Chapter 10: International Financial Institutions and Accountability: The Need for Drastic Change

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I. Introduction

The dramatically increased leverage of International Financial Institutions (IFIs) on political decisions by debtor countries is a major result of the debt crisis. Before 1982, when finance was readily available from private banks, IFI influence and leverage had declined considerably. In 1981, for example, India even preferred the IMF to private sources, using the Fund as a 'lender of first resort', much to the discontent of the US.

This changed drastically after 1982. The debt crisis and their role of 'debt managers' gave IFIs new and increased leverage. During the 1985 IMF/IBRD meeting in Seoul the US Treasury Secretary, James Baker, expressly called on IFIs to support comprehensive macroeconomic and structural policies in Southern Countries (SCs), demanding a continued central role of the IMF together with multilateral development banks, and more intensive IMF and IBRD collaboration.

In 1989 Nicholas Brady reaffirmed and strengthened the role of the IMF and the IBRD as debt managers and promoters of 'sound policies' through advice and financial support. Paris Club debt reschedulings and debt reductions depend on an IFI 'seal of approval'. Prior agreement with the Bretton Woods twins is a condition for debt reduction under the Enterprise of the Americas Initiative. The EC considers SCs with IFI-supported adjustment programmes as automatically, although not exclusively, eligible for Community adjustment resources. Occasionally even domestic laws in the North, such as the US International Lending Supervision Act, base legal consequences on the IMF's judgement on a debtor country. Finally, the dramatic changes in Eastern Europe and the former Soviet Union have increased the number of IFI clients.

In odd contrast to the strong leverage conferred on IFIs, particularly the IBRD and the IMF, by their big shareholders and to their growing importance neither the economic efficiency of their actions nor the problem of financial accountability for their errors seem to have received perceptible attention from Northern governments. This is all the more surprising as efficiency, accountability and the market mechanism rank high in these governments' rhetoric, and official institutions, such as the European Parliament have criticised IFIs quite strongly. Its report of the Committee on Development and Cooperation on Structural Adjustment (1992 p.8) notes 'the substantial overall failure of the "first generation" structural adjustment policies proposed by the IBRD and the IMF', a fact meanwhile also conceded by IFI-employees. It called on the IMF to reconsider the very foundations of its Structural Adjustment (SA) policies in the light of the obvious inadequacy of its proposals, and even demanded a new 'European approach' to SA different from the Bretton Woods variety.

The question whether IFI programmes and projects actually work, has received relatively much attention in academic literature so far. But the problem of accountability as well as the link between accountability and economic efficiency have not received due attention. This is all the more inexplicable as these are two crucial elements of successful market economies. The most basic rule of a market system demands that decision making is inseparably linked with risk. This link promotes economic efficiency and makes those taking decisions accountable. It was severed in the countries of the former Eastern Bloc where decisions were taken by bureaucrats, not held accountable for the outcome of their actions.

In the case of IFIs decisions are delinked from financial responsibilities: while IFIs determine or at least co-determine the policies of their clients, they refuse to share the risks involved. They insist on full repayment, even if damages caused by their staffs occur. Such damages have to be paid for by their borrowers. IFIs can even gain financially from their own errors by extending new loans necessary to repair damages done by prior loans. This kind of riskless decision making is certainly not a sound incentive system and absolutely at odds with Western market systems.

This Chapter is going to discuss the problem of efficiency and accountability. First the high degree of IFI-interference into debtor economies will be documented briefly. Stating the obvious appears necessary because Bank and Fund often try to downplay if not deny their leverage, for example by claiming that they only finance a country's own programme and by phrases like Fund- or Bank-supported programmes. Then the problem of failures by IFIs will be discussed. Particularly with regard to SA this is an important issue because measures that hurt but help may be economically justifiable in contrast to those that hurt without helping. Finally proposals are presented how to link decisions and risks to make IFIs financially accountable and thus - according to the logic of market economies - more efficient.

II. Leverage and Economic Decision Making

In the words of J.J. Polak (1991 p.12), a leading theoretician of the IMF, 'The purpose of the Fund's conditionality is to make as sure as possible that a country drawing on the Fund's resources pursues a set of policies that are, in the Fund's view, appropriate to its economic situation in general and its payments situation in particular'.

