House of Commons
Canada

International Financial Institutions

Nineteenth Report of the Standing Committee on Finance

First Report of the Sub-Committee on International Financial Institutions

June 1993

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HOUSE OF COMMONS

Issue No. 68

Tuesday, June 8, 1993

Chairman: Murray Dorin

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Finance

RESPECTING:

Pursuant to Standing Order 108(2), consideration of a draft report

INCLUDING:

The Nineteenth Report to the House

Third Session of the Thirty-fourth Parliament, 1991-92-93

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Fascicule nº 68

Le mardi 8 juin 1993

Président: Murray Dorin

Procès-verbaux et témoignages du Comité permanent des

Finances

CONCERNANT:

Conformément à l'article 108(2) du Règlement, considération d'un projet de rapport

Y COMPRIS:

Le dix-neuvième rapport à la Chambre

Troisième session de la trente-quatrième législature, 1991-1992-1993

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The Standing Committee on Finance

has the honour to present its

NINETEENTH REPORT

In accordance with its mandate under the Standing Order 108(2), your Committee has examined certain international financial institutions and has agreed to report the following:

TABLE OF CONTENTS

LIST OF ACRONYMS

AG	—	Auditor General (of Canada)
BSF	—	Buffer Stock Facility
CCFF	—	Compensatory and Contingency Financing Facility
CIDA	—	Canadian International Development Agency
CIS	—	Commonwealth of Independent States
CUSO	—	Canadian University Students Overseas
EAOD	—	Environmental Assessment Operational Directive
EBRD	—	European Bank for Reconstruction and Development
ED	—	Executive Director
ESAF	—	Enhanced Structural Adjustment Facility
FOMC	—	Federal Open Market Committee (of the U.S. Federal Reserve)
G-7	—	Group of Seven (industrialized countries)
GAB	—	General Agreements to Borrow
GATT	—	General Agreements on Tariffs and Trade
GEF	—	Global Environmental Facility
IBRD	—	International Bank for Reconstruction and Development
ICEDRC	—	Interdepartmental Committee on Economic Relations with Developing Countries
ICSID	—	International Centre for the Settlement of Investment Disputes
IDA	—	International Development Association
IDA-10	—	the tenth replenishment of IDA funds
IFC	—	International Finance Corporation
IFIs	—	international financial institutions
IMF	—	International Monetary Fund
ITO	—	International Trade Organization

LDCs	—	less developed countries
MD	—	Managing Director (of the IMF)
METAP	—	Mediterranean Environmental Technical Assistance Program
MIGA	—	Multilateral Investment Guarantee Agency
MITI	—	Ministry of International Trade and Industry (of Japan)
NEAPs	—	National Environmental-Action Plans
NGOs	—	non-governmental organizations
ODA	—	Official Development Assistance
OECD	—	Organization for Economic Cooperation and Development
RDBs	—	Regional Development Banks
SAF	—	Structural Adjustment Facility
SAL	—	Structural Adjustment Loan
SAPs	—	Structural Adjustment Programs
SECAL	—	Sectoral Adjustment Loan
SDRs	—	Special Drawing Rights
SFF	—	Supplementary Financing Facility
UN	—	United Nations
UNDP	—	United Nations Development Programme
UNICEF	—	United Nations Children's Fund
WFP	—	World Food Programme
WHO	—	World Health Organization

LIST OF RECOMMENDATIONS

Recommendation 1:

The Canadian government should suggest to its G-7 partners that an independent review be undertaken through the G-7 to study the issues facing the IFIs. We believe that this is an opportune time for an international panel, such as the Pearson Commission established by the World Bank in 1968, to examine ways to deal with the current development and financing challenges facing the IFIs. (Page 22)

Recommendation 2:

Among other issues, the international independent review suggested in Recommendation 1 should examine the respective mandates of the IMF and the World Bank. A major question is whether the IMF should devote more of its resources and expertise to short-term stabilization and adjustment financing while development policy should be shaped by the World Bank. (Page 25)

Recommendation 3:

The government should encourage the IMF to examine whether there is a need for a new facility to provide foreign exchange on a quick-disbursement basis to countries either: meeting unexpected, short-term balance of payments problems; or in the process of negotiating an IMF adjustment program. (Page 27)

Recommendation 4:

The government should support additional research by the World Bank and the IMF into the effects of adjustment programs on the poor. It seems to the Sub-Committee that a good place to start would be to put in place, where necessary, mechanisms in member countries for the acquisition of good quality economic data, particularly with respect to income distribution. (Page 30)

Recommendation 5:

The IMF should be encouraged to cooperate with the World Bank, UNICEF and other international aid organizations to channel assistance to those most affected by Fund adjustment programs. (Page 31)

Recommendation 6:

The government should advise the Canadian Executive Directors of the IMF and the World Bank to inquire whether adequate levels of development expenditures, especially in the areas of health, education, sanitation, etc., are being crowded out by the weight of large or rising non-development expenditures, including military spending. (Page 33)

Recommendation 7:

The Government should monitor the progress of the IMF and the World Bank in operationalizing their respective environmental programs. (Page 37)

Recommendation 8:

The Canadian government should carefully review the World Bank's relationship with the Sardar Sarovar project to see that the Bank's criteria for future involvement are fully met. (Page 37)

Recommendation 9:

The Canadian government should encourage the IFIs to take greater account in their lending policies of respect for human rights in terms of the longer-term economic impact. (Page 39)

Recommendation 10:

The Canadian government should strongly encourage the IMF and World Bank to continue to develop a more effective strategy for dealing with the debts of least developed countries. Part of this strategy could include continuing and strengthening the Enhanced Structural Adjustment Facility (ESAF), a mechanism which has reduced the burden of payment for the poorest countries. (Page 41)

Recommendation 11:

The Canadian government should protect funding to IDA. (Page 42)

Recommendation 12:

The Canadian government should suggest that the World Bank study the feasibility of creating its own Ombudsman. (Page 44)

Recommendation 13:

In the interests of better understanding and transparency, the Canadian government should encourage the IMF to expand the amount of information made available to the public regarding the Fund's operations. (Page 44)

Recommendation 14:

In accord with the Auditor General's suggestion to improve the transparency and accountability of the IFIs to Parliament, the Sub-Committee recommends that the government undertake periodic reviews of Canada's participation in these institutions. (Page 46)

Recommendation 15:

Given the Auditor General's report on the extent of Canada's financial commitment to the IFIs, it would be appropriate and prudent for these institutions to receive the continuing attention of Parliament. (Page 46)

Recommendation 16:

The government should evaluate the quality of representation received by the other countries in Canada's constituency at the IMF and the World Bank. (Page 47)

PART I
INTRODUCTION

A. PURPOSE AND SCOPE OF THIS INQUIRY

1. In early 1992 the House of Commons Standing Committee on Finance established a Sub-Committee to "study the management and policies of international financial institutions (IFIs), in particular the IMF and the World Bank Group." Throughout the rest of 1992 and during early 1993 the Sub-Committee on International Financial Institutions (henceforth, the Sub-Committee) examined these institutions and Canada's relations with them.

2. This parliamentary action is one of a series of inquiries concerning Canada's external financial and aid relationships. In June of 1990 the Standing Committee on External Affairs and International Trade tabled a report highly critical of Canada's handling of Third World debt. In June of 1992 the Department of External Affairs and International Trade responded to these concerns with a seminar concerning Canada's "unfinished business of Third World debt."

3. Several participants from this seminar followed up on those issues at a "roundtable" discussion held by the Sub-Committee in June 1992 where representatives from the Bank of Canada, the commercial banks, non-governmental organizations (NGOs), academia, and others involved with the IFIs, exchanged views. On the basis of this roundtable discussion, a paper was prepared for the Sub-Committee in July 1992 to highlight the main issues and establish a basis for further study.[1]

4. In the fall of 1992, an extended session was held concerning the World Bank and the environment. Testimony was heard about a controversial project in India (the Sardar Sarovar dam in the Narmada Valley) from a number of witnesses, including an individual involved in the independent review established by the World Bank to examine problems connected to the project.

5. Subsequently, the Sub-Committee heard from the Canadian Executive Directors of the World Bank and the IMF, after which representatives from the Bank of Canada and the North-South Institute appeared. During the final hearings of 1992, officials from the Office of the Auditor General summarized the results of their particular investigation into Canada's participation in the IFIs.

6. In late January 1993 the Sub-Committee travelled to Washington, D.C. to hear from representatives of the World Bank Group, the IMF, the Canadian embassy, relevant congressional and senatorial sub-committees, and research institutions (the Overseas Development Council and the Alexis de Tocqueville Institution). These meetings included informal sessions with the Canadian Executive Directors of the IMF and the World Bank that followed up their earlier testimony before the Sub-Committee.

7. In February 1993 the Sub-Committee joined the Standing Committee on External Affairs and International Trade and its Sub-Committee on Development and Human Rights and the Standing Committee on Environment to hear the eminent spokesperson from the United Nations Development Programme (UNDP) Dr. Mahbub ul Haq.

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[1] Marcia M. Burdette and Anthony Chapman, *Discussion Paper on International Financial Institutions,* (Ottawa: Library of Parliament, July 29, 1992)

8. Other sessions in February 1993 were held concerning the role and mandate of the IFIs, drawing in former Canadian Executive Directors to the World Bank and IMF as well as professors from both Canadian and American universities. Representatives from the commercial banking sector and the Department of Finance discussed the issues of multilateral debt and conditionality attached to lending. A representative from the International Centre for Human Rights and Democratic Development raised the possibility of broadening the interpretation of the World Bank's mandate to address human rights violations. A final session was held to reflect on possible reforms of the Bretton Woods institutions.

9. In all, the Sub-Committee heard from 37 witnesses who brought to the discussions a broad range of experience in government agencies and departments, private banks, academia, research institutions, non-governmental organizations, and the IMF and World Bank.

B. ORGANIZATION OF THE REPORT

10. Part II of this report provides some background on the IMF and the World Bank Group, including their history, mandates and purposes, administration and structure, and evolution. This section also examines Canada's relationship with the IFIs taking note of the "trilateral approach" of departmental decision-making with respect to these institutions. It summarizes Canada's reasons for participating in, and this country's contribution to, the IFIs.

11. Part III outlines the rationale for the Sub-Committee undertaking such a study at this time. These reasons reflect developments taking place both at the national and international level. Nationally, budget constraints are affecting Canada's overall aid budget. At the same time, the 1992 Auditor General's Report has raised concerns about Canada's potential liability to the World Bank and has suggested ways to make the IMF and World Bank more accountable and transparent to Parliament. At the international level, the Wapenhans report commissioned by the World Bank has raised concerns about the declining success rate of the Bank's projects. And, the World Bank's first ever independent review found serious problems with the way a specific project, the Sardar Sarovar dam in India, was implemented. Renewed interest in Europe and the United States has also raised the IFIs' profile. Finally, concerns have been expressed by developing countries and Japan about the development model used by the IFIs.

12. Part IV, containing the bulk of the report, examines the primary issues affecting the IFIs starting with the goals and mandates of the institutions and the conditionality question. The conditions connected with IMF and World Bank adjustment lending have been much criticized for harming the poor. Under so-called "positive conditionality" some are now recommending that the principle be extended to poverty alleviation, levels of military spending, human rights abuses, and the environment. The section on the environment emphasizes the evidence received by the Sub-Committee regarding the Sardar Sarovar project in India.

13. The second main issue dealt with in Part IV concerns financial and resource constraints. This discussion relates to the still serious LDC debt situation and questions about the IFI role in resolving it. The need for another IMF quota increase and for IDA replenishment is also outlined.

14. The third section deals with management and decision-making at the IFIs, developing some of the evidence that the Committee received with respect to the Wapenhans report on the World Bank loan portfolio.

15. Fourth, the paper examines three aspects of transparency and accountability of the IFIs: 1) to member countries in general; 2) to the Canadian Parliament; 3) and of the Canadian Executive Directors to their other constituencies in the Commonwealth Caribbean and Ireland.

16. Fifth, the report highlights the demand on IFI resources, both financial and human, due to reforms in Eastern Europe and the republics of the former Soviet Union.

PART II

BACKGROUND ON THE IFIs

A. WHO ARE THE IFIS AND WHAT DO THEY DO?

> «On opposite sides of 19th street in Washington, D.C. stand two of the world's most powerful institutions. As lenders in their own right, they directly control billions of dollars each year; indirectly, tens of billions more. They sit in judgement on governments, using their financial clout to influence economic policy in scores of developing countries. The fate of hundreds of millions of people turns on the decisions these institutions make. The world they were most powerful created to serve no longer exists, yet their role is undiminished.[2]»

17. These two institutions, the World Bank and the International Monetary Fund (the IMF), are today the most prominent international financial institutions (or IFIs).[3] They were established in 1944 by the United States, Britain and their war-time allies at Bretton Woods, a village in New Hampshire, as part of a series of arrangements to introduce a new post-war world order. At that time, plans were already under consideration to create the United Nations.

18. The goals of the Bretton Woods Conference were to promote international trade through a system of stable exchange rates and to rebuild the shattered European economies. A new fixed exchange rate regime supervised by the IMF would, it was hoped, discourage the competitive devaluations of the 1930s, which along with the steep international trade barriers of this period, were aptly termed "beggar-thy-neighbour" policies. The International Bank for Reconstruction and Development would be assigned the task of financing the reconstruction of Europe and Japan. The Bank would also be responsible for developing the former colonial possessions of the major powers.

19. The Bretton Woods Conference also discussed the formation of a third institution, an International Trade Organization (ITO), to create and maintain an open trading system. The ITO was never born, however, because the United States Congress refused to ratify the 1947 Havana Charter, creating the institution. An interim agreement, called the General Agreement on Tariffs and Trade (GATT), eventually took over many of the same functions, although it lacked the ITO's institutional provisions.

1. The IMF

a. *Mandate and Purposes of the IMF*

20. According to David Dodge, Associate Deputy Minister of Finance, the IMF is "banker to the central banks of the world."(1:9) As a key component of the international financial system, the IMF traditionally has had two important tasks: first, to advise members on their economic policies; and secondly,

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2 Clive Crook, "Sisters in the Wood: A Survey of the IMF and the World Bank," *The Economist*, (October 12, 1991).

3 The term "IFIs" also includes the regional development banks and funding institutions, such as the International Fund for Agricultural Development (IFAD).

to provide conditional financial assistance to members facing balance of payments problems in order that they can restore their external sustainability.[4] The IMF's basic source of funds is quotas — subscriptions — paid in by all members, partly in their own currency and partly in other, "hard" currencies. Members' relative voting power is determined by the size of their quotas, with Fund decisions reflecting the economic weight of the most important industrial states, the G-7. As explained by the Canadian Executive Director of the IMF, the Fund works like a credit union using subscriptions to lend to members and requiring repayment in order to re-circulate the funds to other members.[5]

21. As a temporary supplement to members' quotas, the IMF also borrows from official sources, primarily the treasuries and central banks of member countries and the Bank for International Settlements. In addition, under the General Agreements to Borrow (GAB), established in 1962, the Fund may borrow up to SDR 17.0 billion in supplementary resources from 11 industrial countries if necessary "to forestall or cope with an impairment of the international monetary system." A further SDR 1.5 billion may be borrowed under an arrangement with the Saudi Arabian Monetary Agency (SAMA) in association with the GAB.[6]

22. The Fund plays "passive" and "active" roles in international monetary affairs. On the passive side, the Fund's surveillance role, involving regular reviews of countries' economic policies, provides an essential "seal of approval", which can also encourage bilateral and commercial lenders to offer financing. A negative review by the IMF, on the other hand, can make it more difficult to obtain external financing. Thus, IMF reviews deeply influence the lending policies of Western governments, private investors and banks.

23. On the active side, the International Monetary Fund (IMF) is the largest single lender to debtor countries, directly controlling about US$200 billion in funds.[7] This makes the IMF the world's key financial adjustment institution, providing short to medium term loans to finance countries' external deficits.

24. Relatively non-controversial are the Fund's activities as a "gentlemen's club" into which members pay a subscription (their quota) and agree to abide by a mutually advantageous code of economic conduct. More controversial are the conditions, or strings attached, to the lending. When the Fund lends money to members having trouble meeting their external financial obligations, it is on condition that they undertake economic reforms to eliminate the disequilibrium. The letters of intent containing the required economic reforms are often a highly guarded secret while the rigor of the required reforms varies with the level of financing necessary. The Fund is dominated by the largest countries, most prominently the United States, which contribute the most money and determine the large agenda. Nevertheless, the professional staff are also very influential in establishing the details of Fund programs.

25. The IMF Articles of Agreement list the purposes of the Fund as follows:

- to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

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4 Canada, House of Commons, Standing Committee on Finance, *Minutes of Proceedings and Evidence*, 3rd Session, 34th Parliament, June 17, 1991, 3:6-7.

5 Interview with Douglas Smee, Canadian Executive Director to the IMF, January 28, 1993, Washington, D.C.

6 "Central Banks and Other Official Entities Help Augment IMF Resources", *IMF Survey*, Supplement on the IMF, (Washington, D.C.: International Monetary Fund, September 1992), p. 24.

7 Connie Mack, "The Two IMFs", *The Wall Street Journal*, (New York: July 6, 1992).

- to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

- to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

- to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

- to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.[8]

b. *Administration and Structure of the IMF*

26. The governing structure of the IMF is composed of the Board of Governors, the Board of Executive Directors, the Interim and Development Committees, the Managing Director and staff.

27. The *Board of Governors* is the highest decision-making body of the IMF. Each member country appoints a Governor, usually the minister of finance or head of the central bank. Each member also appoints an alternate, empowered to vote on behalf of the Governor if he/she is unable to attend a meeting. The Board of Governors decides upon the admission or expulsion of members, the allocation of Special Drawing Rights (SDRs), and the determination of "quotas" for assessed contributions and drawing rights of member states. The Governors usually meet each fall at the joint annual meeting of the IMF and the World Bank.

