

Issue Brief for Congress

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Multilateral Development Banks: Issues for the 107th Congress

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Multilateral Development Banks: Issues for the 107th Congress

SUMMARY

The U.S. is a member of five multilateral development banks (MDBs): the World Bank, Inter-American Development Bank (IDB), Asian Development Bank (ADB), African Development Bank (AFDB), and European Bank for Reconstruction and Development (EBRD). It also belongs to two related organizations, the North American Development Bank (NADB) and the International Fund for Agricultural Development (IFAD).

As a group, the MDBs are the largest source of development aid for middle- and low-income countries. They lent or invested nearly \$40 billion in 2000, four-fifths of it at market-related terms and the rest on concessional terms. The World Bank accounted for half of all MDB aid and 62% of all MDB concessional aid in 1997.

In the World Bank and most regional MDBs, the U.S., European Union, and Japan control over half of the vote. U.S. participation in the MDBs is managed by the Treasury Department. Congress has substantial influence over the direction and focus of U.S. policy. The MDB market-based loan windows have quasi-permanent funding authority. By contrast, the concessional loan windows require periodic contributions by donor countries in order to continue operations.

In 2000, Congress appropriated \$1.14 billion to fund U.S. participation in the MDBs in FY2001. The Administration had requested \$1.43 billion. Prominent in the appropriation were \$775 million for IDA and \$100 million for the African Development Fund. Congress has made deep cuts in funding for MDBs. Total arrears in U.S. payments to MDB programs increased to \$577 million in FY2001. Other donor countries are deeply concerned, particularly as the U.S. is making more policy

demands on the MDBs at the same time it is cutting funding.

In March 2000, a new debate began about the future of the international financial institutions (IFIs). A congressionally appointed commission advocated major reductions in IMF functions and the MDBs. The U.S. Treasury Secretary proposed that the IMF and MDBs focus their activities, so as to avoid supplanting the private sector, but he said they still had a major role to play in the world economy. Congress passed language in the FY2001 appropriation act recommending changes in the IMF and MDBs.

The MDBs have taken several initiatives to help middle- and low-income countries deal with their foreign debt problems. The MDBs have traditionally made poverty alleviation their first priority goal, though some critics say they should target more of their aid for direct poverty alleviation programs and for encouraging private sector growth. The IMF and MDBs have also increased substantially their transparency and the amount of information they provide to the public on their operations. Many believe this will make them more effective. Critics say that more data should be available. Some borrowers believe they are being forced to reveal too much. Countries may bar the MDBs from releasing information about themselves.

In 2000, it approved a \$600 million U.S. contribution to the World Bank's program to help forgive debt owed by Heavily Indebted Poor Countries (HIPC) and permission for the IMF to use profits from prior gold sales for the HIPC program. In November 2001, a bill authorizing new U.S. contributions to the ADF and IFAD was reported by the House Financial Services Committee.



MOST RECENT DEVELOPMENTS

On July 1, meeting in London, representatives of the IDA donor countries agreed on a new \$22 billion plan (IDA 13) to replenish the resources of the International Development Association. Over \$12.5 billion in new money would be contributed over the next three years, about 20% of it from the United States, and most of the rest would come from loan repayments. They agreed that IDA should provide about 20% of its assistance during the next three years in the form of grants to the poorest countries. Most European countries resisted U.S. efforts to have IDA provide 50% of its aid to these countries in grants. The Administration says the new IDA agreement is a major step towards reforming the World Bank, as it broadens the level of grants and includes new provisions to strengthen the Bank's project evaluation procedures. The Administration suggests, in its announcement of the new IDA plan, that the provision for expanded grants will be a permanent change in IDA operations. Other donor countries have indicated, however, that they view it as a three year experiment. On July 24, 2002, the Senate Appropriations Committee reported legislation (S. 2779) making appropriations to fund FY2003 foreign operations programs. This includes U.S. contributions to MDBs. The House Appropriations Committee has not yet reported its version of this legislation.

BACKGROUND AND ANALYSIS

Introduction

For 50 years, the MDBs have been major forums for economic cooperation and key vehicles through which the United States and other countries have channeled development aid. The cost of U.S. participation in them has been controversial. The Banks have also come under substantial criticism – from many different perspectives – for presumed weaknesses or errors in their policies and operations. In recent years, there has been much discussion in public and official circles about possible changes in the architecture of the international financial system, particularly the relationship between the MDBs and the International Monetary Fund (IMF). For information on specific issues, see: CRS Report RL30786, *World Bank Lending: Issues Raised by China's Qinghai Resettlement Project*, CRS Report RL30467, *IMF and World Bank Activities in Russia and Asia: Some Conflicting Perspectives*, and CRS Report 98-303, *International Financial Institutions and Population Programs: a Survey of Current Activity*.

