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Introducing Financial Accountability at the IBRD: An Overdue and Necessary Reform

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1. Introduction

The OECD (1998, 17) speaks of "an important paradigm shift, with some quite radical implications for the practice of development co-operation" in the 1990s. Among the "key operational implications" of its new concept rank "the need for transparency and accountability, both within the aid agency and among donor agencies and development partners" (*ibid.*, 22), and good governance. Seeing both need and scope to strengthen market mechanisms, the donor community and International Financial Institutions (IFIs) have stressed the principles of good governance, democratization, participatory development, transparency and accountability. These principles include sensible economic and social policies, financial accountability and the creation of a market friendly environment.

The OECD (1993, para 4) identified accountability as essential for successful development efforts, as "vital and urgent" for "any society". Accountability, transparency and high standards of public sector management are "basic values in their own right", but also "means of developmental ends."

One must agree that these principles are indeed important to successful development and to reaching the OECD's declared goals. Therefore they must not only be applied to recipients. Logic demands applying efficient management to bilateral aid and multilateral development cooperation with equal fervor as OECD countries propose it to aid recipients. Donor countries can immediately introduce appropriate management and accountability standards at their own national agencies and at all multilateral institutions they control. This would create model cases, proving honest and unselfish intentions convincingly, allowing aid administrations and IFIs to reap the benefits which the OECD (e.g. 1993, para 70) has repeatedly mentioned, such as better use of scarce resources, or relieving delays and distortions of development.

The International Bank for Reconstruction and Development (IBRD) has been among the most vocal advocates of good governance, transparency, and accountability in developing countries, particularly emphasizing their economic aspects. Meanwhile its critics have started to call for good governance and accountability by the Bank itself. The "Wapenhans Report" (IBRD 1992) stressed accountability, participation by beneficiaries, transparency and "prudent" governance. It urges the Bank to reconsider management procedures in a way apparently inspired by the new OECD-principles of sound management.

But while shortcomings of aid administrators and IFIs are sometimes acknowledged (e.g. OECD 1998, 18f or 67ff) the economically appropriate remedy - financial accountability - has not even been mentioned so far. Too often donors and IFIs do not observe acceptable standards of accountability, which produces perverted, market-unfriendly incentive structures. This fundamental flaw must be redressed by introducing market incentives appropriately. This paper proposes arbitration and damage compensation to make the IBRD financially accountable, thus allowing it to reap the efficiency gains of market systems.

First, this paper discusses the effects of total financial unaccountability. Then it argues that and why the present Inspection Panel is no appropriate remedy. Finally it describes how independent arbitration would link the Bank's decisions appropriately with risk, arguing that financial accountability would be in line with the original intentions of the Bank's founders.

2. Unaccountable Administration - The Heart of the Matter

The realization that unsound management by financing institutions causes damages is not new, although no appropriate consequences have followed. The IBRD (1984, 24) concluded

> Genuine mistakes and misfortunes cannot explain the excessive number of "white elephants". Too many projects have been selected either on the basis of political prestige or on the basis of inadequate regard for their likely economic and financial rate of return ... External financial agencies have shared the responsibility for this inadequate discipline over the use of investment resources.

Unfortunately, the word "shared" is notional at best. External financial agencies have never shouldered their financial shares in genuine mistakes and misfortunes. Nor has the Bank - as Jeffrey Winters argues in this volume - taken any proper measures to reduce corruption in its own operations. Like other IFIs the IBRD claims the privilege of absolute exemption from any financial responsibility for its own actions, decisions, and omissions. The very idea of financial accountability or paying for one's errors is absolute anathema. In contrast to developing countries that feel the economic effects of inadequate implementation, external financial agencies, such as the IBRD, have benefited economically from disasters they helped create. Claiming the status of preferred creditors IFIs profit from their own errors at their client's expense. According to Mosley, Harrigan, and Toye (1991, 24) the Bank "now not only admits its mistakes, but has enshrined learning from them as part of their corporate philosophy." If the Bank has learned, poor countries and vulnerable groups in particular have paid its tuition.

Brazil's Polonoroeste illustrates this point perfectly. *Time* (12 December 1988) reported that a loan of $240 million, granted despite warnings from the Bank's own experts (Rich 1994, 141ff), had caused considerable damage. Admitting to have erred the Bank lent another $200 million to repair damages done by the first loan. Brazil's debts increased by $440 million, the IBRD nearly doubled its income stream.

The Bank claimed that Brazil had failed to comply with conditions of the loan agreement. This is immaterial to the argument. Brazil suffered financial consequences while the Bank gained financially. Delinking decisions and risk explains economically suboptimal practices. (Co)determining its clients' policies and decisions the IBRD refuses to share risks appropriately, insisting on full repayment, even if damages are caused by grave negligence of its staff.