28. The *Executive Board*: Much of the business of the Fund is carried out by the Executive Board, comprised of Executive Directors (EDs) who select the Managing Director. Since the Board of Governors only meets once a year, it delegates the day-to-day business of the IMF to the 22 (now 24) member Executive Board which is in continuous session at the Fund's headquarters in Washington, D.C.[9] Of the 24 EDs, five are appointed by individual countries and the other 19 are elected by groups of the remaining member countries. The Board's duties involve: policy, operational and administrative matters, including surveillance of members' exchange rate policies; the providing of IMF financial assistance to member countries; consultation with members; and comprehensive studies on important issues.[10]

29. Canada "elects" an Executive Director who also represents eleven other countries, mostly the English-speaking Caribbean countries and Ireland. According to the Department of Finance, this Executive Board "plays a very strong role. Direction is taken by the management of the Fund on these issues, often because it's necessary now, in addition to the fund resources, to find bilateral resources to assist in dealing with some of these countries. So it's a very close working relationship between the board and the IMF management."(1:11)

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8 *Bretton Woods and Related Agreements Act*, RS., 1985, c. B-7, Schedule 1, Article 1.

9 As of September 1992, the number of Executive Board members increased to 24 with Russia and Switzerland gaining seats.

10 "IMF Board of Governors Exercises Many Powers Through Executive Board", *IMF Survey*, Supplement on the IMF, (Washington, D.C.: International Monetary Fund, September 1992), p. 4.

30. The main policy advisor to the IMF's Executive Board is the *Interim Committee*, an inter-ministerial level committee created in 1974 to discuss important policy issues and provide advice to the Board of Governors.[11] The Interim Committee's composition reflects that of the Executive Board with each group of countries represented on the Board entitled to appoint one member of the Committee. The fact that each Committee member is entitled to appoint up to seven Associates, who may also attend meetings, means that, effectively, most individual members are represented. The Interim Committee normally meets twice a year, in April or May and at the time of the Annual Meetings in September or October. Among its tasks are:

- to advise and report to the Board of Governors on the latter's supervision of the management and adaptation of the international monetary system.
- to deal with sudden disturbances that might threaten the international monetary system.
- to consider proposals by the Executive Directors to amend the Fund's Articles of Agreement or to increase quotas.[12]

31. The *Managing Director*: The Managing Director (MD) of the IMF is chosen by the Executive Directors to serve as the Chairman of the Executive Board, to participate on the Board of Governors, and to sit on the Interim Committee and Development Committee. Traditionally, the Managing Director has been a European; the current MD is Michel Camdessus.

32. The IMF is also a partner in the Development Committee[13], which is discussed later in the section dealing with the World Bank structure and administration.

c. *Evolution of the IMF*

33. Throughout the 1950s and 1960s the monetary system supervised by the IMF was based on a system of fixed exchange rates. The system has been called a "gold-exchange" standard because each country's currency was fixed against the principal reserve currency, the U.S. dollar, and the U.S. Federal Reserve stood ready to convert dollars into gold at the rate of US$35 per ounce.[14] A country experiencing a current account surplus, for example, would accumulate dollar reserves which it could then exchange for gold at the pegged rate.

34. The IMF's role in the system was to provide countries experiencing temporary balance of payments disequilibrium with access to foreign exchange reserves in order to maintain the value of their currency without resorting to exchange depreciation, exchange controls, trade restrictions, or internal deflation. However, if the IMF agreed that a country's balance of payments was in "fundamental disequilibrium", it could sanction changes in the value of its currency. The system's weak link was the lack of an effective mechanism for devaluing the dollar.

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11 The Interim Committee succeeded the Group of Twenty, which was established in 1972 in an unsuccessful attempt to reform the monetary system. The Committee was called "interim" because it was supposed to be dissolved once a permanent Council with decision-making powers came into existence. This Council was never established.

12 *International Monetary Fund Annual Report 1992*, (Washington, D.C.: International Monetary Fund, 1992) p. 14.

13 This committee's full title is the Joint Ministerial Committee of the Boards of Governors of the Bank and Fund on the Transfer of Real Resources to Developing Countries.

14 Alone among major industrial countries, Canada maintained a flexible exchange rate from 1950-1962. It shifted to a pegged rate from early 1962 to June 1970. Since then, this country has maintained a flexible exchange rate.

35. Nevertheless, the system worked well until the build up for the Vietnam War in the late 1960s eroded the United States' current account surplus and the so-called international "dollar shortage" of the 1950s disappeared. Expectations that the dollar price of gold would be revalued stimulated private gold speculation forcing the creation of a two-tier gold market in March 1968. At the official level, central banks were supposed to continue to redeem gold at the fixed US$35 per ounce rate while on the private market the price of gold was allowed to fluctuate according to supply and demand. The remaining gold-dollar link was severed in August 1971 when the U.S. announced that the Federal Reserve would no longer automatically redeem dollars for gold. Under the Smithsonian agreement reached by the Group of 10 industrial countries in December 1971, the official price of gold was increased to US$38 per ounce and currencies were realigned against the U.S. dollar.

36. Speculation continued against the dollar requiring a further devaluation of 10% in February 1973. When this change also failed to satisfy speculators, the major currencies were allowed to float against the dollar. Although viewed at the time as a temporary measure, this turned out to be the end of the Bretton Woods system of fixed exchange rates. Since then the major currencies have been allowed to float, with the exception of the European currencies whose values are linked together through the European Monetary System.

37. With the collapse of the Bretton Woods system of fixed exchange rates, some argued that the IMF had outlived its usefulness. In fact, the imbalances caused by the international economic turmoil during the two following decades would probably have required the creation of an institution like the IMF if it did not already exist. In the 1970s two major oil price hikes resulted in large current account deficits in oil importing countries and helped drive inflation to its highest peacetime level ever. Adjustment and financing problems were particularly acute for some developing countries which saw a significant deterioration in their terms of trade.

38. The IMF reacted to the first oil shock by creating special temporary oil lending facilities in 1974 for countries experiencing balance of payments difficulties. In recognition of the medium term structural problems facing a number of borrowers, the Fund introduced a new financing facility for developing countries — the extended fund facility — and in 1975 it liberalized the amount that could be drawn under the existing compensatory financing facility. The supplementary financing facility to provide additional assistance went into effect in 1979. That same year loans to the poorest developing countries were made available on concessional terms through the Trust Fund financed by the sale of a portion of IMF gold reserves.

39. The Fund's primary role evolved from defending exchange rates — primarily those of the industrialized countries — to that of a lending institution with the developing countries as the major clients. The 1980s saw a further deepening of this role as industrialized countries began emphasizing monetary restraint in order to reduce the double digit inflation which had developed in the 1970s. As tight money raised interest rates, some developing countries, which had borrowed heavily from commercial sources, found themselves unable to meet their debt service payments. By 1982 the overall debt of developing countries exceeded US$740 billion and commercial lenders became reluctant to extend further credit.

40. The IMF responded to the debt crisis in two ways — adjustment and financing. First, the Fund financed economic adjustment programs to manage balance of payments disequilibrium. These programs generally included controlling internal demand through prudent fiscal and monetary policies and correcting supply side constraints by liberalizing prices and exchange rates. In recognition that developing countries' quotas were small in relation to their balance of payments problems, the Fund adopted in 1981 a new policy known as "enlarged access" to increase the amount of funds available under stand-by or extended arrangements. For low-income developing countries, the Fund established two facilities, the Structural Adjustment Facility (1986) and the Enhanced Structural Adjustment Facility (1987), providing concessional financing to help implement programs to deal with protracted balance of payments problems.

41. The IMF's second response to the debt problem was to mobilize additional lending by arranging financing packages from bilateral and commercial lenders. Provision of IMF adjustment loans, combined with the Fund's "seal of approval" on a country's economic program, were credited with unlocking between four and seven dollars of financing from bilateral and commercial lenders for every dollar of IMF loans. In recent years, the IMF has come under criticism as the net flow of resources from the Fund to the developing countries has reversed with repayment of the loans made in the early and mid-1980s.

42. Throughout the 1970s and 1980s the IMF took a larger role in advising member countries on their macroeconomic policies and exchange rate practices. This role was institutionalized in the Second Amendment to Article 1 adopted in 1978[15] and since 1985, the Fund has coordinated the monetary policies of the G-7. Most recently, the IMF has been overseeing, and assisting financially, in the restructuring of the former Soviet economy.

43. A measure of the IMF's evolution from a simple credit union into a lending and development institution is provided by the financing facilities the Fund offers. Basic IMF financing is provided according to a series of "tranches." The first, known as the *Reserve Tranche*, is not really a credit tranche at all. "Rather it equals the difference between the country's quota in the Fund and the Fund's holdings of that country's currency."[16] This Reserve Tranche is non-conditional, which means it can be drawn at any time without charges and need not be returned to the Fund.

44. The use of the Fund's general resources is made available through four tranches, each equivalent to 25% of a member's quota. The first *Credit Tranche* purchase can raise the IMF's holdings of a member's currency in the credit tranches to no more than 25% of quota. Purchases under the first credit tranche are subject to low conditionality. Subsequent purchases in higher credit tranches are conditional on the member adopting "policies that provide appropriate grounds for expecting that the member's balance of payments difficulties will be resolved within a reasonable period."[17]

45. Use of the upper credit tranches usually takes place through a *Stand-By Arrangement*, which permits the member to make purchases over a period of time up to a specified amount providing that performance criteria and other specified conditions are met. These arrangements typically cover 12 to 18 months but may extend up to 3 years. An *Extended Arrangement*, which permits the member country to borrow in excess of quota, is also done through a stand-by arrangement. The *Enlarged Access Policy* permits members access to funds in excess of that provided under the four credit tranches and the extended fund facility. It is funded through the Fund's general resources (quotas) and by borrowing from individual members. "The current access limits on stand-by or extended arrangements, individually or combined, are 90 or 110 percent of quota annually; 270 or 330 percent of quota over three years,; and 400 or 440 percent of quota on a cumulative basis, net of repurchases."[18]

46. The last industrial states to draw on credit tranches were Italy and the United Kingdom, which had stand-by arrangements approved by the Executive Board in 1977. Since that time the developing countries have been the major users of IMF funds. Their particular financial vulnerabilities have required innovations in the types of facilities offered.

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15 Non-Governmental Liaison Service, *Trade and Finance in the Multilateral System*, (New York: United Nations) p. 7.

16 *Ibid.*, pp. 10-11.

17 "IMF Provides Resources To Members Under Various Facilities," *IMF Survey*, Supplement on the IMF (Washington, D.C.: International Monetary Fund, September 1992), p. 15.

18 *Ibid.*, p. 16.

47. *buffer stock facility (BSF) was created in 1969 to help members finance international buffer stock schemes involving primary commodities. The facility has not been used for the last six years.

48. *extended fund facility (EFF) was established in 1974 to make funds available to countries requiring assistance to meet balance of payments needs over longer periods of time. Countries drawing on this facility must present a program for the period of the purchase, including an annual list of measures to be undertaken in the next year. The EFF extends over 3 to 4 years with repurchase to take place 4.5 to 10 years after each purchase.

49. *a supplementary financing facility (SFF) temporarily operated between 1979 and 1981 to help finance countries' external deficits until it was superseded by the Enlarged Access Policy.

50. *structural adjustment facility (SAF) created in 1986 to provide balance of payments assistance to low-income countries on concessional terms — an annual interest rate of 0.5%. The Facility's funds are derived from repayments to the Trust Fund, which was originally funded by the sale of IMF gold stocks. "The SAF provides loans to support the medium-term macroeconomic and structural adjustment programs of low-income developing countries with protracted balance of payments problems."[19] The amount potentially available is equal to 70% of each member's quota. In order to gain access to the SAF, members must prepare, with the assistance of the World Bank and IMF staffs, a policy framework paper (PFP) setting out the details of the three year adjustment program they intend to undertake. Borrowers must meet certain quarterly financial and structural benchmarks during the course of the program year.

51. *enhanced structural adjustment facility (ESAF) is similar to the SAF except that adjustment programs under this facility are expected to be particularly ambitious, the funds are disbursed in semi-annual instalments (instead of annually) and the amounts borrowed are larger in relation to the member's quota. ESAF funds are available up to 250% of quota over a three year period but this may be increased to a maximum of 350% of quota under exceptional circumstances. Both SAF and ESAF loans are repaid in 10 semi-annual instalments starting 5.5 years after each disbursement. Like the SAF, the interest rate on ESAF loans is set at 0.5% per annum.

52. *compensatory and contingency financing facility (CCFF) essentially has two elements: compensatory financing to fund temporary declines in export earnings or excesses in cereal cost imports; and a contingency mechanism to finance unfavourable deviations in key variables that are largely beyond the member's control. This might include changes in main import or export prices or international interest rates. Access to the CCFF is limited to 122% of quota with drawings under the CCFF additional to those under the regular credit tranche policies.

53. Following the Gulf crisis of 1990-1991 the Fund allowed emergency relief to member countries seriously affected. This was done by adapting and providing for more flexible use of the existing Fund lending facilities.[20]

2. The World Bank Group

a. *Mandate and Purposes of the World Bank Group*

54. The World Bank is explicitly a development institution, focused on the long term and providing technical assistance as well as project and program funds, mostly to the developing world. Although the Bank's traditional role has been to provide project financing and technical assistance, in recent years it has

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19 *Ibid.*, p. 19.

20 This meant changes to the stand-by, extended, SAF/ESAF arrangements, and the CCFF. Also, an oil import element was introduced temporarily to the CCFF to cover excess costs of imports of crude oil. See: Department of Finance, *Report on Operations Under the Bretton Woods and Related Agreements Act 1991*, p. 9.

shifted some of the emphasis to policy-oriented lending. In fact, the World Bank is not a single institution but a group of institutions. The World Bank Group is comprised of the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA). As used here, the term "World Bank" refers to the IBRD and its affiliate the IDA only.[21]

55. The *International Bank for Reconstruction and Development* (IBRD), was established to aid the post-war recovery of Europe and Japan and to assist the developing countries. The IBRD's mission today is to lend funds at near-commercial rates in support of projects and economic adjustment policies in developing countries. Equipped with a Triple-A credit rating, the IBRD is able to borrow on international capital markets at exceptionally good rates. This enables the IBRD to intermediate the funds to borrowers at lower rates than if developing countries borrowed directly from capital markets. The IBRD is the largest non-sovereign borrower in the world. At June 1992 the IBRD had US$97.1 billion in short and long term debt outstanding, including US$11.8 billion raised in FY1992 through new debt issues.[22] IBRD resources are also derived from retained earnings and repayments on its loans.

56. Established in 1960, the *International Development Association* (IDA) is the "soft loan window" of the World Bank, providing loans to the poorest developing countries for 35 to 40-year periods at zero percent interest. The loans carry only a 0.75% service charge and there is a 10-year grace period before payments are due on the principal. Most IDA funds are contributed by the developed countries but some funds are also derived from the net earnings transferred from the IBRD. In FY1992 the IDA disbursed US$4.7 billion in development credits to developing countries.[23] The IBRD and the IDA share the same staff and have the same Governors and Executive Directors.

57. The *International Finance Corporation* (IFC), established in 1956, "supplements the activities of the [IBRD] and IDA by making and encouraging investments on commercial terms in productive enterprises in developing countries."[24] In FY1992 the IFC approved financing of US$1.8 billion for 167 projects.[25]

58. The *Multilateral Investment Guarantee Agency* (MIGA), established in June 1988 in order to promote private foreign direct investment in developing countries, offers investors risk insurance which cannot be purchased on commercial markets. Such risks can involve restrictions on the transfer of earnings and capital, expropriation of capital, war and civil disturbance. MIGA also provides technical and advisory services to developing member countries.

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21 The term "World Bank" is often applied only to the IBRD. However, the World Bank Annual Report includes both the IBRD and its affiliate, the IDA, under the meaning of the term. It is also the approach taken in this report.

22 *The World Bank Annual Report 1992*, (Washington, D.C.: World Bank, 1992).

23 *Ibid.*

24 Department of Finance, *Report on Operations Under the Bretton Woods and Related Agreements Act 1991*, (Ottawa: Dept. of Finance, 1992) p. 24.

25 *The World Bank Annual Report 1992.*

59. The *International Centre for Settlement of Investment Disputes* (ICSID), established in 1966, is technically a separate international organization from the World Bank Group. The ICSID "seeks to encourage greater flows of international investment by providing facilities for the conciliation and arbitration of disputes between governments and foreign investors."[26]

b. Administration and Structure of the World Bank

60. Although officially a specialized agency under the United Nations (UN) system, the World Bank functions quite autonomously in that it makes independent loan decisions. [27] However, the World Bank often works with various UN agencies, such as the World Health Organization (WHO), the World Food Programme (WFP), and the United Nations Children's Fund (UNICEF), and also has a close working relationship with the United Nations Development Programme (UNDP).

61. The IMF and the World Bank are similar in governing structure and membership. Membership in the IMF is a prerequisite for joining the World Bank but a membership in the Fund does not require joining the Bank.[28] The administration of the Bank is composed of a Board of Governors, a Board of Executive Directors, the Development Committee, the President, officers and staff.

62. *The Board of Governors*: Each participating country appoints a Governor (as well as an alternate) to this Board. Most often these are ministers of finance or heads of treasury or the central bank. The Board's powers include: admitting or suspending members, increasing or decreasing capital stock, reaching cooperative agreements with other international organizations and dissolving the Bank if the members decide.