Interestingly conditionality did not exist in the original IMF Articles of Agreement. It was introduced later and has been strengthened over time. The strengthening of conditionality can be best illustrated at the example of the Compensatory Financing Facility. Initially introduced to compensate shortfalls in export earnings beyond the control of SCs its

> conditionality was limited to an obligatory statement by the member to 'co-operate with the Fund ... to find, *where required*, appropriate solutions for its balance of payments difficulties.'
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> ....
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> Over the years, however, the Fund has increasingly come to the realization that *even though a country's export shortfall was both 'temporary' and largely beyond its control the country might still have balance-of-payments difficulties attributable to inappropriate policies and that large amounts of unconditional credit might cause the country to delay adopting needed policy adjustments*
>
> (Polak 1991 p.9; emphasis added)

Even if the country's economic policy is not at all the reason for the temporary problem the country still has to change it if the Fund wishes so. From a logical point of view this is quite strange unless the real reason is increased leverage rather than the elimination of economic inefficiencies.

To assess the influence of the Fund appropriately prior actions, which means changing policies in accordance with the Fund's views before receiving money, must not be forgotten. Reliance on prior actions has become more common in recent years. Polak (1991 p.13, stress mine) suggests that this can be used to the country's advantage 'to minimize the policy commitments it must make in its letter of intent and thus to *present itself as opting for adjustment on its own rather than under pressure from the Fund*'.

In plain English: a distressed country may chose whether to accept the IMF's conditions openly or by 'cleverly' disguising them as its own free choice.

The IBRD, too, has never made unconditional loans, even when financing concrete projects some conditions required policy changes (cf. Mosley et al 1991 p.27). When starting programme lending conditionality was increased. '[T]he Bank felt that it needed a place at the top policy-making table' (*ibid.*, p.34) beyond what it could expect from mere project monitoring.

This view can be corroborated by the description of Structural Adjustment Lending (SAL) by Ernest Stern (1983), an IBRD top executive, praising the 'comprehensiveness' of its 'coverage in terms of both macro and sector issues of policy reform; the exclusive focus on policy and institutional reform; and the detailed articulation of the precise modifications in policy necessary to adjust to a changed economic environment'(*ibid.*, p.91). As the availability of funds is entirely dependent on progress in implementing policy reform SAL enables 'the Bank to address basic issues of economic management and of development strategy more directly and urgently'(*ibid.*). Briefly put, Stern (p.104) saw SAL as a 'unique opportunity to achieve a comprehensive and timely approach to policy reform' and as the response to a '*feasible ... call for increased sacrifices*'.(p.91, stress mine)

Of course, Stern explains, there is a need for a 'firm understanding' of monitoring, a Letter of Development Policies is explicitly referred to in the loan agreement and tranching of disbursements allows preconditions for the release of the next tranche. Stern (*ibid.* p.99) concludes: 'While this procedure may be called "conditionality", it is in principle no different from the relationship involved in Bank sector or project lending'.

Quite naturally the Structural Adjustment Facility (SAF) introduced in 1986 for poor countries shows a similarly stern understanding of conditionality. Administered jointly by Bank and Fund the procedure of lending is described by the *IMF Survey* (Supplement on the Fund, September 1987, p.15)

- a 'policy framework paper'(PFP) has to be developed 'with the assistance of both the Fund and the World Bank'. It contains the macroeconomic and structural policy priorities, objectives and measures for a three year period, as well as a more detailed description of structural reforms and policies to be implemented in the first year
- the PFP is updated annually, reviewed by the IMF's Executive Board and the IBRD's Executive Directors in the Committee of the Whole
- the first instalment is made upon approval by the IMF. The SC is requested to present programmes based on the PFP for the three year period and the first year
- further instalments are made upon the IMF's approval of annual arrangements
- performance is monitored by benchmarks, not all quantified.

Finally, the Enhanced SAF (ESAF) introduced soon after SAF is subject to even stricter conditionality (Polak 1991 p.7).