Projects gone wrong because of the Bank's fault may - and often do - result in new Bank loans to repair damages done by the first loan. Wrong decisions pay off, flops create income and jobs. This is economically unacceptable.

Country lending targets often put pressure on officials to disburse, occasionally even to countries which anyone in the division agreed were unable to absorb the money. Bangladesh, described in great detail by Mosley, Harrigan, and Toye (1991, 72) is by no means a singular case. Quoting examples of lending pressure the IBRD's Operations Evaluation Department (OED) warned that the Bank "needs to be more realistic about the borrowers' implementation capacities" (IBRD 1989, xvii). Regional and country targets combined with gains from flops provide strong incentives to overrule economic reason.

The OED (IBRD 1989) concluded that preparation was good or adequate for only 21 percent of projects. Insufficiently detailed engineering before approval, inappropriate expertise in procurement - an issue the OED could not elaborate on because of inadequate statistics - lack of training, will or motivation by most operations staff were found. Calling the Bank's enduring errors in implementation rate forecasts embarrassing, it noted gaps between appraised and reestimated economic rates of return of up to 20 percentage points(!) for regional averages. The OED's critique is not necessarily heeded. The sector water supply and waste disposal did not do so since the earliest appraisal in 1970 - a sobering result, the OED remarks correctly (IBRD 1989).

The Wapenhans Report (IBRD 1992) repeated the OED's criticisms, frequently even in the same wording. Unsurprisingly, water supply and sanitation was identified as particularly problematic (*ibid.*, ii), and has remained so (IBRD 1999e, 17). The Wapenhans Report was discussed in detail by Raffer (1995). Suffice it to recall its most appalling criticism. It was thought necessary to emphasize expressly: "the perception that the literary quality of the SAR [Staff Appraisal Report] is in itself a criterion of success", is wrong. Actually accruing returns - not wonderful English - matter. Apparently thinking this novel, unheard-of idea might not be immediately acceptable to IBRD-personnel the Report added "that point should be driven home." (IBRD 1992, Annex A, 8)

Cumbersome red tape and economically dubious bureaucratic goals such as pleasing one's superiors' fancies, disbursing given amounts "in time" to fulfill targets or even the beauty of style of memos have enjoyed priority over economic results at the borrowers' expense. Mosley, Harrigan, and Toye (1991, 72) showed that employee's careers depend on fulfilling country targets. On an individual level it is understandable and rational to behave as superiors expect, even if this means insufficient attention to economic outcome. This is precisely the systemic failure of planned economies. With personal promotion depending on producing planned quantities, most managers were able to do so or even to exceed quantitative targets, accumulating heaps of products of dubious quality and usefulness. No real - commercial - bank could survive such management for long, let alone over 50 years.

Changes in evaluation methods hardly dispel suspicions about promotional attitudes. In 1985-86 the IBRD introduced a new methodology. This "less mechanical and somewhat subjective judgment as to performance" was characterized by a *"subjectivity of assessments*, which *increased the weight given to evaluators' perceptions, some of which were difficult to explain fully*." (IBRD 1989, 15f; stress added) This somewhat subjective method produced success, reducing the share of unsatisfactory projects in 1987 from 28 percent according to the previous method to 12 percent with unsatisfactory or uncertain performance. "Uncertain" was itself a window-dressing euphemism, defined as: "Project achieves few objectives, if any, and has no foreseeable worthwhile results" (*ibid*., 15). But in spite of innovative change the share of satisfactory operations went on declining perceptibly.

Meanwhile the IBRD (1997a) has changed its evaluation method again, apparently to the better. It contains a six grade scale including unsatisfactory and highly unsatisfactory outcomes. Sustainability, institutional development impact, Bank performance, and borrower performance are also rated. Soft criteria have become more important, such as more emphasis on social impact, with-without project comparisons - which are "In practice ... often difficult to define" as the Bank contends (*ibid.,* 5) - qualitative observations, and judgments on institutional development. Outcome, Bank and borrower performances are collapsed into binary judgments satisfactory/unsatisfactory. Satisfactory means "an operation has achieved most of its major relevant goals efficiently" (IBRD 1998, 41). In spite of claims to the contrary, no stringent rules for judgment can be found, even in material sent on request by the OED. Stating that the choice of a six point basis for rating outcome - in contrast to three point bases of other counts - means that "we did not have to impose any subjective mechanism to give outcome more weight" (IBRD 1999e, 40) is simply wrong. Nor is there any objective reason for the weights within the development effectiveness index.

Although the development effectiveness index is not meant to substitute rates of return (still calculated for about a third of Bank projects), the IBRD (1999e, 41) argues that shifts towards policy and institution-building make them "ill fitted". Economic Rate of Return (ERR) sounds harder than it is. In the 1980s it included shadow prices, incremental benefits thought to stem from the project, even progress in institution building, an indicator of performance inherent in the costs and benefits considered particularly important (IBRD 1989). Meanwhile the Bank shifted increasingly towards softer criteria, more likely to be valued differently depending on evaluators' preferences.