U.S. Participation in the Multilateral Banks

The MDBs are autonomous international agencies that finance development programs in poor countries using money borrowed in world capital markets or contributed by developed country governments. Run by their own managements and staffs of international civil servants, they are supervised by boards of executive directors and boards of governors selected by member country governments. Voting shares are weighted on the basis of countries' contributions. The IMF is a monetary institution, not a development bank. Still, in recent decades it has lent mainly to developing countries and its policies often affect economic conditions in borrower countries.

The United States belongs to the World Bank and four regional banks: the African Development Bank (AFDB), Asian Development Bank (ADB), European Bank for Reconstruction and Development (EBRD), and Inter-American Development Bank (IDB). It also belongs to two other institutions, the North American Development Bank (NADB) and the International Fund for Agricultural Development (IFAD). In 1999, they lent or invested over \$50 billion – 82% on market-based terms and the rest on concessional terms (low interest rates, long repayment periods) to the poorest countries. The World Bank provided 58% of the total and 77% of the concessional funds.

Member countries monitor activities of the MDBs on two levels: through boards of governors (which usually meet annually) and executive boards (which are in continuous session). Funds cannot be raised and loans and policies cannot be approved without consent of MDB executive boards. For additional background information on the MDBs, see CRS Report RS20793, *Multilateral Development Banks: Basic Background*.

The President has the ultimate authority under U.S. law to direct U.S. policy and instruct the U.S. representatives at the MDBs. This authority has been delegated to the Secretary of the Treasury. The Assistant Secretary of the Treasury for International Affairs manages day-to-day U.S. participation with the help of a professional staff of 20 individuals. With the advice and consent of the Senate, the President names individuals to represent the United States on the executive boards of each MDBs. Though it has final say on U.S. policy, Treasury coordinates U.S. participation in the MDBs through two interagency committees. The Working Group on Multilateral Assistance (WGMA) reviews all prospective MDB loans and policy documents on an ongoing basis. The National Advisory Council on International Monetary and Financial Policies (NAC) has some formal responsibilities for coordinating U.S. policy towards the IFIs. It is also responsible for issuing an annual report discussing U.S. policy and the recent activities of the IFIs.

Congress has a major role in the formulation of U.S. policy towards the IFIs. Congress must give its consent by law before the United States may agree to participate in any new IFI funding agreements. The Senate has advise and consent authority over all persons nominated to major policy-making roles in the executive branch. On many occasions, Congress has enacted legislation specifying what U.S. policy shall be in the IFIs and how the U.S. executive directors at these institutions shall vote and the objectives they shall pursue. Congress has also frequently made specific suggestions to the Administration through Sense of Congress resolutions or language in committee reports accompanying legislation suggesting specific goals and priorities the United States ought to emphasize in the IFIs. This is sometimes called “governing without passing laws.” For additional information on the procedures governing U.S. participation in the MDBs, see CRS Report RS20791, *Multilateral Development Banks: Procedures for U.S. Participation*. For information about U.S. contributions and the procedures for U.S. financial involvement in the MDBs, see CRS Report RS20792, *Multilateral Development Banks: U.S. Contributions FY1990-2001*.

The United States has substantial influence within the MDBs. In most cases, it is the largest single contributor, with the largest vote of any member country. However, no country has a veto and a majority vote of the executive board is required before an MDB can approve a loan or adopt a new policy or operating procedure. The U.S. Japan, Canada, and European Union comprise a near or actual de facto majority of the vote in all but two of the MDBs.

Bush Administration Policy Towards the IFIs

The broad outlines of the current Bush Administration's policies towards the international financial institutions (IFIs) are beginning to take shape. Earlier, there was some doubt about the Administration's level of support for the IFIs, given negative comments that Secretary O'Neill, Deputy Secretary Dam, and Undersecretary Taylor had made prior to assuming office. Dam and Taylor had come close, in some of their earlier writings, to advocating the abolishment of the IMF. As noted below, the Administration's statements have left some questions unanswered. It is also not clear how the Administration intends to implement its policies.

On July 17, 2001, President Bush proposed that the World Bank should allocate half the funds it provides to low-income countries on grants rather than loans. This would total about \$2 billion annually. Mr. Bush said that World Bank should use the new grant program to fund increased levels of assistance for health, education, clean water, and similar activities.

None of the other donor countries support the proposal for 50% IDA grants. Several (Britain, in particular) oppose it outright. Many seem to support the idea that perhaps 10% of IDA's future aid might be grants. The Administration believes that a high level of IDA grants will enhance productivity, ease the debt burden on poor countries, and allow closer monitoring of program implementation and tighter measurement of results. Critics say that the plan would "defund" the World Bank's concessional loan program, raise confusion with other international grant-aid programs, and diminish the value of the IDA program.