63. *The Board of the Executive Directors*: This 24-member body, whose powers are delegated by the Board of Governors, is responsible for the day-to-day decision-making of the Bank. The Executive Directors (EDs) exercise authority in three general areas: 1) the allocation of financial and staff resources; 2) review and approval of policy proposals; 3) reviewing evaluations of projects and Bank experience in different sectors and with different policies. Every two years the Governors select the EDs: five are appointed by members holding the largest number of shares and 19 are elected by groups of countries. In 1992 Russia and Switzerland both gained seats on the board.

64. *The President*: The President, who is elected by the Executive Directors, cannot be another ED or be from among the Bank's governors. The President is also Chairman of the Executive Directors but cannot vote except in case of an equal division of the Board. As the Bank's chief operating officer, the President conducts the ordinary business of the Bank under the direction of the EDs. The President is responsible for the organization, appointment and dismissal of the officers, and the staff. By tradition, the President has always been a citizen of the United States. The two most recent chairmen have been Barber B. Conable, a former US Congressman and the now serving President, Lewis Preston, a former banker.

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26 *The World Bank Annual Report 1991*, p. 108.

27 All loans and guarantees are considered international agreements and are registered as such with the United Nations and published in the UN Treaty Series. The World Bank is associated with the UN through the UN Economic and Social Council. See: *Trade and Finance in the Multilateral System*, p. 22.

28 The World Bank and the IMF hold annual meetings together and jointly publish the periodical, *Finance and Development*.

65. *The Development Committee*: The Bank and Fund both participate in the Development Committee, which was established to study and recommend measures to promote the transfer of real resources to developing countries, paying special attention to the problems of the least developed countries. Although this committee has no formal power, because it is composed of Governors from both the Bank and Fund, it has some degree of influence on the policies of these institutions.

c. *Evolution of the World Bank*

66. The IBRD opened for business in June 1946 and the first four loans, approved in 1947, were for the reconstruction of Denmark, France, Luxembourg, and the Netherlands. The first development loan was provided in 1948 for two projects in Chile. Reconstruction lending as such was finished by 1955 but loans to developed countries remained significant until 1967. In fact, much of the IBRD's total lending of US$13 billion through June 30, 1968 represented commitments to developed countries.[29]

67. In the early years, the IBRD's lending policies were relatively conservative in nature, partly because of the perceived need to build a sound image in international capital markets. The IBRD avoided the riskier projects and paid great attention to the credit worthiness of its borrowers, particularly as reflected in the country's debt-service ratio.

68. With the nomination of Robert McNamara as President of the World Bank in 1968 annual lending increased from US$935 million in FY1968 to US$12.4 billion in FY1981, when the Presidency changed. Cumulative lending over the same period rose from US$13 billion to US$92.2 billion.[30] As the Bank discarded its more conservative approach to development lending, staff levels also grew dramatically, from 1,574 persons in FY1968 to 5,201 in FY1981.

69. While in the early years the Bank's focus was almost exclusively on financing infrastructure projects, such as electric power and transportation facilities, the McNamara period saw a shift of emphasis by the Bank away from such projects towards poverty alleviation. Agriculture and rural development became more important rising from just 6% of total lending in the early 1960s to 31% in 1981.[31] Much of this agricultural assistance was aimed at projects that help the rural poor. Financing for low-cost housing and slum rehabilitation was begun during this period and more attention was given to health and population concerns. The large increase in loan disbursements during the McNamara period raised concerns about "an assembly line approach to project preparation."

70. The growth years of the 1970s also saw significant internal organizational changes in the Bank's structure with a number of new units created. A policy-planning unit was set up in 1972; the Agriculture and Rural Development Department was established in 1973; the Urban Projects Department and the Operations Evaluation Department were created in 1975; and the Population, Health, and Nutrition Department was founded in 1979.

71. In the late 1970s the World Bank found the viability of its projects threatened by the unstable economic environment in which they operated. Specifically, large foreign borrowings, followed by high interest rates and an unfavourable shift in their terms of trade, had created balance of payments problems for a number of developing countries. In response, the Bank decided to place more emphasis on getting the economic fundamentals right.

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29 Robert L. Ayres, *Banking on the Poor: The World Bank and World Poverty*, (Cambridge, Massachusetts: MIT Press, 1983) p. 3.

30 *Ibid.*, p. 4.

31 *Ibid.*, p. 2-5.

72. Thus, the Bank began a program of policy-based lending through structural adjustment loans (SALs) and sectoral adjustment loans (SECALs). The SALs emphasize broad macroeconomic reforms involving trade liberalization, investment policy, fiscal policy, monetary policy, and exchange rates. The SECALs, by contrast, tend to focus on microeconomic adjustment in specific sectors. By 1989 adjustment lending accounted for 26% of total World Bank loan disbursements.[32] In the latter half of the 1980s, these adjustment programs came under heavy criticism (along with IMF adjustment programs) for hurting the poor.

73. In FY1991 the Bank put into effect its poverty reduction strategy involving two main components: 1) encouraging broadly based economic growth that generates demand for labour; 2) ensuring that social services, such as primary education, health care, family planning and nutritional services, continue to be provided. It also involves the introduction of a system of targeted transfers to those affected by economic adjustment. Other concerns in recent years include the environment, human resource development, private sector development and funding debt reduction and debt servicing in developing countries.

3. Canada's Relationship with the IFIs

74. Canada has had a long-standing relationship with, and commitment to, the international financial institutions. Canada was present when the Bretton Woods institutions were established and has remained an important contributor helping to finance their lending activities as well as those of the regional development banks (RDBs) for Asia, Latin America, Africa and the Caribbean which developed later. In fact, Canada is the only country which has an Executive Director on all six multilateral development banks, including the new 56-member European Bank for Reconstruction and Development (EBRD).

75. In addition to representing Canada, the Canadian Executive Directors at the World Bank and the IMF speak for Ireland and countries of the Commonwealth Caribbean. Thus, Canada may be representing both borrowing and lending countries at the same time.

76. Since the 1980s the multilateral agencies have concentrated on assisting the developing world but Eastern Europe is now emerging as a potential competitor for funds. Canada's contribution to the financial resources of the various lending facilities of the IMF, the World Bank Group and the four regional development banks, normally falls within the range of 3% to 5% of the total amount. Although this is less than the amounts contributed by major countries, such as the U.S. and Japan, it places Canada in the middle ranks of the contributing members. According to Arthur Wright of CIDA, Canada uses the multilateral institutions to "leverage our contribution by combining it with others and making it more influential thereby."(2:23)

a. Canadian Agencies Involved with the IFIs

77. Three Canadian departments are directly involved with managing Canada's relationship with the IMF and the World Bank: the Department of Finance, the Department of External Affairs and International Trade Canada, and the Canadian International Development Agency (CIDA). Although these departments take a "trilateral approach" in managing policy towards these IFIs, Finance is acknowledged as the lead agency and oversees Canada's financial interests in these institutions. Other government agencies, such as the Bank of Canada, the Export Development Corporation, and Agriculture Canada are also often involved in their particular capacity.

78. External Affairs and International Trade Canada scrutinize the policies of the IFIs to ensure that these are not in conflict with Canadian foreign policy objectives as approved by the Cabinet. Its officials are also concerned that all IFI members pay their fair share, a concept referred to as "burden sharing." Recently,

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32 Congressional Research Service, *World Bank/IMF Adjustment Loans and the Poor in Developing Countries*, (Washington, D.C.: Library of Congress, Feb. 1, 1991), p. 19.

External Affairs has placed new emphasis on issues of structural adjustment, human rights, democracy and good governance. External Affairs has also been strongly involved in defining Canada's interests in European affairs, including those affecting the EBRD.

79. Traditionally, Canada's approach to the IFIs has been to combine pragmatic diplomacy with a strong humanitarian thrust. Recent media reports indicate that External Affairs has undertaken a major review of Canada's international assistance policy, including multilateral aid. The government is apparently weighing the desire to participate in the multilateral organizations against an overall reduction in the development budget. Reportedly, recommendations to the Minister of External Affairs involve protecting current funding levels for the World Bank while cutting the amount contributed to the regional development banks (RDBs).

80. Such an initiative would have a significant impact on CIDA, a quasi-independent agency under External Affairs, which is principally responsible for administering the flows of funds and giving advice to the regional development banks. CIDA also contributes the Canadian portion of the subsidy which permits the IMF to provide ESAF funds on a concessional basis.

81. The Bank of Canada's IFI involvement is almost solely with the IMF, where its institutional interest lies as Canada's central bank. A primary function of the IMF, which is to establish an international framework of monetary cooperation and more open international trade, is of particular interest to the Bank. Recently it has been involved in bridge loans to developing countries operating with Fund programs. The Governor of the Bank regularly attends annual meetings of the IMF and on a more regular basis communicates with the Canadian Executive Director's office.

b. *Reasons for Canada's Involvement in the IFIs*

82. Canada's participation in the International Monetary Fund and the World Bank and its affiliates is authorized under the *Bretton Woods and Related Agreements Act*. According to the Department of Finance, "Canada has always been a very strong supporter of these institutions. As an open economy that has been dependent throughout its history on both foreign trade and financial flows, Canada has had, and continues to have, a major stake in an open, stable international monetary system. Our membership in the Fund gives us a vehicle for promoting this sort of stable financial system and orderly adjustment. Our membership in the World Bank provides us with an effective means of supporting the economic development of developing countries and, in so doing, it also expands commercial opportunities for us abroad."[33]

83. By virtue of Canada's involvement in these institutions, Canadian firms are eligible to bid on World Bank and RDB procurement contracts for development projects in various countries. In FY1992, for example, World Bank cash disbursements to Canadian firms amounted to C$167 million (or 1.85% of total disbursements), placing Canada 12th among recipient countries. In fact, Canadian firms receive approximately $1.12 in procurement disbursements for every dollar that the Canadian government contributes to the World Bank.[34]

84. According to Philip Somerville of the Department of External Affairs, the IFIs are valuable mechanisms for pursuing important Canadian foreign policy objectives, such as global security and economic prosperity. "[T]hese institutions are dealing with activities aimed at promoting economic

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[33] Canada, House of Commons, Standing Committee on Finance, *Minutes of Proceedings and Evidence*, 3rd Session, 34th Parliament, June 17, 1991, 3:7.

[34] Office for Liaison with International Financial Institutions, *Canadian Procurement at the World Bank and Inter-American Development Bank*, (Washington, D.C.: Canadian Embassy, January 1993), p. 2.

development and prosperity, which do in a broad sense contribute to global security and economic growth, but from the point of view of foreign policy, they're also important vehicles for trade and economic interests, general bilateral relations and regional co-operation."(2:5)

85. A developmental rationale was put forward by Art Wright of CIDA who believes that "these institutions have indeed moved from being simply good financial institutions, careful about their loan portfolios and about their credibility in the international financial community, to being quite effective instruments of development."(2:8)

c. *Canada's Contribution to the IFIs*

86. Canada's quota at the IMF is SDR 4,320.3 million reflecting the increase from SDR 2,941 million authorized by the Canadian Parliament in April 1991.[35] Of this subscription, 25% is paid to the IMF in the form of Special Drawing Rights (SDRs), the remaining 75% is paid in Canadian dollars. The payment of SDRs into the Fund amounts to a change in the composition, but not the size, of Canada's international reserves and has no budgetary effect. Most of the Canadian dollar component of Canada's quota is held by the IMF in the form of non-interest bearing demand notes. This liability of the Government of Canada also creates an asset in the form of an increase in Canada's quota at the IMF; there is no effect on the budgetary allocations of the government.

87. The increase in Canada's quota was part of the Ninth General Review of Quotas authorized by the Board of Governors in 1990 that will raise the total of IMF quotas by approximately 50% to SDR 144.8 billion from SDR 97.4 billion (including new members). The quota increase took effect in November 1992 after three-fifths of Fund members, having 85% of the total voting power consented to the IMF's Third Amendment to the Articles of Agreement. This amendment provides for suspension of voting rights of members found to be persistently in arrears to the Fund. The size of Canada's quota will likely increase with the Tenth General Review of Quotas which must be completed by the Board of Governors by March 31, 1993.

88. Voting power at the IMF is determined by the size of the countries' quotas. Canada's voting weight at the IMF is 2.89% but in combination with the other constituencies represented by the Canadian ED, the voting power is 3.69% of the total.[36]

89. At June 31, 1992 Canada's subscription to the IBRD was US$4,864 million, of which US$318.7 million was paid-in and US$4,545 million was callable capital.[37] Canada's total cumulative contribution to the IDA was US$3,491.3 million to the end of the fiscal year ending June 30, 1992, not including the tenth replenishment of the IDA fund, which amounts to C$829 million over three years. Canada's voting power in the IBRD is 3.12% of total votes but because of the other constituencies represented by the Canadian ED, total voting power amounts to 4.61%. Similarly for the IDA, Canada exercises 3.14% of total votes alone, but together with the other countries represented, has total voting power of 4.26%.[38]

90. The Canadian share in the EBRD is 3.4% of the total capital. The amount that will be paid in over the first five years is equivalent to US$127.5 million while the callable capital is US$297 million.(2:31)

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35 SDR 4,320.3 million equals approximately C$7,431 at the current exchange rate of about C$1.72 per 1 SDR; SDR 2,941 million equals C$5,059.

36 *IMF Survey,* (Washington, D.C.: International Monetary Fund, November 30, 1992) p. 367.

37 *The World Bank Annual Report 1992*, p. 207.

38 *The World Bank Annual Report 1992.*

4. The Future: New Demands

91. The global environment is changing rapidly, creating challenges and opportunities for the world's policy-makers. In this new era of globalization, decisions taken in one part of the world affect trade, migration, capital flows, technology and information flows in other regions.[39] Together with this interdependence is greater instability and turbulence with large swings in interest rates, exchange rates, terms of trade and other factors.

92. Although the G-7 has become an important forum for coordinating economic policy, the IMF and the World Bank, continue to fulfill a valuable role. It is significant that, after the collapse of the Bretton Woods fixed exchange rate system 20 years ago, many observers were writing off any future role for the IMF. Of course, events have subsequently proved this conclusion wrong as the roles of both the IMF and the World Bank have increased in relation to other economic institutions, such as the UN agencies.

93. Given the increased turbulence of the world's economic system, there continues to be a need for short to medium term financing provided by the IMF. Where the problems are temporary, this liquidity can enable countries to avoid painful austerity measures. Where the problems are structural in nature, IMF adjustment lending provides medium term financing to implement the necessary economic reforms. As long as a number of countries continue to have persistent problems financing large external debts, adjustment will continue to be a priority. The international debt problem, however, raises questions about the appropriate role for the IFIs. Should the amounts owed to the IFIs by some developing countries be subject to some form of debt reduction? Must both IFIs ensure a continuing positive net flow of resources to developing countries?

94. The need for an institution, such as the World Bank, focused on the world's long-term development needs is, if anything, more pressing today than in 1944 when the Bretton Woods system was designed. The world's population has grown from 2.5 billion in 1950 to about 5.3 billion today with much of that growth accounted for by developing countries. Thus, 77% of the World's population now lives in developing countries.[40] Despite the enormous growth of international capital flows, private markets, it can be argued, do not fully recognize the social return to financing Third World development. Nor can markets be expected to take into account such considerations as equity.

95. A significant new item on the international agenda is the sheer sustainability of global economic growth given the demands this places on the earth's environment. Growth is imperative for developing countries if the quality of life is to improve for the world's 1.4 billion people now living in poverty. However, there is some question about whether this growth can be achieved using the same pattern of growth experienced by the industrialized countries without serious strains on the globe's resources and carrying capacity. Although the IMF and the World Bank have been criticized for slowness in meeting the new environmental challenge, there are signs that both institutions have begun to respond.

96. The Bretton Woods institutions are also trying to meet the challenge posed by the reconstruction of Eastern European and the republics of the former Soviet Union. The IMF, in particular, is now on the front lines in providing policy advice, technical assistance and balance of payments financing in support of macroeconomic and structural reform programs. Accommodating the future demands of this region, as well as those of the less developed countries, is bound to test the resources of these institutions.

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39 This section is adapted from Professor Gerald Helleiner's testimony to the Sub-Committee on International Financial Institutions. See: Canada, House of Commons, Sub-Committee on International Financial Institutions of the Standing Committee on Finance, *Minutes of Proceedings and Evidence*, 3rd Session, 34th Parliament, February 4, 1993, Issue No. 9.

40 United Nations Development Programme, *Human Development Report 1992*, (New York: Oxford University Press, 1992) p. 13.

PART III

THE RELEVANCE OF THIS INQUIRY

A. BUDGET CONSTRAINTS

97. The present time is especially propitious for conducting an inquiry into the IFIs. In the early 1990s, the Canadian government, at all levels, has been experiencing severe budgetary constraints. These have intensified a search for the most effective and efficient use of public funds. When commitments to the World Bank Group, IMF and the new European Bank for Reconstruction and Development (EBRD) are combined, Canada's total commitment exceeds C$10 billion.

98. The Auditor General (AG) indicated that at 31 March 1991, Canada's subscription to the IMF was C$4.6 billion while total commitments to the World Bank Group and the European Bank for Reconstruction and Development were C$5.6 billion. The AG noted that, although a few countries are deeply in debt to the IMF, the Fund does not write off these arrears. Rather, creditor nations receive lower rates of return and borrowing nations pay higher interest rates thereby covering the delinquent accounts. This burden sharing, combined with other financial management and control practices, minimizes the risk that Canada's subscription will be eroded.