In contrast to the reform of the 1980s this new method increased the share of satisfactory projects sustainably, "a remarkable improvement" according to the IBRD (1999e, xiii). The Bank is kept "on course to meet management's goal of 75 percent satisfactory projects by the year 2000." (IBRD 1997b, 4) Doubts persist that improving the quality of Bank processes to 100 percent satisfactory results - "an aggressive approach, championed by President Wolfensohn," - is "likely to be hit by the year 2000." (*ibid.*) During the first half of 1998 the target set by the Strategic Compact was exceeded (IBRD 1999e, 7). Sectors where economic facts impact more strongly remain problematic. Projects in industry declined to a dismal 36 percent satisfactory in fiscal 1997-98. The Bank rightly observes: "This raises questions." (*ibid.*, 17). Fortunately, industry is a sector with declining emphasis in the Bank. Projects less exposed to hard on-the-ground results, such as public sector management, could improve the percentages of satisfactory outcomes perceptibly. Adjustment loans continue to have higher average outcomes and sustainability than investment loans (*ibid.*, 13) - one wonders why success is not visibly reflected by the performances of adjusting economies.

Raffer and Singer (1996, 192) warned against this increasing neglect of hard economic measures in favor of difficult to quantify benchmarks. By contrast the German Kreditanstalt für Wiederaufbau (KfW) emphasizes economic results much more strongly, a fundamental difference in attitudes. Grade 6 (two projects in KfW 1997) signifies "totally failed", a clearness of language unknown to the IBRD (1997e, 39). 5 signifies "clearly insufficient developmental effects". 87 (49 percent) of 177 evaluated projects are classified as 3 or 4, straddling across the successful/unsuccessful borderline (KfW 1997, 19). Adding that classification may easily change from 3 to 4, depending on viewpoints, the KfW states that some projects classified as 4 will be sustainable as sunk costs make using them more economic than closing down. Even if increased demand uses them to capacity later on, projects are not considered economically viable on their own (qualified under 4) whenever losses at the start cannot be recovered. Qualification as unsuccessful sometimes "comes as a surprise" to "our partners". All 42 projects marked 4 (24 percent of projects, 26 percent of funds) "function and are used" (KfW 1997, 8), but positive effects cannot compensate negative ones. Reaching the project's goals does not automatically mean classification as successful, if costs cannot be covered or payoffs to the country's national economy remain insufficient (*ibid.*, 27). The KfW (1997, 7) emphasizes that it employs external evaluators too.

By comparison the IBRD (1999e, 8) classifies projects with marginally unsatisfactory outcome as satisfactory because of a substantial development impact. In a demonstration case this impact was replacing a loss-making public institution by a "market-based" institution, overruling prosaic facts such as subsidies and free hook-ups to the power grid resulting in too many private electric wells.

This comparison suggests that the IBRD's evaluation is - economically speaking - not international best practice. One may no doubt query the KfW's results and classifications as well. The above average rate of success (KfW 1997, 19) of Structural Adjustment programs may, e.g., raise questions, particularly if compared with the OED's verdicts or practical success of program lending. But all in all the KfW's approach seems more driven by economic factors and less by a desire to window-dress. Its statement that it wants to learn from past errors appears more credible.

Project successes or failures may be relevant for Structural Adjustment, especially in poor countries with high shares of official debts. Economic flops help to accumulate debts. High rates of project failures might render Structural Adjustment necessary, just as failed programs are likely to call for new ones, as long as unconditional repayment to IFIs is upheld. This logical relation might be described somewhat cynically as IFI-flops creating IFI-jobs.

Regarding Structural Adjustment the OED found grave shortcomings too (cf. Raffer 1995). One cannot but concur that "SAL conditionalities should take into account the macroeconomic consequences of the policy prescriptions" (IBRD 1989, 92). The OED called for an integrated analytical framework to understand better the links between programs and their expected macroeconomic outcomes: "Such a framework would also be useful for ex-post evaluations" (*ibid.*, 6). This raises the question on what basis the Bank had implemented programs for quite some time.

The Wapenhans Report (IBRD 1992) mentioned grave shortcomings, such as project conditions conflicting with Structural Adjustment conditionality imposed by Bank and Fund, or insufficient attention to financial risks. Borrowers allege that conditions liked by the Bank's management and the Board are included even "where these may complicate projects so as to jeopardise successful implementation." (*ibid.*, iii). This brings us to the question of risks.