The Group of 24 criticised the increasing restrictiveness of Fund lending and the proliferation of performance criteria in number and scope 'under one pretext or another'(*IMF Survey*, Supplement, August 19, 1987). During 1983-85 nearly 80 per cent of the arrangements contained, on average, more than eight performance criteria, sometimes as many as 14, a number dwarfed by the over 100 conditions of the IBRD's second SAL to Thailand. Quite often they extended to microeconomic variables such as prices for specific products. Reviews have become standard for all except SAF programmes to fill in performance criteria that could not be specified at the outset and to reset targets. Performance criteria are specified quarterly and semi-annually. The IMF may or may not pardon non-compliance by granting a waiver.

Suffice one more quote to establish the claim that IFIs are at least co-responsible for the success of programmes and projects they fund. The IBRD's own Operations Evaluation Department (OED) concluded: 'Finally, borrower preferences are not always seen as important in supervision management, although the outcome often has a critical impact on the borrower." (IBRD 1989 p.26)

Not surprisingly IFIs have repeatedly complained about insufficient borrower commitment or have stressed the need that programmes should be clearly 'owned' by affected governments. Such phrases were absolutely inexplicable if IFIs simply supported the affected governments' own proposals.

III. Efficiency, Failures and Their Costs

Blaming IFIs for making any mistakes is neither intended nor would it be fair. Even the most successful institutions have to put up with a certain rate of failures. Important questions are whether a minimum level of efficiency of operations can be proved, whether organisational arrangements provide incentives to avoid the same errors in the future and who pays for these errors. Finally it is important to ask whether these prescriptions have a sound theoretical and logical basis.

It is important to note that SA-policies do not follow from neoclassical theory (cf. Raffer 1992a). Pure trade theory supports - as Reisen/ van Trotsenburg (1988 p.83) show - that 'in a transfer situation, import substitution is preferable to exports promotion', or the opposite of IFI advice. Historically successful countries such as South Korea, Taiwan or Japan have indeed not opted for IFI-type liberalisation, nor have they reduced the role of the state in the way presently advised by IFIs.

Theoretical models, though, always state meticulously on what restrictive assumptions they depend. They never claim to be valid if these restrictions are not met. One quick look at a textbook will show that the necessary conditions for market optimality cannot be achieved in reality, particularly so if one can apply pressure to emulate the free market on the relatively smaller players only. Even more important: market optima cannot be approximated by eliminating some but not all imperfections - in that case the outcome might even make things worse as any good introductory textbook will warn. Therefore it must be shown for each policy change that it is indeed able to bring about improvements (cf. Raffer 1992a).

While it is common knowledge that unit costs change with output, the assumption that they do not is absolutely essential to defend comparative advantages and the case of beneficial free trade - routine justifications of IFI-policies. If unit costs are assumed constant an inconsistency between trade theory and growth theory follows, as H.B. Chenery (1961) has pointed out. If not, comparative advantage specialisation may lead to productivity losses (Raffer 1992b).

Empirical evidence on the success of SA is, at best, inconclusive, often there is no statistically significant difference between programme and non-programme countries. Khan (1990) even finds significantly reduced growth in programme countries and - as Polak (1991 p.42) points out - a predicted reduction in the growth rate of at least 0.7 per cent of GDP each year a country had an IMF programme. Mosley et al. (1991) found adverse effects of SA on growth rates, particularly in countries with low slippage on conditionality (a very weak favourable impact - because of the inflow of money rather than policy conditionality according to the authors - emerges if one changes periods and country groupings) and declining shares of investment in GDP. Attempts by IFIs to prove success were usually shortlived. Statistical methods, such as the grouping of countries have been repeatedly attacked as purpose serving. The IBRD's *Africa's Adjustment with Growth* published in 1989 together with UNDP is the best known example where bold statements such as 'Recovery has begun' on p. iii had to be corrected quickly.

Strong examples of alleged and proven failures and inefficiencies of IFIs abound in literature. Mosley et al. (1991 p.24) found that the IBRD 'now not only admits its mistakes, but has enshrined learning from them as part of their corporate philosophy.' The IBRD (1984 p.24) for example, admits

> 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.