99. With respect to Canada's investment in the World Bank and the European Bank for Reconstruction and Development (EBRD), the primary risk for contributing countries, like Canada, is that the callable portion of these institutions' capital subscription could be called in order to pay investors in the institutions' securities. The AG notes that the amount of callable capital invested by Canada in the EBRD and the World Bank amounted to C$5.0 billion at 31 March 1991. According to the AG's 1992 report, "per capita, Canada's subscriptions to the World Bank are the highest of the G-7 countries."[41]

100. The AG notes that "adequate levels of reserves and loan loss provision are a critical defence against a possible call on the Bank's callable capital to meet its obligations created by borrowing or guarantees."[42] The World Bank's loan loss provision rate was 2.5% while the reserve-to-loan ratio was 11.2% at 30 June 1991. Canada and other World Bank members have questioned whether the Bank's current loan loss provisioning rate is adequate given the uncertain global economic outlook, the high level of the portfolio risk indicator and other factors.[43]

101. According to the AG's 1992 report, "The World Bank's current loan loss provision of 2.5 percent seems low in light of the situation on 30 June 1991, when the Bank's management assessed 37% of the loan portfolio as high risk, and 3% as non-accruing; five countries represented 45.1% of the loan portfolio; and

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41 *Report of the Auditor General of Canada to the House of Commons 1992*, (Ottawa: Supply and Services Canada, December 1992), p. 304.

42 *Ibid.*, p. 312.

43 *Ibid.*

loans to countries whose loans have been rescheduled represented 49.4% of the loan portfolio."[44] Consequently, the AG has suggested that the Department of Finance consider calling for an assessment, in collaboration with its G-7 partners, of the loan loss provision rate and the method used to determine it.

102. Yet, remarkably little attention has been paid to Canada's participation in the IMF, the World Bank and the EBRD, perhaps partly because few people, including some legislators, are aware of the true scale of Canada's involvement in these institutions. One concern the AG had in this regard was that the vote wording in the *Appropriations Act*, which provided the legislative authority for funding Canada's contributions to the 1988 World Bank general capital increase, did not clearly disclose that payments to the Bank represent only the paid-in portion, or about 3% of the capital subscription; the vote wording of the *Act* did not bring to Parliament's attention the other 97% of the subscription which is callable capital. The AG noted that, since 1988, the value of callable capital purchased by Canada has been almost C$1.5 billion.

103. Moreover, the Auditor General points out that "[t]he objectives of Canada's participation in the Bretton Woods and related institutions are not clearly and completely stated in any one public document to make Parliament and the public fully aware of why taxpayers' dollars are spent — that is, all the reasons for participation and the concomitant responsibilities — and to provide a basis for assessing results."[45]

104. In the fall and winter of 1992 an immediate crisis in Canada's ODA financing was precipitated as the result of budgetary cuts. These are expected to be deepened in the next budget and in subsequent years. After the 10% cutback announced in December of 1992 from the International Assistance Envelope, various channels — multilateral, bilateral, partnership — will be explored for their effectiveness and efficiency. Therefore, given the current budget constraints and the level of Canada's commitments to the IFIs, it seems both appropriate and useful at this time for the Sub-Committee to be reviewing Canada's participation in these institutions.

B. THE WAPENHANS REPORT

105. The World Bank itself has signalled concerns about the operations of this large institution and its affiliates. In July 1992 the World Bank produced a task force review (the Wapenhans Report) of its loan portfolio and found significant problems.[46] The Report estimated that one-third of all Bank-supported projects failed to perform as well as expected and that the quality of the Bank's loan portfolio had been steadily deteriorating over the past ten years. The number of projects judged unsatisfactory at completion rose from 15% of those reviewed in FY1981 to 30.5% in FY1989 and to 37.5% in FY1991. Project cancellations increased by 50% over the last three years.

106. This decline in the performance of the Bank's loan portfolio was attributed to several factors. One reason given is the Bank's corporate culture which emphasizes the size of resource flows (loan approvals) but pays less attention to project implementation. Another explanation is the excess complexity and multiple conditions applied to projects combined with too little consideration of different country circumstances.

107. The most serious aspect of the Wapenhans Report is not the Bank's declining loan portfolio but that most of the same criticisms of the Bank had been heard before. This raises questions about the Bank's ability to effect a change in its corporate culture.

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44 *Ibid.*

45 *Ibid.*, p. 306.

46 Portfolio Management Taskforce, *Effective Implementation: Key to Development Impact*, Report of the World Bank's Portfolio Management Task Force, (Washington, D.C.: World Bank, 1992).

C. PARALLEL INTEREST IN THE CAPITALS OF EUROPE AND THE U.S.

108. In Europe and the United States, discussions are taking place: on the use of public money to fund the IFIs; about the need for greater accountability of these institutions; and on assessing the impact of the past decade of funding on borrower countries.

109. In the United States, a non-partisan group, called the Alexis de Tocqueville Institution, has undertaken the IMF Assessment Project, involving a comprehensive research and publication program on the Fund. The Institution combines legislators and members of environmental and development groups who have been attempting to make the activities of the IMF more transparent to the general public and to Congress. In 1992 the Institution released its report, "IMF Conditionality 1980-1991," the first in a series of publications the IMF Assessment Project intends to release concerning the Fund.

110. The IMF and World Bank have also been under scrutiny in the U.S. from the various congressional committees, which have used IFI refunding to exercise leverage over the activities of these institutions. The U.S. funding for an expanded IMF quota, for example, was held up in the Senate in the fall of 1992 on grounds of the Fund's lack of accountability to Congress on issues of poverty reduction and the environment.

111. In Europe, the Parliamentarians for Global Action have begun to collect information and testimony on the actions of the IFIs. In the Netherlands, the Forum on Debt and Development has linked together eminent officials, private bankers, researchers, Dutch politicians and relevant government departments to explore international monetary issues during most of 1992 and throughout 1993.[47]

D. SARDAR SAROVAR

112. An important development in 1992 was the release of the Report of the Independent Review of the Sardar Sarovar project. The project, partially financed by US$450 million of World Bank funds, involves building a large dam and reservoir on the Narmada River in India along with an extensive canal and irrigation system to provide water to three Indian states. The Independent Review, commissioned by the World Bank, recommended that the Bank "step back" from the project. Nevertheless, the World Bank's Executive Board voted to give the project a six-month extension (until March 31, 1993) after which time, if certain conditions were not met, the Bank would withdraw.

113. The Independent Review found that there had not been a proper appraisal of the project, nor had there been adequate appraisals of the resettlement of inhabitants, or of the project's environmental impact. Most damaging of all, the World Bank failed to follow its own resettlement and environmental protection policies, raising concerns about management and decision-making at the Bank. To some environmentalists the Sardar Sarovar project is indicative of a general disregard by the Bank of environmental and resettlement issues. Groups, like Probe International, are campaigning actively to have Canada withdraw from the World Bank.

E. THE IFI DEVELOPMENT MODEL

114. Some critics charge that the IMF and the World Bank adhere too closely to a market-oriented, free-trade philosophy that is imposed without regard to the individual circumstances of borrowing countries. IFI policies often involve an economic mix of trade liberalization, price deregulation, and privatization. This IFI vision of the world may be due to the industrialized countries' weight in the voting structures of these institutions.

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[47] The first written product from this group is: Jan Joost Teunissen ed., *Fragile Finance: Rethinking the International Monetary System*, (The Hague: Forum on Debt and Development FONDAD, November 1992).

115. Professor Girvan told the Sub-Committee, "We are having a situation where the leverage that has been gained by indebtedness and weakness of the export sectors, policies of widespread liberalization, neo-liberal policies, are being in effect imposed on a large number of countries."(3:15-16)

116. Other witnesses, however, disputed whether a fundamental disagreement exists between IFI policies and the views of developing countries. A recent communiqué of the G-24 less developed countries, provided to the Sub-Committee by Bill White, is instructive. "The ministers noted that sustained structural adjustment and economic reforms in a growing number of developing countries have led to their improved economic performance."(6:34)

117. Professor Norman Girvan also told the Sub-Committee that "the formula of reliance on the market as producing the solutions to the balance of payments problems, the debt crisis, and the growth problem, is one that really has to be re-examined."(3:41) Professor Girvan argued that state intervention in some countries, such as South Korea, has been very effective in fostering export growth. He believes that, rather than relying on trade liberalization, some form of industrial policy, which targets investment and/or protection to certain export and import sectors, may be the key.

118. This is essentially the conclusion reached by a new Japanese study on industrial strategy in South Korea, Indonesia and India published in 1992 by the World Bank. The study found that government interventions in these countries provided valuable lessons for other developing countries which the Bank had ignored.[48] Japanese finance and aid officials have also reportedly told World Bank officials that structural adjustment policies rely too heavily on trade and market liberalizations. The Japanese favour protecting some high value-added industries until these are competitive internationally.

119. It should be recognized, however, that economists are still debating the contribution of industrial policy to the Japanese economic miracle. Some point to the effect of tariffs and import restrictions and the role played by Japan's Ministry of International Trade and Industry (MITI), which channelled funds into industries that MITI believed reflected the country's future comparative advantage.

120. Others question whether MITI's decisions really altered Japan's growth trajectory significantly. They note that two of the country's best performing industries, automobiles and consumer electronics, were not priorities of Japanese industrial policy. They also point to Japan's high savings rate, the educational system's high standards, good labour-management relations, and a business-oriented culture as possible explanations for Japan's success.[49]

121. Even some of those who attribute part of Japan's economic success to industrial planning, emphasize the country's unique post-war circumstances and question the universal applicability of the model.[50] In fact, the post-war Japanese industrial model may have limited application to present day Japan.

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48 Susumu Awanohara, "More ways to skin a cat", *Far Eastern Economic Review*, (June 18, 1992), p. 60-62.

49 Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy*, (New York: Harper Collins Publishers Inc., 1991) p. 273-274.

50 Kozo Yamamura, "Caveat Emptor: The Industrial Policy of Japan", in Paul R. Krugman ed., *Strategic Trade Policy and the New International Economics*, (Cambridge, Massachusetts: MIT Press, 1986).

122. The World Bank is studying the industrial, financial, trade and labour policies of Japan and other Asian countries with emphasis on the government's role in the process. And World Bank President Lewis Preston is reported to have agreed with some of the Japanese criticisms that the World Bank is excessively reliant on the market. "If there is a system out there that is. . .better than the one we've got, we ought to use it."[51]

F. TRANSPARENCY AND ACCOUNTABILITY

123. The IMF and the World Bank are often viewed by outsiders as opaque institutions which provide only limited information concerning their operations. Some have attributed problems, like those associated with Sardar Sarovar, to a lack of transparency and accountability. NGOs, for example, feel that they are largely left out of the decision-making loop at the World Bank, despite the role played by the NGO-World Bank Committee in discussing important issues. One suggestion is the creation of a World Bank Ombudsman to deal with outside complaints and enquiries.

124. The 1992 Report of the Auditor General of Canada (AG) raised a number of significant points concerning transparency and accountability. As noted earlier, the AG cautioned that the World Bank's loan loss provisioning of 2.5% seems low in light of the riskiness of the Bank's loan portfolio. The AG called on the Department of Finance to seek an assessment, in collaboration with other G-7 countries, of the World Bank's loan loss provision rate. This is important because Canada and other countries are potentially liable to pay the 97% of their subscription that is unpaid capital. In Canada's case, the callable capital purchased since 1988 amounts to C$1.5 billion.

125. The AG's report also called for improvements in the way the government accounts for Canada's participation in the IFIs. Specifically, the AG believes that notes payable to the International Development Association (IDA) — C$885 million at 31 March 1991 — should be shown as liabilities on the government's balance sheet rather than being netted against the investment in the IDA. Also, if subscriptions to the IDA were included in budgetary expenditures at the time of issuance rather than at the time of encashment, the impact on the deficit would be felt earlier.[52]

126. The AG's report also stated that the information provided by the government made it difficult to comprehend the extent of Canada's financial commitment to the IFIs, particularly with respect to the question of callable capital at the World Bank. Other improvements in transparency and accountability suggested by the AG include: formalizing the inter-departmental sharing of responsibilities; encouraging the IFIs to adopt a value for money audit; reviews of Canada's participation in the IFIs; and periodic appearances before parliamentary committees by the Canadian Executive Directors of these institutions.

G. FINANCING EASTERN EUROPE AND THE REPUBLICS OF THE FORMER USSR

127. The scale of the reconstruction necessary in the former Soviet Union and Eastern Europe is now becoming apparent. The IMF is already deeply involved after having approved a stand-by arrangement with Russia that could amount to US$24 billion over a period of years. While the World Bank is less heavily involved financially, it will also provide technical assistance, bringing pressure on its human resources.

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51 Susumu Awanohara, "More ways to skin a cat", 1992.

52 It should be recognized, however, that the Comptroller General agrees with the Department of Finance's current accounting treatment of notes payable to the IDA.

128. The European Bank for Reconstruction and Development has begun financing investments in the region although its mandate limits the amount of lending provided to the public sector. This places extra weight on the IMF and World Bank to finance the region's large public debt. The IMF Board of Governors must complete the Tenth General Review of Quotas by March 31, 1993 and some suggest that the demands of Eastern Europe and the former USSR make a large quota increase mandatory.

Recommendation 1:

The Canadian government should suggest to its G-7 partners that an independent review be undertaken through the G-7 to study the issues facing the IFIs. We believe that this is an opportune time for an international panel, such as the Pearson Commission established by the World Bank in 1968, to examine ways to deal with the current development and financing challenges facing the IFIs.

PART IV

ISSUES AND RECOMMENDATIONS

A. GOALS AND MANDATE OF THE IFIS

129. The world monetary system has undergone enormous changes since the Bretton Woods system was designed in 1944. The collapse of the fixed exchange rate system in 1973 and the growth of private international capital markets have reduced — some would say removed — the need by industrialized countries to utilize IMF resources. At the same time, IMF membership has grown from 40 countries at the end of 1946 to the current 178 countries, including all the states of the former Soviet Union. Near universal membership in the IMF has meant that Fund "borrowers" are now chiefly from the developing world.

130. In this process, the Fund has undergone a fundamental shift in orientation. From a credit union to which all members subscribe in the expectation that each is likely to draw on the institution's resources at some point in time, the Fund has become another sort of financial intermediary, perhaps an investment trust, which borrows from one group of members (the industrial countries) in order to lend to another group (the developing countries).[53] This impression is reinforced by the fact that the IMF may borrow funds from industrial countries under the General Agreements to Borrow and that it finances the enlarged access policy, in part, by means of lines of credit with certain countries.

131. The shift in the nature of the Fund's borrowing clientele has also led to a proliferation in the number and type of borrowing facilities. Not only has the IMF shifted from short term lending into the medium term, it is providing concessional financing through the Structural Adjustment Facility (SAF) and Enhanced Structural Facility (ESAF). This evolution into a quasi development institution belies the IMF's original aim, which was to provide short-term liquidity to fund temporary balance of payments disequilibria.

132. As Professor Gerald Helleiner told the Sub-Committee, "The IMF has found itself in a confused role vis-à-vis the World Bank as source of liquidity. It always used to say that it was not a development agency: 'We're not an aid agency; that's the bank's business'. But now all of a sudden it is. It's offering longer-term finance. It's offering it at highly concessional rates in the SAF and the ESAF and formerly in the trust fund. It's now speaking of conditions, growth-oriented adjustment. It's terribly soulful about poverty, about which it never cared that much before. It even concerns itself with military expenditures and the environment. . .It's an inappropriate gatekeeper for the issues that have traditionally been handled in aid agencies and in the World Bank itself."(9:11)

133. Several witnesses suggested that the IMF was, in effect, undergoing an identity crisis with many among the Fund's staff "wondering what on earth the IMF is getting itself into."(9:11) Roy Culpeper stated that the IMF's "clientele, its modus operandi have all changed substantially in the 47 years since the fund was created. Its staff and its member countries are now racked with uncertainty about the objectives of the institution, its relationship with other organizations, and its overall effectiveness."(6:6)

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[53] Peter B. Kenen, *Financing, Adjustment and the International Monetary Fund*, (Washington, D.C.: The Brookings Institution, 1986) p. 9.

134. Bill White of the Bank of Canada, questioned whether, in fact, "the fund staff is racked with uncertainty about its role, its relationships with others and its effectiveness." If such was the case, "Why has this not spilled out?" In Mr. White's experience, the IMF staff are not concerned about their role, but on how to meet the unprecedented demands currently placed on them by Fund members.

135. If the IMF has been accused of "poaching" in the development field, some have also questioned the World Bank's role in providing balance of payments financing through its structural adjustment loans. Professor Helleiner stated that when the Bank "shifts from project financing to structural adjustment lending and begins to confuse its activities with those of the IMF, offering balance-of-payments loans for a longer term and imposing conditions that relate to the overall macroeconomic policy of the country, it risks getting into areas that are not appropriate for it as well."(9:12)

136. The Sub-Committee received several suggestions for resolving what some saw as a problem of overlap and duplication of services by the IMF and the World Bank. One idea was that the Fund and the Bank be merged into a single institution. Another suggestion was that the IMF de-emphasize its lending operations and concentrate on surveillance, technical assistance and research.

137. Professor Morris Miller argued that the IMF and the World Bank have different functions and amalgamating them would be a "retrograde step." Professor Miller's view was that even closer collaboration between the two institutions might result in the World Bank adopting IMF-style conditionality.

138. Bill White of the Bank of Canada believes that, although there's some degree of overlap between the roles of the IMF and the World Bank, a very large part of what the two institutions do is quite separate and is extremely valuable, each in its own right. "So the idea of a merger in that sense, because of an overlap, strikes me as being excessive."(6:28) Or, as Professor Peter Kenen put it, "Untidiness is not reason enough for revising [the Fund's] constitution."[54]

139. Still another suggestion, put forward by Marcel Massé of CIDA, was that the IMF might evolve into a lender of last resort for the central banks of the member states. This idea seems reminiscent of some earlier proposals, such as that of John Maynard Keynes at the Bretton Woods conference, for the creation of a central bank for central banks, which would issue a currency (the bancor) to be used to settle countries' international obligations. Lord Keynes' International Clearing Union would have imposed charges not only on borrowings from the system but also on excessive balances held at the institution. This would solve the "symmetry problem" where the full burden of international adjustment now falls on those countries with current account deficits. Under the present system, surplus countries have little incentive to stimulate their economies or revalue their exchange rate to correct the current account imbalance.