The OED allows us a glimpse at one of the Bank's more critical departments' understanding of a debatable performance: "a zero rate of acceptable performance would indicate that Bank loans made borrowers worse off, an outcome that would raise serious questions about Bank performance." (IBRD 1989, 16) The fact that acceptable is not strictly defined apart, totally unacceptable results would not raise any questions in a market environment. Institutions with this record disappear quickly. Even in Centrally Planned Economies zero rates of success would not just have raised questions, though consequences, such as involuntary resettlements to Siberia, might not have been strictly economic. Finally, the statement is logically wrong: many borrowers may well be worse off at a positive rate of acceptable performance.

Talking increasingly about risk, the Bank (1999d) shifts risks to the extent possible onto clients forced to repay. Variable-rate loans shift interest risk. In the case of fixed-rate single currency loans the Bank charges a premium for bearing some interest risk. Lending and borrowing in the same currency keeps currency risk very limited, according to the Bank. Funding risk, the inability to gain access to a particular currency on terms needed to meet obligations at a particular time, managed by the Bank, seems rather negligible. Practically, the Bank is deciding without risks.

3. The Inspection Panel - A Small Move into the Right Direction

The IBRD was the first IFI establishing an Inspection Panel, a pioneering and laudable step, followed in 1994 by the IDB's independent investigation mechanism. Demanding independent arbitration one is therefore confronted with the IBRD's (1999c, 3) claim to have already an "independent forum" providing relief "when adversely affected people believe the Bank itself has failed, or failed to require others, to comply with its policies and procedures".

The in-house Inspection Panel created to investigate whether decisions by the Bank or IDA were not in conformity with the Bank's own operating rules and procedures is the result of particularly severe criticism, pressure by NGOs, parliamentarians, academics, even from within by some executive directors. Apparently no need was perceived to assure that the IFC respects its own operating rules and procedures.

The Inspection Panel's mandate became more restricted than proposed by some executive directors (Raffer and Singer 1996, 52ff). With all its faults this Panel is a pioneering innovation, but no substitute for arbitration. Severe flaws do not allow it to guarantee proper legal relief satisfying the basic principles of the rule of law. Nor does it make the IBRD accountable.

First, in spite of misleading wording this in-house Panel is not "independent", meaning "not dependent on one of the parties". It is an internal arrangement fully dependent on the board whose permission it must seek to open a case, only "independent" of inspected staff. There is of course no reason why president or board should not create such an internal controlling unit, dependent on them, although one might ask whether its fate might eventually be similar to the equally "independent" OED's, once established due to US pressure for more accountability, whose findings were occasionally disregarded for decades. It does not make the IBRD accountable in its external relations.

Second, panel members are Bank officials "subject to the requirements of the Bank's Articles of Agreement concerning their exclusive loyalty to the Bank" (IBRD/IDA 1993, para 10). This hardly suggest impartial relief, rather raising suspicions of one party being judge and jury. Such loyalty is not demanded from the IDB's (1994, 5) panelists.

Third, the panel's non-binding recommendations are submitted to the executive directors and the president for consideration. The board may give limited agreement (Caufield 1998, 268). It decides whether and which action should be taken.

Fourth, Caufield (1998, 267) sums up, complainants have no right to address the board before it decides whether to allow the investigation to proceed, to appeal a rejection or to be told its reasons, to examine or cross-examine evidence supplied by the Bank's management. Irrespective of damages, complaints cannot be made once projects are completed.

Fifth, if borrowers get another loan to finance corrective action, the Bank gains from its faults at borrowers' expense.

A comparison with decent legal procedures immediately highlights fatal flaws. Without an external authority independent of the IBRD, and able to award damage compensation the Bank is essentially allowed to remain unaccountable (Raffer 1993, 1995). Minds more critical than I might call this Panel a whitewash facility, but with all its shortcomings, giving greater publicity to problematic projects is an improvement. According to "one long-serving staffer" the "very, very constrained" panel "has improved things just by being here." (Caufield 1998, 268)

The Panel proved annoying enough to trigger immediate attempts to limit its mandate further. The first request for investigation (Arun III) claimed the Bank had violated the requirements for determining adequate compensation for involuntary resettlement (Bradlow 1995), a particularly important issue. Multilateral financiers have often been accused of turning a blind eye to human rights violations in connection with their own projects. The Bank has always protected property rights of foreigners, thus fair compensation for expropriation should be extremely important. Evidence supports the view that the Bank, like many other development financiers, appears to have entertained double standards, depending on who was expropriated and whether expropriation occurred for and within a project or not.

The Bank finally cancelled the Arun III loan, citing cost overruns and questioning the ability of the Nepalese government to coordinate the project and to raise electricity prices enough to pay for it. None of these problems could have been unexpected and new. Public pressure seems to have been the real reason. The Panel provides an institutionalized focus of such pressure, which is a good thing.

This very first case made the Bank look for procedural requirements restricting future access to the Panel. Soon "Some Executive Directors also appear to be reconsidering the wisdom of their decision to establish" it (Bradlow 1995, 4). Since the Bank alone defines the rules, changing them unilaterally is easy - rather disquieting for the victims of development finance.