On December 17, the Administration told other donor countries that it was willing to raise the U.S. payment to IDA by up to 18% if the Bank adopted certain unspecified steps to improve performance. Few donors are willing to raise their contributions accordingly. Many worry that a grant program will undercut the long-term viability of IDA and they are concerned that the Administration's efforts to achieve unspecified changes in Bank operations will have (whatever the Administration's claims) a negative impact on the poor. On May 1-2, 2002, the IDA donor countries reached agreement on procedures for improving Bank operational accountability. They were unable to reach agreement, however, on the issue of IDA grants. Until agreement is reached on this remaining issue, the Administration will be unable to submit authorization legislation for IDA 13 to Congress. For further discussion of this issue, see CRS Report RL31136, *World Bank: IDA Loans or IDA Grants?*, substantially updated on February 8, 2002. For an analysis of future costs of the grant proposal (and of the HIPC proposal as well), see CRS Report RL31418, *World Bank: Funding IDA's Assistance Program*, updated May 21, 2002.

Functionally, the difference between a one-half grant program and the current IDA arrangement is not great. For the first 10 years (because IDA loans have a 10-year grace period), there is de facto no difference between an IDA grant or loan. Thereafter, then full effects (and costs) of a grant program would be phased in over the next 3 decades. A grant program would have no impact on current debt levels of poor countries and would provide them little help in servicing their debt. On the other hand, it would not increase their debt burden. If countries grow and develop, they should be readily able to pay the low cost of IDA loans. On the other hand, if they remain stagnant, additional loans will be difficult to service. In practical terms, the real issue in the IDA loan/grant debate is not financial and

has little to do with long-term IDA operations. Rather, it seems to be a test of wills between the United States and other donors as regards their relative influence in the World Bank.

Testifying before the House Foreign Operations Appropriations Subcommittee in May 2001, Secretary O'Neill observed that the MDBs have "an important role to play in increasing productivity and thus improving the standard of living of people around the world." He said that the MDBs could do a better job than they are doing now.

Secretary O'Neill said the United States would pursue a reform agenda in the MDBs. The first priority, he said, was to raise the standard of living of people throughout the world. Increased productivity was the key, he said, and he claimed that poverty was explained by low productivity. The World Bank's current activities are too diffuse, he argued. He said it should concentrate on raising per capita income and productivity. He mentioned education as well as increased capital and better technology. He stressed that more economic liberalization was needed in developing countries, along with lower taxes and sensible regulation. Also important, he said, were the rule of law and good governance. He said the Administration would seek to make the MDBs more transparent in their operations.

O'Neill said the Bank should focus on helping countries that lack access to private capital markets and that many countries' needs can be met more suitably through private markets. He also said the MDBs should have a differentiated pricing policy for their loans, in order to "achieve better prioritization of lending" to middle income countries and more incentive for them to rely on private markets.

Some Remaining Questions

Most observers agree that there will be some settlement of the disagreement among the IDA donor countries regarding the issue of IDA loans or grants. However, many are concerned that the controversy may complicate future congressional consideration of the upcoming IDA 13 authorization bill and on future U.S. relations the European countries.

In a broader sense, it is unclear how Secretary O'Neill's emphasis on the need for increased productivity comports with President Bush's emphasis on the need for increased IDA assistance for education, health, and clean water. In the long run, improvements in health and education will enhance country productivity. But in the more medium term, programs to improve the efficiency of transport and other infrastructure and reform of country economic policy and procedures will have a more immediate effect in that regard. Many activities targeted towards the immediate alleviation of poverty involve neither education and health activities nor improvements in infrastructure and country policy. It is not clear how the policy views announced by President Bush and Secretary O'Neill accord with the existing policies and priorities of the IFIs. Critics worry that emphasis on productivity and growth may lead to initiatives which diminish the MDBs' current emphasis on poverty alleviation. They also ask whether he is signaling, through his stress on macroeconomic and financial issues, that the IMF should pay less attention in the future on long-term structural reform and poverty reduction in its loan programs.

The executive boards of the MDBs have stated often, in recent years, their belief that poverty alleviation should be the principal goal of the development banks. During their first three decades, the MDBs subscribed to the view that rapid economic growth was the most

effective antidote to poverty. A large portion of their lending then went to fund transportation, power, and other activities which sought to enhance productivity levels and spur growth. Later studies found, however, that poor people often did not benefit much from economic growth. Levels of national per capita income increased but in many countries – particularly in those with strong initial differences – income disparities also grew and many rural people and people lacking modern skills participated only marginally in the growth process. Studies found that their involvement could be enhanced by programs targeting their needs. In recent decades, the MDBs have put increased emphasis on health and education programs, safety-net programs, poverty-alleviation programs and other activities which directly address the specific needs of rural and low-income people.