140. In summary, there was general agreement among Sub-Committee witnesses on the need for the World Bank and the International Monetary Fund to continue operating. As one witness put it, "If there was not an IMF and a World Bank at this time, then it would be necessary to create them."(9:8) Yet, little consensus was achieved on the respective roles of each institution. There also appeared to be some fundamental contradictions in the expectations which some witnesses have of these institutions.

141. On one hand, some witnesses suggested that it was inappropriate for the IMF to be involved in longer-term, development financing, such as that provided through the SAF and ESAF facilities. On the other hand, some decried the short-term, revolving nature of Fund financing which, in recent years, has resulted in net transfers from the developing countries to the IMF; sometimes, the same witness took both positions. Although the Fund was not created to transfer real resources from developed countries to the developing

[54] Peter B. Kenen, *Financing, Adjustment and the International Monetary Fund*, 1986, p. 56.

world, the interest rates of one half of one percent on the SAF and ESAF facilities do represent such a transfer. Thus, it is inconsistent to argue that the IMF should not be involved in development finance (like the SAF and ESAF) but it should maintain net transfers to the developing world.

Recommendation 2:

Among other issues, the international independent review suggested in Recommendation 1 should examine the respective mandates of the IMF and the World Bank. A major question is whether the IMF should devote more of its resources and expertise to short-term stabilization and adjustment financing while development policy should be shaped by the World Bank.

B. CONDITIONALITY

142. Conditionality refers to a set of policies that the IMF and the World Bank require borrowing countries to adhere to as a condition of obtaining funds. Typically, these policies involve structural economic reforms such as: reducing government deficits, devaluing the exchange rate, liberalizing trade policies, removing interest rate controls and privatizing government-owned enterprises. Drawings on IMF resources beyond the member's first credit tranche are subject to conditions while the roughly 25% of World Bank lending associated with structural adjustment comes with such "strings attached."

143. These IMF and World Bank economic programs contained in the loan conditions have been criticized on a number of grounds. Perhaps, the most damaging charge, and the one that the IFIs are most sensitive to, is that their policies hurt the poorest population segment in borrowing countries, especially women and children.

144. A more basic criticism is that IFI adjustment policies are effectively imposed on borrowing countries thereby infringing on their sovereignty. Yet some are now suggesting that the principle of conditionality be extended to cover additional areas, such as poverty alleviation, the environment, human rights and democratic reforms, and military spending. The following sections examine some criticisms levelled at IFI economic programs and evaluate the need for an extension of the conditionality principle into new areas.

1. The Imposition of Conditionality

145. At the birth of the IMF in 1944 there was some debate about whether the Fund should exercise "a grandmotherly influence and control over the central banks of the member countries." By now, however, all countries (both developed and developing) agree that the IMF is justified in attaching conditions to some loans.[55]

146. Nevertheless, certain witnesses disagreed with the way in which, in their view, IFI conditionality was imposed on borrowing countries against their will. Edward Broadbent, for example, stated ". . .those structural adjustment programs, which is a bizarre misuse of language, in my view, to say that these were all voluntarily accepted by the countries involved. It is true in a strict legal sense, but in terms of power relations it is a misnomer in any serious sociological, political analysis to say that those decisions were totally voluntarily accepted by the countries affected."(3:23-24)

[55] Sidney Dell, *On Being Grandmotherly: The Evolution of IMF Conditionality*, Essays in International Finance, No. 144, (Princeton, New Jersey: Princeton University, International Finance Section, October 1981), p. 4.

147. It is important to recognize, however, that countries seeking access to IFI funds are often facing economic crisis with inflation and chronic current account deficits, which can no longer be sustained by available capital inflows. The orthodox economic solution to this problem involves reductions in domestic spending, monetary restraint and exchange rate depreciation. The difficulty is that these measures almost always hurt economically in the short run.[56] On the other hand, studies by the IMF and the OECD show that a country which refuses, or delays, adjustment to a balance of payments problem can impose even greater costs on its economy.

148. As Marcel Massé explained so colourfully to the Sub-Committee, for a country in deep economic difficulties, in this case Guyana, "the real choice is not between going on happily ever after or taking a structural adjustment program and dying of the shock. The choice is between dying anyway, or perhaps with a shock treatment having a chance to be rescued."(9:41)

149. It is true that the IFIs have been the target of angry protests, even riots, because the population believed that IMF or World Bank austerity measures were imposed upon their country. Nonetheless, it is also true that the IFIs have been used as political scapegoats by some governments which lack the courage or political support to make the tough economic choices.[57] In the long run, however, blaming the IFIs for bad news may backfire on governments since by doing so they admit bowing to external pressure thereby losing "legitimacy and thus the ability to mobilize domestic support for their policies."[58]

150. Art Wright of CIDA told the Sub-Committee, "neither the IMF nor the IBRD go into a country and engage in a structural adjustment program unless they are asked to do so. The beginning process is one where they have been invited in because a country realizes it is in a position where it requires assistance."(2:28)

151. Dr. Mahbub ul Haq's testimony also reinforced the need for some countries to undertake adjustment measures. "There is nothing wrong with the IMF's telling the developing countries, you have to balance your budgets. . .Nobody can live beyond their means forever."(8:22) The problem, according to Dr. ul Haq is that the IMF has not concerned itself enough with social effects of where the expenditure reductions are made. The result has been that the country makes the wrong sacrifices, such as cuts in social spending.

152. Although Professor Gerald Helleiner did not appear to dispute the principle of conditional financing, he did argue for a return to low conditionality applied to compensatory and contingency financing arrangements in order to meet the bridge-financing needs of developing countries. "The frequent and large shocks felt by weaker and smaller and typically commodity-dependent countries cannot be handled by high-conditionality finance that takes a long time to negotiate. . .By the time you finish the negotiations and agree on the conditions a substantial time is likely to have elapsed and you may not get the money at all."(9:10)

153. The Sub-Committee recognizes the need for adjustment programs. Countries, like individuals, can only live beyond their means while others are willing to finance their external deficit. Once commercial and bilateral sources of credit run dry, the only alternative is some form of economic adjustment program. In undertaking an IMF or World Bank adjustment program, borrowing countries not only obtain financing, which might not otherwise be available from commercial or bilateral lenders, they receive the benefit of the experience and technical knowledge of these institutions. Furthermore, the IMF seal of approval is often the catalyst that stimulates an inflow of funds from commercial and bilateral lenders.

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56 Rudiger Dornbusch, "Comments, Chapters 7-10," in John Williamson ed., *IMF Conditionality*, (Washington, D.C.: Institute for International Economics, 1983) p. 225.

57 Peter B. Kenen, *Financing, Adjustment, and the International Monetary Fund*, 1986, p. 51.

58 *Ibid.*, p. 52.

154. Nevertheless, the Sub-Committee was impressed with Professor Helleiner's argument that there is a need for more quick disbursing, low conditionality funds to provide bridge loan financing for some developing countries that meet unexpected foreign exchange shortfalls. The idea is not to replace existing high conditionality facilities, which are a necessary component of medium-term adjustment programs. Rather, the proposal would address the need to provide a short-term, low-conditionality source of liquidity for a country: a) meeting unexpected, short-term balance of payments difficulties, which do not require economic adjustment; b) which is in the process of negotiating an adjustment program for which the funds have not yet been disbursed. The Sub-Committee understands that the Compensatory and Contingency Financing Facility (CCFF) is not appropriate for this role because of the relatively high conditionality associated with this mechanism.

Recommendation 3:

The government should encourage the IMF to examine whether there is a need for a new facility to provide foreign exchange on a quick-disbursement basis to countries either: meeting unexpected, short-term balance of payments problems; or in the process of negotiating an IMF adjustment program.

2. Poverty Alleviation

155. A great deal of criticism has been levelled at IMF and World Bank adjustment programs for causing hardship to the poorest segments of the population, particularly women and children. Reports, such as UNICEF's "Adjustment with a Human Face," questioned the IMF and World Bank view that adjustment programs did not hurt the poor.[59]

156. John Munuve, a CUSO officer from Tanzania, told the Sub-Committee that IMF adjustment policies in that country resulted in a shift from food production into coffee and tea cultivation and reduced subsidies for health care and education. The hardship involved in such IMF programs drove Tanzanians into the streets in protest, according to Mr. Munuve.

157. Roy Culpeper of the North-South Institute noted that, "the IMF has acknowledged the fact that the biggest winners of adjustment programs tend to be those with assets and abilities to exploit commercial opportunities. In contrast, the poor often figure among the losers if they lose entitlements to food subsidies, education, and health care."(6:11)

158. The 1989 Commonwealth Expert Group report stated that adjustment policies involving reductions in the public service and spending cuts on health and education affect women particularly. Government posts offer access into the formal sector for some Third World women, albeit usually in lower level jobs. Evidence shows that when these women lose their jobs, they find it more difficult to gain another, partly as a result of discrimination arising from the "male breadwinner ethic." Equally, women and their dependents are disproportionate users of most social services, so cutbacks in these areas affect them more severely.

159. John Mihevc of the Inter-Church Coalition on Africa told the Sub-Committee that the combined effect of the debt crisis and the structural adjustment programs (SAPs) has been identified as the number one issue for the African women represented by the Coalition. "Our women partners euphemistically refer to the structural adjustment programs as 'Sophisticated Arrangements for Poverty'." (3:33)

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59 Giovanni Andrea, Corni *et al.*, ed. *Adjustment with a Human Face. Vol. 1. Protecting the Vulnerable and Promoting Growth*, Sponsored by the United Nations Children's Fund (UNICEF), (Oxford: Clarendon Press, 1987).

160. On the other hand, Art Wright of CIDA informed the Sub-Committee that the adjustment policies being put in place now are quite different from earlier programs. He believes that both the Bank and the Fund have learned over time that cutbacks in educational and health expenses can have a detrimental effect on economic performance as well. (2:29)

161. Assessing the income distribution effects of Fund and Bank adjustment policies has proved difficult because the counterfactual case — what would have happened in the absence of an IFI adjustment program — is impossible to observe and, therefore, must be estimated. Other methods of analyzing the question, such as studying the economic situation before and after an adjustment program, or comparing countries with adjustment programs to those without adjustment programs, can be less satisfactory.

162. One analysis by the IMF based on sample countries found that the largest poverty groups (in most cases the rural poor) were made better off by IMF policies.[60] Nonetheless, other poverty groups, such as the urban poor, may have been made worse off in the short run. Yet the study asserts that the alternative to an orderly stabilization program in these cases would have been much worse.

163. This conclusion is supported by a recent OECD study which examined adjustment measures implemented by seven countries — Chile, Côte d'Ivoire, Ecuador, Ghana, Indonesia, Malaysia and Morocco. Some measures were implemented in cooperation with the IMF, others were carried out independently. "If non-adjustment is defined as a government's refusal to modify its budgetary, monetary or exchange policies — a refusal that compels it, once the possibilities for borrowing abroad have been exhausted, to resort to rationing, beginning with imports — then all adjustment policies are, according to our simulations, more efficient (less fall in economic activity) and more equitable (smaller increases in poverty) than not adjusting."[61]

164. The OECD report further states, "there is a need to refocus political debates about adjustment, which are misleading because comparisons of adjustment and non-adjustment count the costs of adjustment (often confused with the crisis) but do not take into account the costs of not adjusting."[62]

165. Even if the need for adjustment is accepted, it is legitimate to question whether IFI programs might have been more carefully designed or implemented in order to minimize the effects on the poorest population segments.

166. Typically, adjustment programs demand some reductions in government expenditures. The IMF Assessment project found that of 42 IMF programs examined, 86% called for some restriction on overall government expenditure.[63] The Fund does not usually target the various components of government spending, rather it establishes overall goals for government expenditure and other variables and allows the borrowing country to decide on where to make the spending cuts. The official IMF position has been that

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60 Peter S. Heller, *The Implications of Fund-Supported Adjustment Programs for Poverty-Experiences in Selected Countries*, Occasional paper No. 58, (Washington, D.C.: International Monetary Fund, May 1988).

61 François Bourguignon and Christian Morrisson, *Adjustment and Equity in Developing Countries —A New Approach*, (Paris: Development Centre of the Organization for Economic Co-operation and Development, 1992) p. 13.

62 *Ibid.*, p. 13.

63 IMF Assessment Project, *IMF Conditionality 1980-1991*, (Washington, D.C.: Alexis de Tocqueville Institution, 1992), p. 97.

"questions of income distribution should not be part of Fund conditionality."[64] This accords with the IMF Articles of Agreement which require the Fund to "respect the domestic social and political policies of members. . ."[65]

167. On the other hand, if requested by the member country the IMF stands ready to help with income distribution questions. Most letters of intent, which set out the terms of a member country's purchase agreement with the Fund, now refer to the goal of maintaining a social safety net.[66] Nevertheless, this goal must be understood in the context of adjustment programs which usually require overall reductions in government expenditures. These two goals do not necessarily conflict if sufficient reductions can be found in non-social expenditures or if social programs can be designed more efficiently to deliver equivalent (or better) benefits with less money.[67]

168. Unfortunately, the evidence suggests that in practice social programs have been adversely affected by IMF and World Bank adjustment programs. Analysis of a number of IMF programs, for example, indicates that conditionality reduced social welfare spending in three key areas (housing, health care and economic services, such as food subsidies) by 0.8% of GDP/GNP.[68] Admittedly, other types of government spending received deeper cuts — in the range of 1.6% to 3.5% of GDP/GNP.[69] Still, this tends to confirm that in an absolute sense social welfare spending is negatively affected by IMF conditionality.

169. Adjustment programs typically have two main components: 1) demand management; 2) supply side measures. Any orthodox approach to correcting an unsustainable current account deficit necessarily includes a reduction in the growth of demand in order to bring domestic absorption of goods and services more in line with available supply. This is brought about by demand management policies involving some combination of fiscal and monetary restraint and exchange rate depreciation.

170. The second component of most adjustment programs, supply side measures, raise the productive capacity of the country's economy. These policies typically involve deregulation of price and interest rate controls, privatization, trade and investment liberalization (and exchange rate depreciation). Since the effects of demand management policies are felt almost immediately these will tend to dominate supply side measures in the near term. "In the short run, growth losses are likely to accompany stabilization, as the newly favored sectors take time to respond while newly disfavored sectors contract." Over the long run, however, "benefits of stabilization are likely to outweigh these costs, especially where trade-regime bias is eliminated.[70]

171. The Bank and the Fund have argued that adjustment programs, by establishing conditions favourable to growth, will also raise the incomes of the poor. This argument has been attacked on two fronts. First, some have argued that IFI policies have sacrificed economic growth in an effort to adjust to balance of

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64 *IMF Annual Report 1990*, p. 41.

65 Articles of Agreement of the International Monetary Fund, Article IV(3)(*b*).

66 IMF Assessment Project, *IMF Conditionality 1980-1991*, p. 100.

67 *Ibid.*

68 *Ibid.*, p. 101.

69 *Ibid.*

70 William R. Cline, "Stabilization in Developing Countries," in John Williamson ed., *IMF Conditionality*, (Washington, D.C.: Institute for International Economics, 1983) p. 190.

payments disequilibrium. As already noted, most orthodox adjustment programs necessarily involve some combination of spending cuts, monetary restraint and devaluation. Therefore, this criticism is essentially a technical debate about the appropriateness of the macroeconomic mix, or the speed or sequencing of economic reforms.

172. Second, and more tellingly, it is argued that pro-growth strategies — a rising tide that raises all boats — is not sufficient to protect the poor because, in the short to medium term, adjustment policies reduce demand and government social services. This was the argument put forward by the UNICEF report "Adjustment with a Human Face." Other groups, such as the Bank Information Centre[71] and the NGO Working Group on the Bank[72] have concurred in this assessment but go further in calling for measures to address the issue of income distribution in the long run rather than using so-called short-term, band-aid solutions to poverty alleviation.

173. One of the obstacles facing the Fund and the Bank in dealing with income distribution is resistance from member countries who may regard interference in this area as an infringement of sovereignty. A country faced with making cuts in government spending may wish to preserve some leeway in how these are implemented. Unfortunately, as Dr. Mahbub ul Haq Special Adviser to the United Nations told the Sub-Committee, this frequently means that expenditures on food subsidies, health and education are cut before spending on the military or on corrupt public enterprises. The reason, according to Dr. ul Haq, is that the poor often do not carry the same political weight as the elites. Of course, any government contemplating a painful adjustment program must balance equity considerations with what is politically feasible.

174. Another problem in addressing the poverty question is the lack of good quality statistics on income distribution in many developing countries. Both critics and supporters of the IFIs see the collection of reliable data as necessary for evaluation of adjustment programs and better targeting of aid to the disadvantaged.

175. The recent OECD study on adjustment states "Whether it is a question of knowing the composition of groups targeted for specific anti-poverty policies or using models to simulate the effects of alternative policies and choose the most equitable, nothing is possible without information, which is lacking in many countries carrying out adjustment."[73] The IMF Assessment Project and a 1991 Congressional Research Service Report to Congress[74] have also suggested the need for better data.

176. This Sub-Committee does not have the resources necessary to undertake a full scale investigation of the distributional effects of structural adjustment policies. However, there does appear to be a need for more careful appraisal of the effects of these policies.