In 1998 a working group was established to assess and review procedures, proposing to weaken the Panel process significantly (IBRD 1999a). The board has tended to split mainly between borrowing and non-borrowing members. Like many staff members, borrowing governments dislike panel investigations that might shed light on their own shortcomings too. According to Bradlow these new criteria would have pre-empted a number of high profile cases (Aslam 1999). Advocating with-without comparisons to asses material adverse effect (IBRD 1999a, 3) a highly speculative method was recommended that might easily be turned against complainants. All changes fit alarmingly well into a history of attempts to clip the Panel's wings.

4. Bringing the Market to the IBRD

Operating in a market environment private consultancy firms have always been liable to pay damage compensation if damages occur due to their (gross) negligence. Clients can sue them. Independent courts adjudicate or deny damage compensation. The limits of liability may stretch quite far. As the *Financial Time* (September 5, 1995) reported an English court ruled Lloyd's Bank to compensate a couple who had been given a loan to buy a house. The court found the bank's employee had gone beyond lending by adding advice on the housing market. Thus acting as a consultant he had failed to attract due attention to risks he should have been aware of. Offering money and advice, often actually imposing decisions on clients, the IBRD should be glad not to be an English commercial bank. Holding the IBRD as financially accountable as consultants is logical and necessary, particularly so as it has started to emphasize non-lending services more strongly.

Regarding financial accountability one has to differentiate between projects and programs. If projects go wrong, errors, faults and shortcomings due to negligence can be more easily identified and assigned. Financial consequences necessary to make up for damage caused can be more easily determined. If borrower and lender do not agree on compensation or on sharing costs if both sides are to blame, the solution used between business partners or transnational firms and countries to solve disagreement could be applied: arbitration, a traditional mechanism for international investments. The Bank itself created the International Centre for the Settlement of Disputes (ICSID) to provide arbitration. If disagreements between transnational firms and host countries can be solved that way there is no reason why disputes between the IBRD, borrowing countries or affected individuals cannot be solved too. Arbitration has become increasingly popular with OECD governments, as NAFTA, WTO dispute settlement, and the envisaged investor-state arbitration of the Multilateral Agreement on Investment prove.

The IBRD's (1985, Section 10.04) *General Conditions* foresee arbitration as the means to settle disagreements with borrowers, be they members or not, for "Any controversy between the parties to the loan agreement", or "any claim by either party against the other" not settled by agreement. Bank and country (guarantor country and borrower if these are not identical) appoint one person each. Both sides agree on a third arbitrator. The President of the International Court of Justice or the UN Secretary General appoint this umpire if parties fail to agree. Section 10.04 contains the necessary procedural provisions. Procedures making the Bank financially accountable need not be invented. Arbitration could be applied if governments or other borrowers claim damages suffered due to the Bank's or IDA's negligence. Naturally the IFC should also be subject to arbitration.

Although other borrowers than governments can demand arbitration as well, people suffering project-inflicted damage remain excluded, a shortcoming one could change with the stroke of a pen. It has to be changed. Mostly affected people cannot exert pressure on their own governments let alone borrowers to represent them appropriately against multilateral financiers.

Governments and public entities may not wish to sue for several reasons. They might not have suffered damages and/or be or feel under IBRD pressure. Dependent on the IBRD's money or its (and the IMF's) seal of approval governments might not wish to pick a fight. Involved themselves in projects governments might not wish to raise the issue of damages to avoid shedding light on their own shortcomings. Their interest to represent people actually harmed might not be great. If borrowers' attitudes towards the Inspection Panel is any guidance, governments seem to oppose proper investigation as strongly as influential groups within the Bank.

Affected people might even be physically endangered if and when trying to get relief. Repression - sometimes in extreme forms - has happened during project implementation. Big dams may imply "involuntary resettlement" of thousands of people. Not seldom people are chased off their land by security forces - occasionally even death squads - to make room for projects. Compensation is quite often insufficient, if granted at all. George (1988, 158) reports that people resisting resettlement under Indonesia's *transmigrasi* project were crushed by security forces. In several countries people unwilling to clear their land for large development projects were killed. While NGOs blamed police or military death squads, governments were usually unable to find any proofs for such accusations.

Resettlement problems were recognized long ago by the IBRD. Cernea (1988, 44) estimated about 40 IBRD projects to "cause the relocation of at least 600 000 people in 27 countries" during 1979-85, warning that "the number of people needing to be resettled is *chronically underestimated*." (*ibid.*, 45, stress in orig.) Projects appear cheaper by externalizing costs. Without mechanisms internalizing all costs - making multilateral planners financially accountable - economic reasoning suggests to expect this outcome. Cernea found that forcefully resettled people often get a raw deal to make projects cheaper. Compensation payments are often inadequate, leading to impoverishment, particularly in the case of dams. Cernea cites the destruction of productive assets, higher morbidity and mortality, ecological disaster and the destruction of social structures as effects of compulsory resettlement. This did not make the

Bank look for appropriate remedies, as more recent literature confirms. A Bank report covering nearly 200 projects during 1986-93 estimated the relocation of 2.5 million without discernible improvements on Cernea's findings (Caufield 1997, 262f; Rich 1994, 155ff).