Financial responsibility however has not been shared by all. If IFIs have learned during the last decade poor countries and vulnerable groups in particular have paid their tuition. Brazil's Polonoroeste illustrates this point perfectly. *Time* (12 December 1988) reported that a loan of $240 million had caused considerable environmental damage. Bank officials admitted that they had erred and lent another $200 million to repair the damage done by the first loan. Brazil's debts increased by $440 million, the IBRD increased its income stream.

Such examples render the remark by the Bank's OED (IBRD 1989 p.xiii) that a 100 per cent success rate, if ever achieved 'would invite questions about whether an appropriate level of risk was being faced in development investments' particularly sarcastic.

The delinking of decisions and risk could explain economically suboptimal practices. In addition it is a strong incentive to yield to political influence. Country lending targets often put pressure on officials to disburse. Mosley et al. (1991 p.72) present an extremely telling example. Although the whole division including its chief agreed that Bangladesh could not absorb any more money, the lending programme was not slowed. The division chief explained that if he advised slowing down he would be fired. This is by no means a singular case. Quoting examples of pressure to lend the OED (IBRD 1989 p.xvii) warns that the Bank 'needs to be more realistic about the borrowers' implementation capacities'.

The problem is further exacerbated by an even greater inflexibility on the regional level, which means funds that should be ideally switched from, say, Africa to Asia cannot be allocated this way. Right or wrong - they have to go into the predestined region.

This structural rigidity is certainly one factor explaining grave shortcomings pointed out by the OED (IBRD 1989), such as unrealistic scheduling and objectives at appraisal, excessive expectations leading to gaps between appraised and reestimated economic rates of return of up to 20 percentage points(!) for regional averages. It calls the Bank's enduring errors in implementation rate forecasts embarrassing. Evaluation concluded that preparation was good or adequate in 21 per cent of projects, which means it was not in 79 per cent. Insufficiently detailed engineering prior to 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 as well. The OED's critique was not always heeded. In the sector water supply and waste disposal this was not done since the earliest appraisal in 1970 - a 'sobering' result, as the OED correctly remarks.

To asses success rates of projects properly one must understand that the Economic Rate of Return (ERR) depending on costs and benefits measured by shadow prices or even by incremental benefits thought to stem from the project is itself not the hardest concept. An indicator of performance inherent in the costs and benefits considered 'particularly important', such as 'progress in institution building' is certainly not a hard monetary figure and might be valued differently depending on whether the IBRD's own department or someone else assesses it. Furthermore success is often 'based on the accomplishment of the project objectives and achievements' (IBRD 1989 p.3) Projects with major shortcomings but 'still considered worthwhile' (by the Bank itself) qualify as 'marginally satisfactory' according to the OED's methodology newly introduced in 1985-86 exactly for the purpose of 'adequate recognition' of these marginal projects. This 'less mechanical and somewhat subjective judgement as to performance ... posed its own problems, not the least of which was the *subjectivity of assessments*, which *increased the weight given to evaluators' perceptions, some of which were difficult to explain fully*.' (*ibid.* pp.15f; stress added). Nevertheless this new method described in some detail in IBRD (1989) produced success stories. While 28 per cent of projects were unsatisfactory for the 1987 cohort according to the traditional method, the new technique found only 12 per cent to have an unsatisfactory or uncertain performance. 'Uncertain' is in itself a window-dressing euphemism. The OED defines this category as: 'Project achieves few objectives, if any, and has no foreseeable worthwhile results' (*ibid.* p.15). In spite of such generous evaluation the share of satisfactory operations has declined perceptibly during the recent past.

The Bank has shown a predilection for convenient vagueness for quite some time. Figures on people affected by or expected to benefit from projects were already shown to be a bluff by Tetzlaff (1980 p.438). Interestingly the OED often criticized very much the same points with projects in the 1970s as it does today, which does not suggest an immense impact of its findings on actual practice.

The question of success or failure of projects is also of some importance for SA, especially in poor SCs with sufficiently high shares of IFI-activities. Their economic flops help to accumulate debts. A high rate of IFI-failures might therefore render SA necessary, which in turn is administered by IFIs, just as failed SA-programmes are likely to call for new SA-programmes, as long as unconditional repayment to IFIs is upheld. This logical relation might be described somewhat cynically as IFI-flops securing IFI-jobs.