Recommendation 4:

The government should support additional research by the World Bank and the IMF into the effects of adjustment programs on the poor. It seems to the Sub-Committee that a good place to start would be to put in place, where necessary, mechanisms in member countries for the acquisition of good quality economic data, particularly with respect to income distribution.

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[71] The Bank Information Center, *Funding Ecological and Social Destruction*, (Washington, D.C. 1989).

[72] *Position Paper of the NGO Working Group on the World Bank.* (Geneva, Switzerland, Dec. 1989).

[73] François Bourguignon and Christian Morrisson, *Adjustment and Equity in Developing Countries —A New Approach.* 1992, p. 87.

[74] Congressional Research Service, *World Bank/IMF Adjustment Loans and the Poor in Developing Countries,* February 1, 1991.

177. In this regard, we recognize that some progress is already being made by the World Bank in improving household data through the Living Standards Measurement Study and the Social Dimensions of Adjustment program. However, we also note that the Bank does acknowledge that "much more needs to be done" to improve data gathering in developing countries.[75]

178. Not only would improved data result in better quality studies on the effects of adjustment policies on various income segments, these would permit more precise targeting of social expenditures to those in need. This would reduce the cost of social safety net measures necessary to alleviate the hardship associated with adjustment policies. Purely, from the standpoint of cost-effectiveness, the collection of good quality data appears to be a sensible first step.

179. We understand from the testimony of Allan Gill that the IMF intends to establish an evaluation unit sometime this year. At this stage it is unclear exactly what the duties of this new unit will be. We suggest that the mandate of the evaluation unit should include work on the impact of adjustment programs on the poor and that this issue receive priority.

180. We also recognize the contribution that the World Bank and other international aid organizations, like UNICEF, as well as NGOs, can make to alleviating the effects of adjustment programs. The role played by these international organizations in reducing the social costs of adjustment is well known, for example, in Ghana's 1988 program and Bolivia's 1986-87 adjustment.

Recommendation 5:

The IMF should be encouraged to cooperate with the World Bank, UNICEF and other international aid organizations to channel assistance to those most affected by Fund adjustment programs.

3. Military Spending

181. As the 1992 UN Human Development Report points out, the peace dividend from the demise of the cold war has opened new opportunities for both rich and poor countries to strengthen their social agenda.[76] Industrial countries have reduced their total military spending from a peak of US$838 billion in 1987 to US$762 billion in 1990 — a cumulative savings of US$158 billion.[77] Similarly, the developing countries have lowered their military spending from a peak of US$155 billion in 1984 to US$123 billion in 1990 providing a cumulative peace dividend of US$119 billion.

182. Nevertheless, two of the poorest regions, South Asia and Sub-Saharan Africa, have not yet reduced their military spending. And in the developing world as a whole, military spending in 1988 was roughly three times the amount spent on health care and 1.3 times that spent on education.[78] Dr. Mahbub ul Haq, Special Adviser to the United Nations Development Program, told the Sub-Committee that a freeze on

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75 *The World Bank Annual Report 1992*, p. 49.

76 United Nations, *Human Development Report 1992*, (New York: Oxford University Press, 1992) p. 85.

77 *Ibid.*

78 Based on data from: Ruth Leger Sivard, *World Military And Social Expenditures 1991*, (Leesburg, Virginia: WMSE Publications, 1991).

military spending in the developing countries could release US$50 billion over the next decade. According to Dr. ul Haq, "That would put all the children in schools and finance primary health care, clean drinking water and family planning services for all, and end malnourishment."(8:12)

183. The evidence showing a lagged correlation between the volume of arms imports and the level of economic aid received suggests that foreign aid may be helping to finance Third World arms purchases. The 1992 Human Development Report states that many countries are beginning to take into account military spending by aid recipients.

184. Allan Gill, of the Department of Finance, told the Sub-Committee that the IFIs have become more sensitive to the issue of military spending as part of "good governance." During the Sub-Committee's visit to the IMF in Washington, we were informed that the Fund's staff is now compiling data on military spending by member countries. Though to date, neither the IMF nor the World Bank have made defence spending cuts an *explicit* condition for gaining access to funds.

185. There are several reasons for this. First, as Allan Gill said, such explicit conditionality lies outside the mandate of both institutions. (10:9)[79] And, according to Frank Potter, Canada's Executive Director to the World Bank, it is not a trivial exercise to open the Articles of Agreement up for renegotiation. Nevertheless, since military spending represents a major part of many countries' economic policy mix, Mr. Potter noted that the Bank may address concerns about the military expenditures while still keeping within its mandate to consider only economic circumstances.

186. Second, Allan Gill noted that explicit conditionality to address military spending, human rights and other social considerations might undermine the integrity of the Fund and the Bank as financial institutions. This is particularly relevant to the IBRD, which, using its Triple-A credit rating, borrowed over US$17 billion in 1992 at highly favourable rates to lend to developing countries also at preferred rates.

187. This view was echoed by David Hilton of the Bank of Nova Scotia, who stated that the World Bank and the IMF have been successful precisely because they have operated as financial, rather than political, institutions.

188. Third, there may be more effective ways to obtain *sustained* reform of military expenditures by countries that receive aid than to introduce explicit conditionality. Nicole Ball, a visiting fellow at the Overseas Development Council, has suggested a number of policy tools at the disposal of bilateral and multilateral agencies. These include policy dialogue, financial and technical support, rewards for good behaviour, efforts to set expenditures and performance targets in non-military areas (which can imply reductions in military aid), and encouraging countries to increase the accountability and transparency of the military sector.[80]

189. The idea that explicit conditionality would not necessarily lead to a permanent change in government policies on non-economic criteria, such as levels of military expenditures, was expressed by Professor Gerald Helleiner. "I'm sceptical, frankly, about the practical effect of attempts to lever unwilling decision-makers, political people, to do that which they really don't want to do. I just don't think it works. It won't last. If it works for a while, it won't survive until its truly internalized." (9:37)

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[79] Article IV, Section 3(*b*) of the IMF Articles of Agreement states: "These principles shall respect the domestic social and political policies of members. . ."

Article, Section 10 of the IBRD Articles of Agreement states: "The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I."

[80] "Seminar Panelists Discuss Ways and Means to Reform Military Spending," *IMF Survey*, (Washington, D.C.: International Monetary Fund, December 14, 1992).

190. As noted earlier, the IMF gathers data on military expenditures by member countries. Keeping within its mandate to respect a country's social and political policies, the IMF may discuss the level of military spending in Article IV consultations where the level of, or changes in, expenditures is large and have macroeconomic or structural implications.[81]

191. The World Bank appears to view the problem as an aspect of good governance. Are resources being used wisely or is military spending crowding out essential social services?[82] Over the last ten years, the Bank has expressed concern about the level of military spending in at least twenty cases.[83] Countries that wish to convert military-industrial complexes to civilian uses can obtain World Bank aid. The Bank has also undertaken two research projects on military spending topics.[84]

192. The Sub-Committee believes that it is important for countries receiving aid to control their military spending. Money is fungible. It is no use providing development funds if, one way or another, these end up financing the military or other non-productive ends.

Recommendation 6:

The government should advise the Canadian Executive Directors of the IMF and the World Bank to inquire whether adequate levels of development expenditures, especially in the areas of health, education, sanitation, etc., are being crowded out by the weight of large or rising non-development expenditures, including military spending.

4. The Environment

a. The World Bank's Environmental Program

193. The environmental record of the World Bank has been criticized on two grounds. First, environmentalists charge that large development projects, like the Sardar Sarovar Dam in India, damage the environment and displace indigenous peoples.[85] Second, the World Bank is criticized for failing to place sufficient emphasis on the environment in designing the conditions associated with structural adjustment loans.

194. After just returning from the UN Conference on the Environment and Development in Rio de Janeiro, Tim Dramin, from the Canadian Council for International Co-operation, told the Sub-Committee that "sustainability is not on the agenda of the international financial institutions either and it has to be put there."(3:20) Tim Dramin and Akouété Akakpo-Vidah, also from the Canadian Council for International Co-operation, raised concerns about the accountability of the Global Environmental Facility (GEF) and participation in the program by developing countries.

195. Clearly the environment is becoming a more important part of the World Bank's agenda. The Bank's 1992 World Development report, for example, is entirely devoted to "Development and the Environment." The World Bank also produces an annual report on the institution's environmental activities

81 *Ibid.*

82 *Ibid.* p. 375.

83 *Ibid.*

84 *Ibid.*

85 See the later discussion of the Sardar Sarovar project.

during the preceding fiscal year. And the Bank, in conjunction with the United Nations, is implementing the Global Environmental Facility (GEF) to provide developing countries with concessional financing for environmental projects in the areas of greenhouse gases, ozone-layer depletion, international waters and biodiversity.

196. Under the World Bank's October 1989 Environmental Assessment Operational Directive (EAOD) all projects with potential significant environmental impacts must undergo environmental assessment, while sectoral assessments are applied to sector investment programs. In addition, the Bank's structural adjustment loans incorporate environmental provisions, for example, to encourage sound management of agricultural land or forests.

197. The 1991 World Bank Annual Report states that the Bank's Environment Department and the four regional environment divisions have 106 high-level and 34 support staff. About 270 staff-years, or about 10% of total World Bank staff time, were devoted to forestry or the environment in 1991.[86] According to Marcel Massé, President of CIDA, the Bank's vice-president for the environment is more progressive on environmental issues than CIDA, whose environmental assessment procedures are considered among the best in the development business.

198. The World Bank's four operational regions, Africa, Asia, Europe-Middle East-North Africa, and Latin America and the Caribbean, are integrating environmental concerns into their work programs in different ways.[87] In Africa, national environmental-action plans (NEAPs) have been designed in response to requests by individual countries. In Asia, problems involving soil degradation, disappearing forests, and poor air quality are being addressed through measures, including sectoral adjustment loans.

199. Actions in the Europe, Middle East, and North Africa region include cleaning up Eastern Europe's environment and implementing the Mediterranean Environmental Technical Assistance Program (METAP). In Latin America and the Caribbean region, the Bank has emphasized measures to strengthen the authorities responsible for regulating and policing the environment.

200. Despite these activities, some environmental groups continue to be highly critical of the World Bank green program. Patricia Adams of Probe International, told the Sub-Committee that, "Changes in response to the criticisms levelled against the bank have been toothless and irrelevant. Additional environmental staff have been powerless and they have been sabotaged by entrenched interests and institutional structures."(4:42)

201. Ms. Adams called the World Bank's annual environmental report, "nothing more than a public relations document and one that embarrasses the bank rather than redeems it." The Global Environmental Facility, according to Ms. Adams, perverts the polluter-pay principle, by taxing the world's biggest polluters, the industrialized countries, in order to subsidize developing country polluters. Representatives from Probe International were particularly critical of the Bank's involvement in a series of large dam projects, which they believe have had harmful environmental effects and have displaced large numbers of indigenous peoples.

[86] *The World Bank Annual Report 1991*, p. 60.

[87] This section is taken from *The World Bank Annual Report 1991*.

b. Sardar Sarovar

202. The Sub-Committee held a day long session concerning one of these projects, the Sardar Sarovar dams in India, which is financed, in part, by US$450 million in World Bank loans and IDA credits. Although World Bank involvement dates from the late 1970s, and some difficulties later become apparent, it was not until 1992 with the release of the Report of the Independent Review conducted by Bradford Morse and Thomas Berger that the extent of the problems became apparent.

203. As indicated earlier, the Independent Review found the project to be seriously flawed in several respects. The report states: "Under Bank policy at the time resettlement and rehabilitation and environmental impact had to be appraised at the threshold of a project. Yet, there was no proper appraisal of the Sardar Sarovar Projects; no adequate appraisals of resettlement and rehabilitation, or of the environmental impact, were made prior to approval."[88]

204. Furthermore, two of the Indian states affected by the project were not providing adequate resettlement for the people displaced by the project, particularly the landless "oustees." This violated a World Bank policy that all oustees, including landless persons, be enabled "to improve or at least regain" their standard of living after resettlement.

205. With respect to the environment, the report notes that, "The history of the environmental aspects of Sardar Sarovar is a history of non-compliance. There is no comprehensive impact statement. The nature and magnitude of environmental problems and solutions remains elusive."[89] There are also concerns about risks to human health posed by water borne diseases, particularly malaria.

206. Most disturbing of all, according to Donald Gamble, chief of staff of the Independent Review, "is that most, if not all, of these findings are evident in the files of the bank, and have been, in one way or another since the very early 1980s."(4:63) Mr. Gamble also told the Sub-Committee, "There is something systematically wrong. I cannot speak to the fact of how far that goes to other projects. . .but I assure you and I can cite ample evidence that this is a problem that has existed with respect to this project from the very beginning."(4:64)

207. The Independent Review, commissioned by the World Bank, recommended that the Bank step back from the project and take a fresh look. After considering the Report, the World Bank's Executive Board voted to give the project a six-month extension (until March 31, 1993). At that time, if the Indian states fail to meet certain benchmarks, the Bank has indicated that it will withdraw from the project.

208. Professor Smitu Kothari outlined many of these same problems to the Sub-Committee and described some of the civil rights abuses which have resulted because of protests in India over the project. He also pointed to the vigorous international opposition to the project both in India and internationally. For example, a total of 867 organizations signed full page advertisements in the Financial Times of London and the New York Times. Professor Kothari expects that many of these groups will oppose IDA-10 refunding as a result of this and other projects.

209. Citing a number of other dam projects in which the World Bank is involved, Peggy Hallward of Probe International told the Sub-Committee that the Bank has a history of failing to carry out proper project assessments and of dealing fairly with the resettlement of indigenous peoples. According to Probe International, Canada should cease funding the IDA arm of the Bank because of this pattern of environmental violations by World Bank financed projects.

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88 Bradford Morse and Thomas Berger, *Sardar Sarovar: The Report of the Independent Review*, (Ottawa: Resource Futures International (RFI) Inc., 1992), p. xiv.

89 *Ibid.*, p. xxi.

210. The Sub-Committee heard another point of view from David Hopper a former senior vice-president of the World Bank, who had been involved in the Sardar Sarovar project since its inception. Mr. Hopper explained that part of the reason why the project failed to meet certain standards with respect to environmental compliance and resettlement and rehabilitation of the oustees was that the standards had evolved since the appraisal report and the loan documents were signed in 1985.

211. Donald Gamble acknowledged that the standards by which the project was judged have changed over the years. However, he noted that the project did not meet the standards for resettlement and rehabilitation set even back in the early 1980s. The Bank set a certain timetable for conditions to be met but, according to Mr. Gamble, very few ever were met, including an environmental work plan which was required by December 1985 but had not been submitted as of November 1992.

212. David Hopper also had a different perspective on the development process than some other witnesses. He outlined the impact that the "green revolution" had had on India's food supply since the 1960s and the role that the water from the Sardar Sarovar dam could play in continuing to feed the population.

213. Mr. Hopper pointed out that the development process *does* imply some trade-offs. "The bank will always be subject to environmental criticism; you can't have development without it, and I think for this sub-committee the issue has to be what's the most logical way of weighing this? How do we place the long-term interests of a nation against the very short-term interests of particular groups who will be hurt by the development process. . .?"(4:31-32)

c. *The IMF's Environmental Program*

214. The IMF is also under increasing pressure to take into account environmental effects in the design of its policies. The U.S. Congress, for example, passed legislation instructing the U.S. Executive Director to encourage the Fund to carry out a systematic review of the environmental impact of its policies.[90] However, some have suggested that the broad brush of macroeconomic policy that the Fund uses may not be well suited for dealing with environmental concerns. For instance, a devaluation stimulates exports, including, say, log exports, which may lead to deforestation. On the other hand, a devaluation may also raise the price of imported petroleum products and fertilizers thereby reducing consumption and lowering pollution.[91]

215. During an IMF Executive Board meeting in early 1991 the Fund decided not to address environmental issues through conditionality but by raising staff awareness of linkages between economic policies or developments and the environment. Fund staff involved in environmental issues can also assist missions to member countries to help clarify the environmental implications of certain macroeconomic choices.[92]

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90 Jacques J. Polak, *The Changing Nature of IMF Conditionality*, Essays in International Finance, No. 184 (Princeton, New Jersey: Department of Economics, Princeton University, September 1991) p. 27.

91 *Ibid.*, p. 28.

92 *International Monetary Fund Annual Report 1992*, p. 53.

216. The Fund's recommendations to member countries can affect the environment through price policy, savings policy, fiscal policy, and trade policy.[93] Environmentally-sound price policy is one that allows prices to reflect scarcity, discouraging the unnecessary use of environmentally-sensitive products, such as petroleum, electricity, and water. The aim is a price structure that fully reflects social costs.

217. Savings policy can affect consumption patterns in the industrial countries. Appropriate fiscal policy means a tax policy that avoids the wasteful use of natural resources or excessively capital-intensive technology. It also involves an income distribution policy where broad-based subsidies on water resources, energy products, pesticides, and fertilizers are replaced with social safety net measures targeted at the poorest. Trade policy can reduce pollution through trade liberalization thereby encouraging investment in more modern, less polluting technology. Trade liberalization may also increase efficiency and incomes facilitating a shift to more economical use of natural resources.

d. Summary and Recommendations

218. Clearly, the IFIs have a range of policy tools at their disposal in dealing with environmental concerns. While the Fund uses only broad macroeconomic levers, it is clear that price policy, fiscal policy, savings policy and trade policy can make a difference.

219. Nevertheless, the Bank is acknowledged to have greater environmental expertise as well as the development mandate to implement environmental projects. In addition, the Bank's sectoral adjustment loans can finance the introduction of conservation and sound resource management policies in specific sectors, like forestry and agriculture. At the same time, the Bank is subject to more criticism on environmental issues than the IMF, particularly when projects, like Sardar Sarovar, go awry.