The necessity to internalize all relocation costs, to enforce property rights and the rule of law requires that anyone suffering or alleging to suffer damages due to the IBRD's fault must be able to seek redress. This principle is firmly established in OECD countries. Keenly preaching human rights and respect of private (especially foreigners') property IFIs and donors have frequently financed projects violating these principles. The right of victims to make official lenders accountable for what they do is needed to improve the lot of the poor, whose human rights and even lives are too often considered unworthy of respect by their governments and their governments' public financiers.

Representation of affected people by NGOs less under pressure from IFIs or member governments is mandatory and crucial in such cases. The group of those able to demand arbitration, enabling the poor to defend against damages caused by ill-conceived projects must therefore be appropriately large. There is scope for an advocacy role of NGOs. It is mandatory to give the right to file complaints to individuals, NGOs, domestic firms and international organizations.

The IBRD's (1999b, VII.3) Articles of Agreement allow actions against the Bank except by members or persons acting for or deriving claims from members. Property and assets are "immune from all forms of seizure, attachment or execution *before* [emph. added] the delivery of final judgment against the Bank." Actions may be brought against the Bank in courts of competent jurisdiction in the territories of members in which the Bank has offices, appointed agents for the purpose of accepting service or notice of process, or issued or guaranteed securities. The Bank's founders had no intention to exempt and protect it from all legal, and economic consequences of failures. Accountability was not initially meant to be removed.

Suing the Bank before national courts was therefore considered technically feasible. One might argue, though, that a specialized panel, more familiar with development work, would be a better choice.

Technically, arbitration could be done by panels custom made for each case separately, or by one permanent institution. The alternative of a permanent international court of arbitration might be considered better if and when financial accountability becomes the rule in development cooperation. It could but need not be affiliated with the International Court of Justice. Its arbitrators could be nominated by members of the International Court of Justice, after giving interested parties - the IBRD, governments, international organizations, and NGOs representing civil society - a right to propose arbitrators. Both sides could nominate lists, similar to the IDB's roster. But this alternative would raise a number of difficulties, such as which NGOs should be entitled to propose arbitrators or which should be heard. It would have to be assured that the lists would be balanced between arbitrators nominated by those being held accountable and those holding accountable. There would have to be a right of parties to reject judges because of potential bias. Though possibly a good solution in the long run, establishing a proper and generally accepted permanent institution would be unnecessarily time consuming.

Custom made panels for each case would allow introducing accountability more speedily, as these problems do not exist and custom made "Arbitral Tribunals" already exist within the IBRD's statutory framework. Especially for the IBRD group alone a permanent institution would - one should hope - be unnecessary. Traditionally, panels of arbitrators are established by each side nominating the same amount of people, who elect one further member to reach an uneven number. As there may be many afftected groups or people filing complaints with regard to the same project, this is simpler than and thus preferable to appointment by the two sides pursuant to Section 10.04(c) of the General Conditions. For practical reasons the panel should never be larger than five persons.

Separate panels would be perfectly viable, as NAFTA's state-investor dispute settlement suggests, which allows a huge number of companies to demand arbitration. If firms are able to demand damage compensation, why should this be refused to the poor? OECD governments wanted this as part of the MAI - which would have given even more companies access to arbitration. This corroborates that OECD governments must consider separate panels operational. Neither the number of cases of the Bank's Inspection Panel nor of those registered by ICSID suggest an inoperatively high number of complaints. Once a panel is established for damages allegedly done by one project, all claimants joining the case later would automatically file their requests for compensation at this panel. There is no point in having several panels for the same project. Those raising the issue first, which is often more difficult than joining later, would be able to nominate arbitrators.

Naturally, claimants would have to demonstrate that their "rights and interests have been or are likely to be directly affected by" a negligent action of the Bank, IDA or the IFC, which "has had, or threatens to have, a material adverse effect" (IBRD 1993, para.12). The number of cases should remain manageable, particularly so as financial accountability should quickly reduce the amount of badly and hastily designed projects.

Arbitrators would, of course, have the right and duty to refuse hearing apparently ill founded cases. The need to prepare cases meticulously would deter abuse. The court of arbitration would decide whether the IBRD is liable for damages, and determine concrete payments. Unlike the in-house Inspection Panel arbitrators must not be restricted to investigating conformity with the Bank's operating norms, but free to examine these norms too. Normally, compensation should be paid directly to injured parties. If the borrowing country itself files complaints, the IBRD could simply waive a percentage of the loan to cover damages for which it is responsible. Indemnifying individuals, one might also think of arrangements where the IBRD converts part of its claims against the country into domestic currency to pay indemnities to domestic injured parties.