Regarding SA the OED found sometimes dated technical expertise (in the area of public enterprise), overall outcomes on the macroeconomic front below expectations, or overly ambitious targets. One cannot but concur with the OED that 'SAL conditionalities should take into account the macroeconomic consequences of the policy prescriptions' (*ibid.* p.92) or with its call for an integrated analytical framework to understand better the links between a programme and its expected macroeconomic outcomes: 'Such a framework would also be useful for ex-post evaluations' (*ibid.* p.6).

The OED also allows us a glimpse on the Bank's own 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.' (*ibid.* p.16) The fact that acceptable is not strictly defined apart, totally unacceptable results over a year would not raise any questions at all in a well functioning market economy. Institutions with this performance record are immediately dissolved. Even in Centrally Planned Economies an absolutely zero rate of success would have done more than just raised questions.

Regarding the efficiency of Fund-programmes even IMF-sources are occasionally quite frank. Goldstein (1986 p.45) contends that depending on how one measures the effects markedly different results, both with regard to size and direction of effects are obtained. Not surprisingly 'the Fund has come to a rather different assessment of programme effects than some observers.' It appears that the Fund prefers methods rendering positive results. Regarding critique of the IMF's efficiency suffice it to refer to Spraos (1986), who is most outspoken.

What appears to be particularly alarming is that SA is even prescribed in cases where it is not needed:

> As a consequence the Bank often succumbed to the temptation to prescribe policy reform even in markets where its own analysis had revealed no significant distortion and to ride into battle, like Don Quixote with his lance tilted, even in fields where there were no noble deeds to be done. In some cases the Bank's SAL [=SA Loan] conditionality even ran counter to the policy changes which its own staff were trying to bring in at the project level ...
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> (Mosley et al. 1991 p.300)

A similar problem has been created by so-called cross conditionality, or the unpleasant situation when two lenders, such as the IMF and the Bank, demand actions that cannot be reconciled and the borrower is therefore logically unable to fulfil both lists of conditions.

Vali Jamal (1992) presents the example of Somalia in the 1980s where absolutely inappropriate policies were prescribed by the IMF, apparently because of insufficient assessment of the country's economy. After detailed criticism the author sums up: 'All in all, the spectacle is one of the IMF trying to impose the trappings of a free market economy on Somalia whereas one already exists in all but name.'

The Republic of Trinidad and Tobago documented grave irregularities and deficiencies in the IMF's assessment of its economy, which created the impression of economic mismanagement and led to an SA programme. After the IMF became aware of these substantial errors no correction was published in spite of the importance to the country. Because of the government's need for the IMF's 'seal of approval' Trinidad's own expert advised them not to pick a fight with the IMF. It is of interest to note that no OECD country, which as a non-borrower could have done so without any fear of consequences, bothered to ask for a detailed enquiry although this case became famous as the so-called 'Budhoo affair'.

IFIs have a long history of political lending. The Bank did, for example, not lend to Brazil under Goulart, Algeria until 1973, Egypt under Nasser, Chile under Allende, Indonesia under Sukarno,Ghana under Nkrumah, Argentina under Peron, Jamaica under Manley or Grenada under Bishop. On the other hand the IBRD organised a consortium of donors to provide aid to Saigon shortly before the fall of the city, or lavished money on military juntas such as in Argentina and Chile under Pinochet. It is, of course, logically possible that all projects considered during the periods mentioned above were economically unsound while a flood of economically sound projects came up after for example the coups of General Videla or General Pinochet. This possibility is however certainly low. As the famous example of the IBRD's loan to Argentina in 1988 shows, which was quickly disbursed and allowed the country to pay US banks in time, the Bank is even prepared to antagonize the Fund to please one major shareholder.

This does not mean that political considerations are beyond the IMF. Shortly before the Sandinista victory in Nicaragua, for instance, the IMF made a sizeable loan to Somoza, just in time to be gratefully pocketed by the fleeing dictator. Naturally the country was supposed to pay this money back. Duvalier's Haiti provides a similar example. According to *Time* magazine (2 July 1984) $20 million disbursed to alleviate balance of payments problems vanished without a trace, although the movement of a similar amount into the Duvaliers' palace account could be noticed. *Time* also reported the IMF's reaction: it '*threatened* to *halt aid* to the country *until Haiti made sure more money would not disappear the same way*.' (emph. add.) As this example shows some debts to IFIs are in need of scrutiny. Comparison with other clients, such as Manley's Jamaica, where an agreement was suspended on a minor technicality, does not provide purely economic explanations.