220. The example of Sardar Sarovar does raise some questions about how the World Bank is handling the environmental issue. Has the new "greening" of the senior levels of the Bank really penetrated into the middle and lower ranks of the Bank staff and consultants? What lessons has the Bank learned from the from the independent review process? At present, these questions remain unanswered.

221. While the Bank and the Fund are relatively fresh converts to environmentalism, the Sub-Committee supports the efforts of both institutions, particularly the World Bank, to incorporate the ideas of sustainable development into their programs.

Recommendation 7:

The Government should monitor the progress of the IMF and the World Bank in operationalizing their respective environmental programs.

222. The Sub-Committee was also pleased to see that the World Bank is monitoring carefully the terms and conditions of the six-month extension afforded the Sardar Sarovar project.

Recommendation 8:

The Canadian government should carefully review the World Bank's relationship with the Sardar Sarovar project to see that the Bank's criteria for future involvement are fully met.

5. Democracy and Human Rights

223. As noted earlier, the Articles of Agreement of the World Bank and the IMF do not permit consideration of member countries' political affairs. Nevertheless, some groups believe that these institutions should use their leverage as major lenders to apply pressure on borrowing countries guilty of democratic or

[93] See: "Environmental Concern and Growth Must Go Together, Says Camdessus," *IMF Survey*, (Washington, D.C.: International Monetary Fund, June 22, 1992).

human rights abuses. A paper provided to the Sub-Committee by David Gillies of the International Centre for Human Rights and Democratic Development argues that "durable development requires a political environment that sustains economic growth and human development."[94]

224. Edward Broadbent, President of the International Centre for Human Rights and Democratic Development, noted that in the past the World Bank had suspended aid to China (following the Tiananmen Square massacre), Zaire, Kenya and Malawi because of political and civil rights abuses in those countries. Mr. Broadbent believes that there should be direct linkage between the principle of respect for human rights and IFI decision making because the "appropriate meaning or purpose of development itself necessarily entails. . .human rights."(3:24)

225. According to David Gillies, systematic abuses of civil and political rights are not usually sufficient to trigger World Bank lending conditionality except under rare circumstances.[95] These circumstances include either a UN Security Council decision not to lend to a particular country or when the violation of human rights reaches such a proportion that they have overriding economic effects. In these instances, human rights abuses can be classified as contrary to the principle of "good governance."

226. The narrow definition of good governance which, according to Mr. Gillies is *de facto* World Bank policy, essentially requires only sound management and minimal corruption. A more liberal interpretation of the concept, derived from the UN Universal Declaration of Human Rights would include the legitimacy of government, and respect for fundamental human rights, such as the safety and security of the person, rule of law, and freedom of association and expression.

227. Human rights conditionality naturally raises questions about when and how this should be applied. The International Centre For Human Rights and Democratic Development suggests that the Bank should freeze loans to countries guilty of "state complicity in persistent and flagrant human rights violations. By that we mean unlawful killings, systematic torture, deliberate starvation, and possibly widespread arrests and prolonged detention without trial." (11:8) David Gillies believes that the interpretation of good governance can be broadened sufficiently within the Bank's mandate to effect change in human rights policy.

228. The decision in November 1991 by countries (including Canada) in the World Bank Consultative Group to suspend bilateral aid to Kenya because of corruption and human rights abuses in that country appears to have been instrumental in persuading the Bank to withdraw multilateral assistance.[96] Marcel Massé told the Sub-Committee, "Canada indicated that it was not ready to pledge its money for Kenya unless there were considerable changes in the human rights situation, in particular in terms of the creation of multi-party government or politics in Kenya."(9:23) Within a few months Kenya changed its constitution to allow for multi-party elections. Yet, the Sub-Committee was told by a World Bank official in Washington that there had been absolutely no acceptance on the part of the Bank of a link between aid and human rights and democratization.

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94 David Gillies, *Human Rights, Democracy, and "Good Governance": Stretching the World Bank's Policy Frontiers*, (Montreal: International Centre for Human Rights and Democratic Development, June 1, 1992)

95 *Ibid.*

96 David Gillies, *Human Rights, Democracy, and "Good Governance": Stretching the World Bank's Policy Frontiers*, June 1, 1992.

229. The IMF has not, in general, denied access to funds by members guilty of human rights abuses. The Fund continued to do business with Chile, Zaire, Uganda, Liberia and Romania, despite human rights violations in those countries. Nevertheless, in cases involving South Africa (from the mid-1980s), China (after Tiananmen Square), and Vietnam, funds were denied ostensibly for economic reasons, although political considerations were the real cause.[97]

230. The Sub-Committee believes that governments guilty of systematic, persistent and flagrant human rights abuses should not have unrestricted access to international aid. The Sub-Committee applauds recent Canadian policy in this respect, including statements by the Prime Minister, suggesting that Canada will deny bilateral aid to repressive regimes. We also commend Canada's part in the 1991 decision by the Consultative Group to suspend bilateral assistance to Kenya because of the need for political reforms. This decision has been credited with influencing the World Bank also to reduce aid to that country.

Recommendation 9:

The Canadian government should encourage the IFIs to take greater account in their lending policies of respect for human rights in terms of the longer-term economic impact.

231. Finally, we recognize that in this, as with all of these recommendations, Canada can accomplish little without international support. Therefore, we encourage the Canadian government to build coalitions of member countries who share some of the concerns expressed in this section of our report.

C. FINANCIAL AND RESOURCE CONCERNS

1. LDC Debt: How Serious For All Sides?

232. The issue of developing country debt has faded from the world's headlines despite the fact that it now stands at more than US$1,500 billion. The nature of the debt crisis has changed over the past three years. More of the middle income countries are able to service their debts and fewer commercial banks are threatened by nonpayment. On the other hand, debt is now more concentrated and harder to deal with. For certain low-income countries, particularly in Sub-Saharan Africa, the debt burden continues to be as acute as ever. As UN Secretary-General Boutros-Ghali said in Geneva in December 1992, "external debt is a millstone around the neck of Africa."[98]

a. How Important Is the IFI Role?

233. The issue of multilateral debt is complicated by the IFIs' regulations which do not permit debt forgiveness or rescheduling. So while multilateral debt in Sub-Saharan Africa accounts for about 28% of the total stock of debt, it consumes 45% of the region's debt servicing (excluding Nigeria's). [99]Thus, untouched by recent debt cancellation or rescheduling, multilateral debt constitutes a particularly severe burden on the poorer countries.

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97 Jacques J. Polak, *The Changing Nature of Conditionality*, 1991. p. 31.

98 Secretary-General Boutros-Ghali in his statement to the Panel of High-Level Personalities on African Development, Geneva, 28 December 1992.

99 Africa Recovery Unit/cpmd, Department of Public Information, *African Debt Crisis: A Continuing Impediment to Development*, (New York: United Nations 1993).

234. As a result, the IFIs have been in the unfortunate position over the past few years of receiving more monies from the developing countries than they supply in transfers. According to Professor Gerald Helleiner, "The IMF has found itself in the past few years with negative transfers, transfers out of the developing countries — in every year since 1984, except for a very small positive amount in 1991."(9:11) He further noted that in 1992 the transfers from developing countries to the IMF were approximately $2.2 billion. With respect to the World Bank, Professor Helleiner stated that the institution, including its soft loan arm the IDA, is also receiving more monies from the South than it is transferring in. "Every year since 1987 there have been negative transfers from developing countries: $1.5 billion in 1991, the last reported year in the world debt tables."(9:11)

235. Witnesses' opinions varied on the propriety of these negative transfers and some questions were raised about the wisdom of forgiving multilateral debt. Several witnesses argued against changing the existing system. Bill White of the Bank of Canada stated that the net payments to the IMF from developing countries in the second half of the 1980s were exactly what was supposed to happen. He noted that the Fund's role is that of a provider of short term credits to finance balance of payments problems. Since the funds were lent on a revolving basis, they were supposed to be repaid over the short term. "The fact the countries were capable of repaying is an indication of the success of the policies the Fund was recommending."(6:14)

236. Another opinion was that forgiveness of multilateral debt could create a "moral hazard" problem. In other words, if one country's debts are written off, what would prevent other countries from defaulting on debt service payments in order to obtain similar treatment? It might also be argued that writing off multilateral debt would make quota increases or replenishments of these institutions more difficult. For example, Bill White of the Bank of Canada asked, "How easily would those be granted by member nations who had so clearly in mind the recollection that what they had previously contributed they had had to write off?"(6:26)

237. Other witnesses had a different view, arguing that the multilateral rules on debt forgiveness and rescheduling need to be reviewed. Dr. Mahbub ul Haq, special adviser to the UNDP, told the Sub-Committee,

> . . .the World Bank and the IMF should themselves become a part of the debt restructuring exercise. They ask all the donors and even private banks to do it, and they have done it. The World Bank is now left holding the debt, 80% in many developing countries. They are becoming debt collectors. They refuse, according to their charter, to look at the debt issue. Donors should now carefully look at it. Can they continue to do that without becoming negative-transfer resources? (8:45)

238. Witnesses from the private banking sector also agreed that there should be some form of debt forgiveness or reprofiling by the multilateral banks. One witness stated that it created an imbalance in international debt refinancing efforts since the IFIs became "preferred creditors." This disadvantages the commercial banks making them less interested in lending to these countries, thus leading to more reliance on official lending.

239. Other witnesses took a developmental perspective arguing that, as debt increased through the "miracle" of compound interest, it created a funding trap for the poorest countries from which it was impossible for them to escape.

240. Although the IFIs' Articles of Agreement do not provide for the forgiveness of debts, there are indirect methods of easing the problem. For instance, the IMF subsidizes the poorest countries through the Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF), which allows them to borrow from the Fund at highly concessional rates. As Marcel Massé noted, "if you turn over the debt that's owed to you over a 10-year period at one-half of one percent, the value of your dollar in net present value becomes, depending on the outside interest rates, let's say 35 cents after 15 years, and 18 cents after 30 years. This is the way the fund is making the repayment of its own obligations much easier on the debtors without infringing its articles of agreement."(9:22) Similarly, increased assistance from the soft loan window of the World Bank, the IDA, can help to ease the debt servicing pressure on some countries.

241. Another problem arising from the multilateral debt forgiveness issue is the development of arrears of debt payments to the IFIs. According to the 1992 IMF Annual Report, ten countries were in arrears to the IMF with total amounts outstanding at SDR 3.5 billion, or approximately US$4.9 billion. The World Bank debt tables indicate that the total amount of arrears on debt owed in 1991 by all countries was US$106 billion, including amounts owed to the IMF, the World Bank, commercial banks and bilateral lenders.[100]

242. Although some observers have declared the "debt crisis is over", it certainly is not over for some parts of the developing world. Band-aid solutions, according to a witness, which included individual donor countries supplying monies to cover debt servicing, are not sufficient and may actually divert funds from bilateral development assistance. One witness suggested that the IMF should consider selling a portion of its gold stocks to finance a reduction in the debts of developing countries without additional contributions from creditor nations.

Recommendation 10:

The Canadian government should strongly encourage the IMF and World Bank to continue to develop a more effective strategy for dealing with the debts of least developed countries. Part of this strategy could include continuing and strengthening the Enhanced Structural Adjustment Facility (ESAF), a mechanism which has reduced the burden of payment for the poorest countries.

2. The General Question of Liquidity

243. A recurrent issue for the IFIs is the uncertainty connected to the flow of funds which are made available for financing international monetary stability and development work. In the 1980s there was a pattern of continued IFI refunding, usually referred to as quota increases for the IMF and replenishment for the World Bank and RDBs. With budget constraints facing a number of industrialized countries, it is uncertain how successful future refunding exercises will be. The recent 50% increase in the quota for the IMF did not receive much opposition or even commentary in Canada but was subject to considerable political interest in the United States. In the next year and a half several key IFI refundings will occur, creating points of access for legislators to examine the effectiveness and channelling of international financial assistance.

244. The next refunding to pass through the legislative process of the creditor countries will be the tenth replenishment of the International Development Association (IDA-10). In December of 1992 the IDA deputies met and replenished IDA to SDR 13 billion, the same level as IDA-9, but which was less than was hoped for by World Bank officials. Furthermore, with more countries now eligible for IDA and with larger populations in those countries, the IDA dollars per capita are actually lower in real terms. The Canadian contribution is C$829 million over 3 years[101] amounting to a reduction from 5% to 4% in Canada's share of the IDA burden.[102]

245. The reduction in the Canadian contribution to IDA-10 was of considerable concern to a number of Sub-Committee witnesses. They argued that, since the IDA loan window provides funds for the poorest countries, it should be protected as a key element in this country's Official Development Assistance. It is

[100] *World Debt Tables 1992-93*, Volume 1, (Washington, D.C.: The World Bank, 1992), p. 15.

[101] The Canadian contribution is to be paid over 3 years and is to be encashed over 8 years.

[102] Information from the Canadian Executive Director's office in Washington, D.C.

important to recognize that the IDA contribution represents cash payments from the Canadian government and not simply possible commitments, such as callable capital. Consequently, Canada's IDA contribution provides this country with the greatest degree of leverage in the multilateral development sphere. According to Professor Gerald Helleiner, "IDA is the centre; it's the soul of the development finance business at the international level. For us to reduce contributions at this point is, in my judgment, outrageous."(9:12)

Recommendation 11:

The Canadian government should protect funding to IDA.

D. MANAGEMENT AND DECISION-MAKING

1. The Wapenhans Report

246. The Report of the Independent Review of the Sardar Sarovar dam in India, dealt with in a previous chapter on the environment, illustrates some specific problems associated with the management of a major World Bank project. In 1992 the World Bank also undertook a comprehensive study of its entire loan portfolio and issued a report entitled *Effective Implementation: Key to Development Impact*. The report has come to be known as the "Wapenhans Report" after the Bank Vice-President, Willi Wapenhans, who headed the Task Force.[103] When in Washington, the Sub-Committee had the opportunity of receiving a briefing from Mr. Wapenhans personally on the contents of his report.

247. The Wapenhans Report, an internal document presented to the President of the World Bank in July 1992, said what many insiders had believed for some time — that there are some serious problems with the Bank's portfolio. In fact, Wapenhans reported that about one-third of all Bank-supported projects fail to perform as well as expected and that the quality of the Bank's loan portfolio has been steadily deteriorating over the past ten years.

248. Specifically, the share of projects with major problems increased from 11% in FY1981 to 13% in FY1989 to 20% in FY1991. The number of projects judged unsatisfactory at completion increased from 15% of those reviewed in FY1981 to 30.5% of the group examined in FY1989 and 37.5% of projects in FY1991. In addition, "Borrowers' compliance with legal covenants — especially financial ones — remained startlingly low."[104]

249. The Wapenhans Report did conclude that part of explanation for the decline in the Bank's portfolio had to do with macroeconomic factors. This included worsening global conditions (the oil shock, the debt crisis, declining terms of trade). Other problems included institutional constraints such as borrower inertia, shortages of counterpart financing, poor management and defective procurement.

250. Nonetheless, the Report did find that aspects of the Bank's project management were a problem. First, the corporate culture at the Bank may encourage a promotional approach to loan appraisal and approval. In other words, too much emphasis is placed on the quantity of loans approved rather than the quality. Second, the emphasis on loan approval is not matched with equal emphasis on risk assessment or careful

[103]Portfolio Management Task Force, *Effective Implementation: Key to Development Impact.* Report of the World Bank's Portfolio Management Task Force, (Washington, D.C.: World Bank, 1992)

[104] *Ibid.*, p. iii.

implementation of the projects and there may be too many project components. Third, the role of Bank staff in project implementation is not adequately defined. Fourth, generic country or sectoral obstacles to implementation are not systematically addressed. Fifth, evaluation must also be made during the operational phase of projects rather than shortly after the last disbursement. Finally, the Report sets out a list of recommendations and supporting measures to correct the poor performance of the Bank's loan portfolio.

E. TRANSPARENCY AND ACCOUNTABILITY

251. There are three important components to the transparency and accountability question as it affects Canada's participation in the IFIs: first, the degree of openness and responsiveness of the IFIs to the member countries, non-governmental organizations and the general public; second, the transparency and accountability of these institutions to the Canadian Parliament; third, the accountability of the Canadian Executive Directors to their other constituencies, the countries of the Commonwealth Caribbean and Ireland.

1. Transparency and Openness

252. Both the IMF and the World Bank have been criticized for a lack of transparency and openness. One of the difficulties outsiders have in evaluating IMF programs, for example, is the cloak of secrecy that the institution throws over the content of its programs with client countries. This lack of transparency in operations, it is argued, makes IFIs less accountable to national legislatures since they are unable to properly assess the record of these institutions based on complete documentation.

253. During the Sub-Committee's Roundtable discussion in June 1992, Roy Culpeper of the North South Institute advocated opening up the discussion on issues dealt with by the IFIs beyond the small circle of officials in Ottawa and those in the Executive Director's Office in Washington. Although Christopher Neal of CUSO acknowledged the role that the NGO-World Bank Committee played in exposing important issues, he also believes that the NGOs should be allowed to participate more fully.

254. On the other hand, Morris Miller, a former Canadian Executive Director to the World Bank cautioned that, although the NGOs claim that the World Bank is exceptionally secretive, "a certain secretiveness is necessary when an agency negotiates with sovereign countries. There has to be a bit of room for them to do their bargaining."(9:17) Mr. Miller noted, however, that some information, such as Bank reports, could be made available on a more liberal basis.

255. The Committee received an interesting proposal from Professor Daniel Bradlow to open the World Bank up to scrutiny by establishing an independent Ombudsman to deal with problems of maladjustment and administrative injustice. Mr. Bradlow attributes many of the Bank's operational and policy problems to a lack of transparency and accountability. He believes that an independent Ombudsman would prevent a situation like Sardar Sarovar developing because people adversely affected would have a formal mechanism through which to bring their complaints to the Executive Board.