Financial accountability would act as an incentive for the Bank to perform better and a disincentive against its approval culture, thus benefiting the Bank itself too. It would give its staff good arguments against pouring money into regions just because of lending targets, against political interference by important shareholders including demands to bail out other creditors. It would have increased the weight of warnings from conscientious staff in the Polonoroeste case.

In contrast to projects, determining the IBRD's fair share of fault is practically impossible with programs. Structural Adjustment programs are administered by Bank and Fund, but the country, other IFIs, donors, or simply changes in the global economy may also affect outcomes. Except in extreme cases of negligence, which can be documented sufficiently well, the solution proposed for projects is not viable.

There is an easy way of holding the Bank financially accountable. Instead of attempting to determine precise shares in failed programs, the Bank - all IFIs in general - should lose the same percentage of claims as other creditors once a country becomes unable to repay. Instead of present "preferred creditor" status the Bank should be treated symmetrically. For countries with high Bank involvement, forced to orient their policies according to the Bank's "advice" over years, this is particularly needed and justified. While the importance of decisions by donors and IFIs varies it has always been particularly strong in the poorest countries, where shares of multilateral debts are relatively higher, due to lack of local expertise to participate appropriately in decision making, and high dependency on official flows. Protecting the Bank from losses is done at the expense of particularly poor clients, often highly dependent on solutions elaborated by the Bank.

Proposing a solution to overindebtedness Raffer (1990) and Raffer & Singer (1996) advocated internationalizing US Chapter 9 insolvency. These procedures for US municipalities, debtors with governmental powers, provide a clear and simple way to solve cases of sovereign bankruptcy, while making multilaterals, such as the Bank, accountable. Their essence could be adapted immediately to sovereign debtors. Their transparency and the affected population's right to be heard conform with the principles presently advocated by all OECD governments. Naturally, a country's affected population would have to be represented, e.g., by NGOs. As US Chapter 9 provides for representation of the municipality's employees by trade unions or employees' associations this is no fundamental change. Independent arbitration must replace courts due to their potential bias in creditor and debtor countries.

Reducing multilateral debts by international Chapter 9 insolvency would automatically introduce an element of financial accountability of IFIs. Accumulated bad projects financed by loans or a string of unsuccessful programs, eventually triggering insolvency would reduce IFI-claims. As official financiers, particularly the IBRD, control the use of loans, this would be highly positive, establishing principles of economics and justice in the last sphere where they are still excluded.

Projects and programs actually financed under conditions of accountability would have much better rates of success and much better developmental impacts. Being totally unaccountable the IBRD has neglected appropriate care - a textbook-type moral hazard problem as the OED and the Wapenhans Report prove. If the Bank had planned more conscientiously, it might well have had less business, fewer jobs, but also fewer bad projects, and possibly no problems caused by its own loans. As present problems with multilateral debts prove, the Bank, like other IFIs, will lose money due to operations designed and implemented without proper care. The Fifth Dimension, bilateral donors bailing-out Bank or Fund (cf. Raffer & Singer 1996, 28), or the HIPC-Initiative prove that large parts of poor countries' debts to the Bank are no longer recouperable.

If all project lending had been subject to appropriate care loans and credits would presumably be self-liquidating, earnings would cover repayments. Considering the riskiness of the development business, repeatedly mentioned by the IBRD, and admitting that a certain share of loans may always fail does not change this argument fundamentally. With careful planning and without the practices described above, loans would earn more money, at least reducing present problems.

Economic sense calls for a solution avoiding bail-outs and losses, which also eliminates the root of the problem, moral hazard, non-accountability, and the systemic failures they cause. Naturally it will cost shareholders something to clean up past failures.

Money to repay the IBRD's own loans to itself - for instance via the HIPC Trust Fund - is an inferior solution: costs without the benefit of eliminating moral hazard and systemic failures. There is no more reason to spare IBRD-owners, even though they are all governments, the results of past decisions than any other shareholders anywhere else. As both bilateral and private lenders accepted reductions of their claims quite some time ago IFIs, such as the IBRD, remain the last remnants of Centrally Planned Economies still untouched by market mechanisms, clinging formally to preferred treatment, although HIPC implies the loss of parts of their claims. If the Bank cannot survive financial accountability, dissolving it would be economically indicated.

The IBRD argues that foregoing its "preferred creditor status" by agreeing to debt reductions would deteriorate its own excellent rating as a borrower, increasing its costs of borrowing and lending. This argument is flawed. The IBRD simply refuses to acknowledge default, even if countries have not paid anything for six or seven years (Caufield 1998, 319). Claiming no default as long as such countries stay "in mutual respectful contact" (*ibid.*) with the Bank, the IBRD mocks all acceptable accounting rules. If publicly known though officially denied defaults have not reduced its rating, properly acknowledged and handled default seems unlikely to do so. Apparently, guarantees by OECD governments rather than its own lending record account for the IBRD's rating. Finally, the Bank has loan loss reserves.