Economic theory suggests that economic inefficiencies and political decisions are fostered by riskless deciding. Without financial risks other factors become more important, such as disbursing enough to meet targets or pleasing one or more big shareholder(s). Financial accountability would provide a disincentive to do so.

IV. The Need of Financial Accountability

The idea of financial accountability or paying for one's errors is absolute anathema to IFIs. As both bilateral and private lenders have meanwhile accepted reductions of their claims they remain the only exception. The main argument of the IBRD - debt reduction has been more often suggested for development banks than for the Fund - is that its own excellent rating as a borrower would suffer unless all loans were repaid to the last cent. If that were true all commercial banks would have enormously low ratings as no bank ever gets all loans back. A certain amount of lost loans is simply part of the costs of running a bank. The understandable selfinterest of any creditor apart, there exists no reason for preferential treatment.

It is true that IFIs charge interest rates below the debtor's market rate, even in normal lending, which is too tough to qualify as ODA according to the DAC definition and for which this difference is small. Concessional money is not exclusively provided by IFIs and not necessarily cheaper than from bilateral sources.

But slightly better financial terms of a loan do not necessarily make this loan cheaper. If the country has to pay for wrong decisions by IFIs it might finally turn out to cost much more than money at market terms.

The strong participation in decision making by IFIs is the other difference, particularly in comparison with private banks. As shown IFIs have massively influenced the use of loans and the adoption of policies they thought appropriate to regain economic viability. The IBRD has been proud of its strict monitoring for decades, a pride not quite as perceptibly expressed in the recent past.

All in all there is no reason for preferential treatment of IFIs. The systemic bias towards accommodating other goals discussed above, be they internal to the IFI or external political demands, rather than strict economic efficiency strongly demands accountability. Protecting institutions from the results of their own decisions cannot be justified in a market economy.

Discussing the introduction of financial accountability one need differentiate between programmes and projects. As it is practically impossible to determine an IFI's fair share in programmes that went wrong, a clear and simple solution emerges in the case of countries where other lenders grant debt reductions. IFIs should lose the same percentage of their claims as other creditors, they should be treated symmetrically. In SCs with high IFI invol-vement, which have been forced to orient their policies according to IFI "advice" for some time, this solution is particularly justified. As the shares of multilateral debts are relatively higher in the poorest countries, protecting IFIs from losses is done at the expense of particularly poor clients, whose scarcity of experts has often made them extremely dependent on solutions elaborated by IFI staff. Using a term coined by Svendsen (1987 p.27) for African debts we may call these IFI-debts 'creditor-determined' or (mainly) the result of creditors' decisions.

As there is no sufficient proof that SA or IMF programmes work while there is substantial evidence of their extremely negative effects - even IFIs agree, for instance, that the poor are hurt, their effects on capital formation endanger future development - they should be discontinued. Strictly logically it does not even matter whether programmes do not work because of failures and inconsistencies, which appears to be the case, or because IFIs cannot make them work in SCs. There is no economically valid point to fund something that does not work but harms. Discontinuing programmes would also have the doubly beneficial effect that aid presently used to repair damages done by them would be free to be used in an economically better way.

As a consequence the IMF could be dissolved. Considering that proposals to melt the Bretton Woods twins into one institution have already been made this is not a wholly new thought.

Present SA should be substituted by a solution where debtor countries' debt services are brought in line with their abilities to pay under present, protectionist conditions. The fairest and economically most sensible way to do so would be the internationalisation of Chapter 9 of US insolvency laws. As it regulates the reorganisation of debtors with governmental powers, so-called municipalities, it could be internationalized quickly and with minor changes (cf. Raffer 1990). Its introduction would also mean that lenders would lend money if repayments can be financed by proceeds. Debts which have to be serviced out of the budget would and should remain the exception. Lenders would stop lending if previous loans are not put to efficient use, as they would be sure to lose their money eventually. Briefly put, if international insolvency had existed in the 1970s the burden of debt would be much lower, maybe there would not even be a debt crisis now.