256. Professor Bradlow also maintains that World Bank decision-making would be improved by creating a World Bank Ombudsman. He told the Sub-Committee that the 24 members of the Bank's Board of Directors simply do not have time to independently assess the 222 loans approved by the Board in 1992. Professor Bradlow believes that reliance of the EDs on the Bank staff has resulted in a remarkable degree of staff autonomy. In his view, the creation of an independent World Bank Ombudsman would provide the EDs with a formal independent channel of communication about specific Bank projects.

257. It should be noted, however, that existing mechanisms already perform some of the duties that would fall to an Ombudsman. The World Bank Operations Evaluations Department, for example, provides independent information to the Board of Directors, albeit after the project is completed or the funds are disbursed. And as noted earlier, the World Bank-NGO Committee does provide a communication channel between outsiders and the Bank staff.

258. Moreover, as Donald Sherk noted, and the recent Wapenhans report clearly indicates, the Bank's staff is often the institution's best critic. Yet, this strength also illustrates the opaqueness of the Bank operations to outsiders, according to Mr. Sherk. He told the Committee that there should be some formal mechanism, like the Ombudsman, for making information available and for challenging Bank decisions to keep information confidential.

259. Although the Sub-Committee does believe that the World Bank would benefit from more transparency and open discussion of the issues, it is not yet ready to recommend wholeheartedly the creation of a World Bank Ombudsman. We do believe, however, that this proposal, which would provide an early warning system on potential problems, merits serious consideration by the World Bank.

Recommendation 12:

The Canadian government should suggest that the World Bank study the feasibility of creating its own Ombudsman.

260. The Sub-Committee believes that the IMF would also benefit from more openness.

Recommendation 13:

In the interests of better understanding and transparency, the Canadian government should encourage the IMF to expand the amount of information made available to the public regarding the Fund's operations.

2. Accountability to Parliament

261. The Department of Finance is the lead agency responsible for the IMF, the World Bank and the European Bank for Reconstruction and Development (EBRD). In addition to annual reports on the operations of each of these institutions, the Minister of Finance is required to provide Parliament with the communiqués issued by the Interim Committee of the IMF and the Development Committee of the IBRD and the IMF. Financial information on Canada's contribution to the IFIs is also available in the Public Accounts of Canada and the Estimates of the Government of Canada.

262. The Auditor General's (AG) 1992 Annual Report examined Canada's participation in the IMF, the World Bank and the EBRD. The AG's report found that, although the amount and quality of information contained in the Department of Finance annual reports to Parliament had improved, there was room for further enhancement. Specifically, the AG believes that the annual reports on the IFIs do not provide "measurable objectives, targets and actual results of Canada's participation."[105] It also states that the reports made it difficult for Parliament to comprehend Canada's total financial commitment to these institutions.

263. The AG expressed concern that the *Appropriations Act,* which provides the legislative authority to fund Canada's contribution increase to the World Bank, does not clearly disclose that payments represent only the paid-in portion, or just 3% of the capital subscriptions. The other 97% of capital (callable shares), which represents Canada's potential financial commitment to the Bank, is not mentioned in the *Appropriations Act*.

264. As noted earlier, the main risk for contributing countries, like Canada, is that the 97% of World Bank and EBRD shares represented by callable capital will be called in order to meet payments due investors in these institutions' securities. According to the AG, Canada's investment in the callable capital of the EBRD

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[105] Auditor General of Canada, *Report of the Auditor General of Canada to the House of Commons 1992*, (Ottawa: Supply and Services, 1992) p. 314.

and the World Bank amounted to C$5.0 billion at 31 March 1991. With a total commitment to the World Bank of C$5.1 billion, "per capita, Canada's subscriptions to the World Bank are the highest of the G-7 countries."[106]

265. The AG's report also pointed out that "adequate levels of reserves and loan loss provision are a critical defence against a possible call on the Bank's callable capital to meet its obligations created by borrowing or guarantees."[107] The World Bank's reserve-to-loan ratio was 11.2% while the loan loss provision rate was 2.5% 1991. This has led some World Bank members, such as Canada, to raise questions about the adequacy of the Bank's current loan loss provisioning rate in view of the uncertain global economic outlook, the high level of the portfolio risk indicator and other factors.[108]

266. The AG's 1992 report raised the same question. "The World Bank's current loan loss provision of 2.5 percent seems low in light of the situation on 30 June 1991, when the Bank's management assessed 37% of the loan portfolio as high risk, and 3 percent as non-accruing; five countries represented 45.1 percent of the loan portfolio; and loans to countries whose loans have been rescheduled represented 49.4 percent of the loan portfolio."[109] Accordingly, the AG has called upon Canada and its G-7 partners to seek an assessment of the World Bank loan loss provision rate and the method used to determine it.

267. Although a few countries are deeply in debt to the IMF, there is, as noted earlier, no provision for writing off their arrears. Instead, delinquent accounts are covered through lower rates of return to creditors and higher interest rates charged to borrowing countries. "This sharing of the burden, together with other financial management and control practices, minimizes the risk that the value of Canada's subscriptions — its 'reserve position' — in the IMF will be eroded."[110]

268. The AG stated that "[t]he objectives of Canada's participation in the Bretton Woods and related institutions are not clearly and completely stated in any one public document to make Parliament and the public fully aware of why taxpayers' dollars are spent — that is, all the reasons for participation and the concomitant responsibilities — and to provide a basis for assessing results."[111]

269. The AG noted that, although the sharing of inter-departmental responsibilities seemed to be working well, there was no documentation of the role played by each of the departments with responsibility for the IFIs. Vinod Saghal from the Office of the Auditor General, told the Sub-Committee that "it would be appropriate to formalize the procedure. . .there should be more visibility and more transparency in how the major decisions are taken, who plays the key role and who's managing the financial risk and who's managing the development risk. . ."(7:19)

270. The AG also suggested that the scope of the audit performed on these institutions might be broadened from a traditional "attest audit" to a "value-for-money audit" similar to that done by the AG for the federal government.

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106 *Ibid.*, p. 304.

107 *Ibid.*, p. 312.

108 *Ibid.*

109 *Ibid.*

110 *Ibid.*, p. 311.

111 *Ibid.*, p. 306.

271. A further suggestion by the AG for improving the transparency of these institutions and their accountability to Parliament included periodic evaluations of Canada's participation in the Bretton Woods institutions. In this regard, the AG pointed to a recent review of Australia's membership in the multilateral development banks.[112]

Recommendation 14:

In accord with the Auditor General's suggestion to improve the transparency and accountability of the IFIs to Parliament, the Sub-Committee recommends that the government undertake periodic reviews of Canada's participation in these institutions.

272. The current tight fiscal situation suggests that such a study would be useful now in order to evaluate the IFIs' priority in Canada's overall development budget. The Sub-Committee notes that next year will be the 50th anniversary of the Bretton Woods conference establishing the IMF and the World Bank, and Canada has never had a complete evaluation of this country's participation in these institutions.

273. Deputy Auditor General, Lawrence Meyers, told the Sub-Committee that, as part of a broader evaluation of the IFIs' operations, the Canadian Executive Directors should report periodically to a parliamentary committee.

Recommendation 15:

Given the Auditor General's report on the extent of Canada's financial commitment to the IFIs, it would be appropriate and prudent for these institutions to receive the continuing attention of Parliament.

3. Accountability of the Canadian EDs to their Constituencies

274. Canada's Executive Directors at the IMF and the World Bank must also speak for Ireland and the countries of the Commonwealth Caribbean. Professor Norman Girvan, who is from Jamaica, has the impression that "we haven't maximized the potential of that relationship on either side. For example, there is a sense that there is not as much consultation as there could be between the Canadian Executive Director and the Caribbean ministers of finance, governors of central banks, when questions come up that would affect the interests of developing countries or the Caribbean in a broad way, or when specifics of stand-bys or SALs come to their respective boards."(3:14)

275. This view was reiterated by Roy Culpeper, who found during his tenure at the World Bank, "Communication with our Caribbean constituents, and to a lesser extent our Irish constituents, was almost non-existent."(3:29) Mr. Culpeper stated that the other countries represented by Canada were given very little chance to participate in formulating the constituency position because Canada controlled 85% of the votes.

276. By contrast, the Sub-Committee's impression from Canada's current Executive Director, Frank Potter, is that there is active communication between his office and the other countries in the constituency. There also seemed to be a genuine interest in incorporating these other countries' views in the ED's position at the Board meetings.

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[112] Australian International Development Assistance Bureau, *Australia and the Multilateral Development Banks —A Review of the Effectiveness of Australia's Bank Membership in Achieving Australia's Development Assistance Objectives*, (Canberra: Australian Government Publishing Service, 1992).

Recommendation 16:

The government should evaluate the quality of representation received by the other countries in Canada's constituency at the IMF and the World Bank.

F. FINANCING EASTERN EUROPE AND THE FORMER SOVIET UNION

277. The Russian Federation became an IMF member on 1 June 1992. By the end of September, fourteen other constituent states from the former Soviet Union had also joined the IMF. On 5 August 1992 the IMF approved a stand-by arrangement for Russia authorizing a drawing of up to the equivalent of SDR 719 million (about US$1.04 billion). This is the first phase of a possible US$24 billion standby agreement designed to stabilize the Russian economy, implement structural reform and coordinate monetary arrangements with the others states of the former Soviet Union.

278. For its part, the World Bank is committed to providing technical assistance and loans to Eastern Europe, including US$1.5 billion to the republics of the former Soviet Union. In addition to the Bretton Woods sisters, the new European Bank for Reconstruction and Development opened its doors in 1991 and committed 621 million ecus (US$770 million) to projects in Eastern Europe.

279. Restructuring the former command-style economies appears to be more difficult than expected. The IMF reports that the costs of transition have been larger than expected due to distortions and misallocations of resources under central planning. Furthermore, elements essential to a market economy, such as the proper legal and institutional environment, are lacking. In addition, the political situation remains unsettled in some of the republics and conservatives in the Russian Federation are threatening to slow down, or turn back, market reforms.

280. David Hilton told the Sub-Committee, one of the effects of the high level of debt in the region is that commercial banks have been withdrawing financing. "Generally, speaking, banks are not even going in on trade financing in that part of the world. . .The payments record is such that not only banks but also individuals are finding it highly risky to go into any operations. . ."(10:27) Any withdrawal of private capital from the region suggests that more responsibility for external financing will fall on the shoulders of the IFIs, unless bilateral donors step in.

281. Professor Gerald Helleiner noted that, although the IMF had just had a 50% quota increase, "this was much less than the staff of the IMF believed necessary. Now we have the CIS and Eastern Europe added. . .There's a review again- its due by the end of March- of the size of the IMF quotas. In my judgement, these need a large expansion, whatever else one does."(9:10)

282. Aside from the drain of IFI financial resources, rebuilding the former USSR republics and Eastern Europe will place a heavy burden on the human resources at these institutions. The Sub-Committee was told in Washington that the World Bank has set quotas on the number of people who could be transferred from existing divisions to the new divisions dealing with this region. In addition, a number of new people with expertise in the area were hired. On the other hand, the Sub-Committee is not aware of any similar mechanism at the IMF to safeguard the number of personnel dedicated to other regions. However, IMF Managing Director Michel Camdessus did announce in August 1992 a number of organizational changes to enable the Fund to meet the increased demands placed on it.

283. The Sub-Committee supports IFI assistance for the countries of Eastern Europe and the former Soviet Union in order to stabilize and rebuild their economies. Nevertheless, we do not think that this should be at the expense of the developing countries, some of which have yet to recover from the debt crisis.

284. Therefore, the Sub-Committee encourages both the IMF and the World Bank to continue to provide resource flows to both the developing countries and Eastern Europe and the former Soviet Union. We understand that this may require further funds from member countries. In our view, the expected demands on the international system are another argument for Canada in the next refunding cycle not to back away from its commitment to the multilaterals.

APPENDIX A
List of Witnesses

Associations and Individuals	Issue No.
Bank of Canada	
William R. White, Deputy Governor	3, 6
James Powell, Assistant Chief, International Department	3, 6
Bank of Montreal	
Michael (Mike) G. Maila, Senior Vice-President, Special Country Unit	3, 11
Bank of Nova Scotia	
David Hilton, Senior Vice-President, International Affairs	10
Canadian Council for International Co-operation	
Tim Draimin, Acting Executive Director	3
Akouété Akakpo-Vidah, Development Policy Officer—Africa	3
Canadian International Development Agency	
Marcel Massé, President	9
Art Wright, Vice-President, Mutilateral Programmes Branch	2
CUSO	
John Munuve, Field Staff Officer in Tanzania	3
Christopher Neal, Communications Officer	3
Department of External Affairs and International Trade	
Philip Somerville, Director General, Economic Policy Bureau	2
Department of Finance	
David Dodge, Associate Deputy Minister	1
Michael G. Kelly, Senior Adviser, International Trade and Finance Branch	1, 5
Micheline Aucoin, Economist, International Finance and Development Division	1
Douglas E. Smee, Executive Director, International Monetary Fund	5

Associations and Individuals	Issue No.
Department of Finance—*cont'd*	
Frank Potter, Executive Director, World Bank	5
Allan Gill, Director, International Finance and Development Division	2, 10
Development Alternatives Inc., Bethesda MD	
Donald Sherk, Vice-President	12
House of Commons	
Honourable John A. Fraser, Speaker	8
Individuals	
David Pollock, Adjunct Professor of International Affairs, Norman Paterson School of International Affairs, Carleton University	3
Professor Norman Girvan, Director, Consortium Graduate School of Social Sciences, University of West Indies	3
Dr. Smitu Kothari, Professor	4
David Hopper, Consultant	4
Gerry Helleiner, Professor, University of Toronto	9
Morris Miller, Adjunct Professor, Faculty of Administration, University of Ottawa	9
Daniel Bradlow, Associate Professor of Law, American University	12
Inter-Church Coalition on Africa	
John Mihevc, Programme Officer	3
International Centre for Human Rights and Democratic Development	
Edward Broadbent, President	3
David Gillies, Policy Coordinator	11
North South Institute	
Roy Culpeper, Vice-President, Research Coordinator	3, 6
Office of the Auditor General of Canada	
D. Lawrence Meyers, Deputy Auditor General	7
Bonnie Miller, Assistant Auditor General	7
Vinod Sahgal, Principle, Audit Operations Branch	7
Probe International	
Patricia Adams, Executive Director	4
Peggy Hallward, Researcher	4

Associations and Individuals	Issue No.
Resource Futures International Inc.	
Donald J. Gamble, Chairman	4
United Nations Development Program	
Mahbub ul Haq, Special Adviser to the Administrator	8

Associations and Individuals	Issue No.
Department of Finance—cont'd	
Frank Potter, Executive Director, World Bank	
Allan Gill, Director, International Finance and Development Division	6
Development Alternatives Inc., Bethesda MD	
Donald Sherk, Vice-President	12
House of Commons	
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Dr. Smitu Kothari, Professor	4
David Hopper, Consultant	4
Gerry Helleiner, Professor, University of Toronto	9
Morris Miller, Adjunct Professor, Faculty of Administration, University of Ottawa	9
Daniel Bradlow, Associate Professor of Law, American University	12
Inter-Church Coalition on Africa	
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Bernie Miller, Assistant Auditor General	7
Vinod Sahgal, Principal, Audit Operations Branch	7
Probe International	
Patricia Adams, Executive Director	4
Peggy Hallward, Researcher	4

A copy of the Minutes of Proceedings and Evidence to this report (*Issues Nos. 1 to 13 of the Sub-Committee on International Financial Institutions and Issue No. 68 of the Standing Committee on Finance, which includes this report*) is tabled.

Respectfully submitted,

MURRAY DORIN,
Chairman.

Minutes of Proceedings

TUESDAY, JUNE 8, 1993
(83)

[*Text*]

The Standing Committee on Finance met at 9:50 o'clock a.m. this day, in Room 269, West Block, the Chairman, Murray Dorin, presiding.

Members of the Committee present: Clément Couture, Murray Dorin, Diane Marleau, René Soetens and Greg Thompson.

Other Members present: Stephen Langdon, Don Blenkarn.

Pursuant to Standing Order 108(2), the Committee proceeded to the consideration of the First Report of the Sub–Committee on International Financial Institutions.

On motion of Clément Couture, it was agreed,—That, the First Report of the Sub–Committee on International Financial Institutions be adopted and that the Chairman present it to the House as the Nineteenth Report of the Committee.

On motion of Clément Couture, it was agreed,—That, the Report be printed in tumble format.

At 9:54 o'clock a.m., the Committee adjourned to the call of the Chair.

Susan Baldwin
Clerk of the Committee

Minutes of Proceedings

TUESDAY, JUNE 8, 1993
(83)

[*Text*]

The Standing Committee on Finance met at 9:30 o'clock a.m. this day, in Room 269, West Block, the Chairman, Murray Dorin, presiding.

Members of the Committee present: Clément Couture, Murray Dorin, Diane Marleau, René Soetens and Greg Thompson.

Other Members present: Stephen Langdon, Pat Sobeski.

Pursuant to Standing Order 108(2), the Committee proceeded to the consideration of the First Report of the Sub–Committee on International Financial Institutions.

On motion of Clément Couture, it was agreed,—That, the First Report of the Sub–Committee on International Financial Institutions be adopted and that the Chairman present it to the House as the Nineteenth Report of the Committee.

On motion of Clément Couture, it was agreed,—That, the Report be printed in tumble format.

At 9:58 o'clock a.m., the Committee adjourned to the call of the Chair.

Susan Baldwin
Clerk of the Committee