A certain amount of lost loans is simply part and parcel of running banks, economically a necessary part. The possibility of losing money acts as an incentive for appropriate care. If the

Bank's argument were true no commercial bank would have excellent ratings as none gets everything repaid as stipulated. Banking centers such as London's City or New York would be perceived as assemblies of credit risks.

Whenever commercial banks believed they would not lose money, misallocation of funds occurred. The perception that countries would always exist and repay propelled the lending spree of the 1970s. Operating on the IBRD's principle of guaranteed repayment led to an overhang of commercial debts, just as the multilateral debt overhang resulted from waiving market discipline for IFIs. If international insolvency had existed before 1982 one could expect much lower debt burdens. There might even be no debt crisis. International insolvency would be a powerful incentive for lenders to stop lending if previous loans are not used efficiently, as they would be sure to lose money eventually.

Always subject to market discipline consultants can be and have been sued. This might make bad consultants disappear from the market, which is not necessarily a negative effect. Understandable institutional self-interest apart, there exists no reason for the IBRD's preferential treatment.

Its Articles of Agreement (IBRD 1999b) recognize default as a fact of life. Article IV.6 demands a special reserve to cover what Article IV.7 calls "Methods of Meeting Liabilities of the Bank in Case of Defaults". To the extent necessary - if this reserve proves to be insufficient - "other reserves, surplus and capital available to the Bank" can be used. Finally, appropriate amounts of unpaid subscriptions of members can be called. As the Bank is only allowed to lend either to members or if member states fully guarantee repayment (Article III.4) the logical conclusion is that default of member states was definitely considered possible, maybe even an occasionally needed solution. Unaware of any preferred creditor status, a legal concept which cannot be found in its Articles of Agreement and does not formally apply to the IBRD (Caufield 1998, 323), the Bank's founders wanted the IBRD subject to some market discipline rather than totally exempt from it. Mechanisms allowing the Bank to shoulder risks appropriately were designed. Thwarting its founders' intentions the IBRD has refused to use them, wrongly claiming this would make development finance inoperational.

The IBRD argues that its loans at near-market terms have lower interest rates than countries themselves could get, a fair argument as far as it goes. But slightly better financial terms of loans - even the low fees of IDA credits - do not necessarily make them cheaper. If countries must pay for wrong decisions by the IBRD or IDA loans might finally turn out much more expensive than borrowing at market terms, a fact also recognized by the IBRD's own evaluation method. The IBRD's strong involvement in decisions is another difference, particularly compared with private banks, which demands consequences. The IBRD has massively influenced the use of loans and the adoption of policies it thought appropriate (Raffer 1993, 1995). It had been proud of strict monitoring for decades, a pride not quite as perceptibly expressed in the recent past.

Close scrutiny of how loans are used does not mean the end of concessional lending as its debt service can be covered with relatively lower income streams than required for market interest. This, it should be recalled, was the original intention of the Bank's founders. Nor does it mean the end of financing social agenda or projects in the poorest countries. These, however, should be financed by grants. Institutional changes, such as the reorganization of domestic legal systems or reforms in the course of democratization must not be financed by loans, particularly not at expensive "development finance" terms. While no doubt important for a sound framework of future development such changes do not generate foreign exchange income directly and must be serviced out of budgets. In indebted countries where debt service already puts heavy strains on the budget new loans not earning their own debt service are likely to deteriorate the situation further.

That evaluating such activities is particularly dependent on what the OED called subjectivity of assessment or perceptions difficult to explain fully should be a further caveat. Logically, increasing shares of such projects offers an easy way to eschew critical evaluation. If principles such as democracy are as important to OECD governments as their present rhetoric asserts they should support them by grants.

5. Conclusion

The systemic bias towards accommodating other goals than strict economic efficiency strongly demands accountability. Protecting institutions from the results of their own decisions cannot be justified in market economies. Financial accountability via independent arbitration and damage compensation would provide incentives to give "due attention to considerations of economy and efficiency ... without regard to political or other non-economic influences or considerations" such as beauty of language, as Article III.5 (IBRD 1999b) demands.

Naturally the amount of the Bank's activities would strongly decrease to fewer but economically better operations. This is desirable as no projects at all are preferable to costly flops - at least for those who have to pay: "The costs of tolerating continued poor performance is highest not for the Bank, but for its Borrowers." (IBRD 1992, 5) Financial accountability linking decisions and risks is needed to provide an economically adequate incentive system. By introducing damage compensation, market mechanisms must finally be brought to the IBRD.

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