This close scrutiny of how loans are used does not mean the end of concessional loans as their debt service can be covered with relatively lower income streams. 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 reorganisation of the legal system within a country or reforms in the course of democratisation should not be financed by loans, particularly not at the expensive terms of 'development finance'. While such changes are no doubt important for a sound framework of future development they do not generate foreign exchange income directly and will have to be serviced out of the budget. In indebted countries where debt service already puts heavy strains on the budget new loans that do not earn their own amortisation and interest service are not unlikely to deteriorate the country's debt situation further. The fact that the evaluation of such activities is particularly dependent on what the OED called subjectivity of assessment or perceptions difficult to explain fully should be a further caveat. If democracy is actually as important to OECD governments as their present rhetoric suggests they should be prepared to support the creation of democratic structures by grants.

Naturally the amount of IFI-activities would strongly decrease to fewer but economically more viable projects. This is desirable as no project at all is preferable to a costly flop - at least for those who have to pay for it.

This brings us to the problem of financial accountability for projects. Economically viable projects, which means projects that earn their amortisation and interest payments, pose no problem. But if a project goes wrong the need would arise to determine financial consequences. In the simplest case borrower and lender(s) agree on a fair sharing of costs. If they do not the solution used between business partners or transnational firms and countries in cases of disagreement could be applied: the decision of a court of arbitration. This concept is well introduced in the field of international investments. If disagreements between transnational firms and host countries can be solved that way there is no reason why disputes between IFIs and borrowing countries could not be solved by this mechanism as well.

A permanent international court of arbitration would be ideal, where SCs and IFIs nominate the same amount of members, who elect one further member to reach an uneven number. If necessary this court might consist of more than one panel established in the way proposed above. It decides on the percentage of the loan to be waived to cover damages for which the IFI is responsible. The right to file complaints should be conferred on NGOs, governments and international organisations. As NGOs are less under pressure from IFIs or member governments their right to represent affected people is particularly important. The court of arbitrators would, of course, have the right and the duty to refuse to hear cases that are apparently ill founded. The need to prepare a case meticulously would deter abuse. The possibility of being held financially accountable would act as an incentive for IFIs to perform better.

Financial accountability would thus also be beneficial to IFIs themselves. It would give their staffs a good argument against pouring money into regions just because of lending targets as well as against political interference by important shareholders including demands to bail out other creditors. Projects and programmes actually financed under these conditions of accountability would therefore have a much better rate of success and much more positive impacts on development.

Looking at present evolutions this proposal might probably not be as revolutionary as it seems. Signs that IFIs are likely to face increased problems with repayments in the near future exist: since 1982 IFIs have substituted a great deal of private loans in debtor countries, thereby bailing out private banks but deteriorating their own exposure. IFIs have already started to give loans to allow debtors to honour repayments to themselves as due. To keep up appearances third parties had to be involved repeatedly. This recalls a bit the situation of private banks in the early days of the debt debacle. Mounting problems with debt service and arrears, and even calls upon Northern governments for help are clear signs of alarm. The IBRD (1988 p.xxxvii) asked bilateral donors for money to help finance repayments of IBRD loans by countries now in the IDA-only category. The total amount of debt outstanding was a mere $3 billion and its service could neither be covered by IDA nor by the revenues of these IBRD-financed activities. While calls for bail-outs hardly inspire confidence in IFI-management they also show that the stage where an increasing number of SCs are simply unable to service IFI-debts might be near unless Northern governments are prepared for a bail-out.

Economically it would make sense to look for a solution before such a bail-out becomes necessary. This solution should also eliminate the root of the problem, which is non-accountability and the systemic failures it causes. Naturally it would cost IFI-shareholders something to clean up the failures of the past but there is no more reason to spare IFI-owners than any other shareholders of a firm. Furthermore a big bail-out would cost money as well. If development banks cannot survive being financially accountable dissolving them totally would be the economically indicated solution. Considering the increasing involvement of IFIs in Eastern Europe and the former Soviet Union the problem of efficiency and accountability becomes even more important. Pouring money there just to meet regional targets would certainly not be indicated.

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