre-empt it through genuine change.

5. Different forces inside and outside the Bank are pulling it in different directions. However, on the whole, for the Bank to prolong its own economic and political power seems to have become an end in itself. The Bank may talk about the poor, but its policies have so far ensured their continued exclusion.

6. If the Bank does not undertake an intellectual, cultural and strategic revolution, nothing anyone outside does or says can prevent its becoming increasingly irrelevant and its eventual collapse. The obstacles to change are political and ideological as well as institutional. If the Bank intends to make good on its solemn declaration that "sustainable poverty reduction is the overarching objective ... and the benchmark by which our performance as a development institution will be measured", it will have to abandon its obsession with the market.

7. So long as the Bank's decisions are based on what the market says, it will be condemned to impotence with regard to the poor. Only a different politics can change their lot and promote 'sustainable poverty reduction'. It is pointless to ask the market to accomplish what it was never cut out to do.

Transparency International:

1. Corruption is one of the greatest obstacles to development, and as important in this regard as environmental degradation, AIDS, population growth, or indebtedness. Therefore, the IMF and the World Bank have to recognise the priority of controlling corruption. At present it is, however, dealt with reluctantly and as a side-issue, as if attacking it would be in breach of the prohibition in the Bank's Charter against political interference.

2. The current tools of the World Bank - such as procurement, public sector reform, budget control, public sector expenditure programmes, financial records and auditing - are very useful to increase transparency and accountability. They have to be applied and developed more vigorously, with an explicit anti-corruption focus.

3. The IMF/WB staff need professional skills to address this problem (training, consultants, incentive system). Interaction with NGOs and other actors in what could become an "anti-corruption coalition" has to be strengthened.

4. The World Bank should be able to exclude companies which who do not respect internationally agreed guidelines on ethical behaviour from bidding for World Bank-funded projects. "Islands of integrity" could be created among participating companies and countries.

5. Such an effort to control the sources of "grand corruption" would have to be approved by the Board of Directors of the World BAnk. It would probably necessitate amendments to the Procurement Guidelines of the Bank. Presumably, there would be a majority for such a proposal if it is properly prepared.

6. The corrupting impact of development assistance: The Bretton Woods institutions are in a good position to help reduce the corrupting impact that development assistance often brings with it. As part of this effort, the Bank should try to arrange among donors a system to control and reduce the payment of daily allowances, travel expenses and bursaries for officials in recipient countries where this custom has developed.

7. A small, Strategic Expert Round Table with the participation of the IMF and the World Bank, selected leaders of developing countries and NGOs could be organised, in order to prepare anti-corruption strategies to control corruption in international development.

KAIROS - Europa:

1. Would it be feasible to set up a UN "Development Security Council" on a democratic basis (with the participation of various popular movements and NGOs)? It would be entrusted with:

- introducing new criteria for assessing economic effectiveness, oriented toward sustainable development and including social and ecological indicators;

- introducing, on this basis, a new, world-wide tax system for social redistribution (including reparation payments for 500 years of inequitable trade) and to save the environment;

- introducing a more balanced and fair world trade régime in commodities and services between developed and developing countries;

2. Would it be feasible to introduce a tax on developed countries that do not achieve, within a given time period, more balanced trade relations through increased imports from trading partners suffering trade imbalances?

3. Should, and if so how, the IMF be transformed into a "democratically established global central bank", linked to a system of regional and national central banks. Such a bank would be respectful of political, social and ecological priorities, and be responsible to the Ministries (or other political institutions) of economy and planning with, among others, the following functions:

- the issuing of a global currency, similar to the Special Drawing Rights (SDRs), as "parallel money" to - but independent of - national\regional currencies;

- controlling the actors on international capital markets as regards eg securities, thereby making speculation against national central banks impossible;

4. Should, and if so how, the World Bank be transformed into a "global structural development fund"? Such a fund would not issue credits but rather redistribute global taxes on interests and speculation obtained in international capital markets, as well as the "peace dividend", "eco-taxes" and gains made through unequal opportunities in the marketplace. How could organisations of the people be included in the distribution of such funds in the beneficiary countries?

5. In order to overcome the debt crisis, so as to stop its devastating economic, social and ecological effects on the indebted countries in the South and the East, the following measures are suggested:

- reducing the debt owed to industrialised countries, in the realisation that this debt, incurred particularly over the past twenty years, has in effect been repaid through spiralling interest rates; one of the effects of such a reduction would be to reduce the migratory pressure on industrialised countries;

- awarding tax deductions to banks which cancel non-performing debt (instead of nominally maintaining them);

- developing an insolvency law for public entities such as indebted states (by analogy with Chapter 9 of the US insolvency legislation);

- abolishing bank secrecy, not only for drug money but also for that resulting from capital flight, closing tax havens for such money capital and helping the return of capital flight money of corrupt elites to the indebted countries through international agreements;

- developing an international legal system against corruption, capital and tax flight, and enlarging the mandate of the International Court of Justice to deal with economic and financial issues between states, including trials against governments which support or engage in capital flight;

- letting the International Court of Justice decide on the legality of the debtincurred by undemocratic governments in an unconstitutional manner;

6. With regard to structural adjustment programmes of the Bretton Woods institutions, it is suggested to:

- leave aside the "neo-liberal" model which has proven to be not only economically ineffective but in many respects crippling, and instead include social and ecological criteria;

- support those countries which try "Alternative Adjustment Programmes" (ASAPs), and which include not only social and ecological criteria but solicit the participation of the people as is happening at present in Guyana;

- abandon the externally imposed export orientation in agriculture as one of the key elements in structural adjustment programmes, and instead ensure food security and environmental protection in the South, as well as a more mixed, and environmentally sustaining, economy.