Some analysts worry that a renewed emphasis on growth and productivity may lead the MDBs back towards more emphasis on infrastructure and heavy capital investment, at the expense of lending for human capital development and poverty alleviation. Alternatively, many believe that shifting a major share of the banks' concessional assistance towards health, education, and other programs may undercut the overall effort to reduce poverty.

The Meltzer Commission recommended in 2000 that the World Bank stop lending to countries that have access to private capital markets. Many if not most middle-income countries have been able to borrow some money internationally from private sources. It is unclear, from the Secretary's comments about greater reliance on private markets, whether he believes that these countries should see their access to MDB loans reduced or eliminated.

In April 2001, O'Neill and other G-7 finance ministers approved a statement by the World Bank/IMF Development Committee calling for more MDB lending to middle income countries. The Committee noted that most of the world's poor people live in these countries.

The IMF, said Secretary O'Neill, should focus more on the prevention of international financial crises rather than principally fighting them after they appear. Nevertheless, despite earlier comments to the contrary, the Administration has supported the IMF's recent loans to Argentina and Turkey. He said that the IMF should charge more for its loans. He also said that the IMF should also provide less support for poor policy decisions by countries. It is not clear from the testimony how these goals might be achieved. The IMF can be a strong source of economic advice for member countries. However, it cannot make countries adopt reforms or implement policies they do not accept – especially when they defer applying for loans. The recent Asian financial crisis shows that, if (as in Thailand) the IMF tells countries urgently and privately that they need to adopt major policy changes, it may not be sufficiently persuasive. On the other hand, if the IMF publicizes its concerns about conditions in an unstable country, it can precipitate the very crisis that all wish to avoid. The Administration might want to clarify, in further statements, the steps the IMF should take to head off potential financial crises.

Secretary O'Neill told the House Financial Services Committee in 2001 that the IMF has been "involved in a much too wide set of policies in borrowing countries." The IMF has gone beyond its core expertise in macroeconomic issues to address issues outside its principal area of responsibility. It should sharpen and shorten the list of conditions it attaches to its loans. It is not clear from Secretary O'Neill's remarks which issues he believes the IMF should avoid. Still, many analysts agree with O'Neill's basic point. The IMF is preparing new guidelines narrowing the focus of conditionality and requiring that more changes be adopted by countries before they can qualify for IMF loans.

Nevertheless, critics worry that issues such as good governance, corruption, or military spending might no longer be addressed by the IMF. Others wonder if the United States would stop supporting IMF efforts to effect structural reform in borrower countries. Many of these reforms address issues which are not, strictly speaking, macroeconomic and they often take several years to implement. Some structural reforms aim to strengthen institutions responsible for implementing a country's macroeconomic policies. Others seek to improve the efficiency, flexibility, and rate of growth of a borrower country's economy.

In 2001, the IMF published four major studies (available on its web page) on conditionality and structural reform. It says that often, without broad reforms, a country may have difficulty implementing the macroeconomic measures needed to stabilize its economy. Most structural reforms are complex. The IMF has found that successful implementation of these reforms requires "ownership" on the part of the borrower country. Broad domestic support must be built favoring basic changes in government operations, national pension systems, privatization, or reform of a country's financial infrastructure. Without such ownership, the IMF believes, most reforms will not last beyond the terminal date of the IMF loan. Most of the structural reforms required by IMF loan agreements are actually funded and supervised by the multilateral banks and other donor agencies. The IMF's annual reviews provide an opportunity for donors to examine country progress and an incentive for countries to move forward with their plans. Even when the country's macroeconomic performance has been adequate, the IMF may suspend disbursements if it believes there has not been sufficient progress on the structural reforms. These structural issues often take the IMF far afield of its original short-term macroeconomic mandate.

Many analysts believe that, if the United States persuaded the IMF to focus only on macroeconomic and financial issues and to ignore broader structural concerns, the IMF's capacity to pursue its "core" responsibilities might be constrained. Likewise, they say, an important tool for coordinating policy between the IMF and the MDBs might be lost. The Administration may want to clarify, in future testimony before Congress, whether it believes the IMF should no longer pay attention to non-economic issues, such as governance and corruption. It may also want to clarify whether it believes the IMF should stop requiring its borrowers to implement structural reforms as a condition for access to IMF resources.

Congressional Action

Authorization Legislation, 2002

Asian Development Fund/IFAD. On May 1, the House approved H.R. 2604, authorizing new \$412 million U.S. contribution (over 4 years) to the Asian Development Fund (ADF) and \$30 million (over 2 years) to the International Fund for Agricultural Development (IFAD). The bill has been referred to the Senate Foreign Relations Committee.

This was the second time since 1980 that either chamber has approved by regular order (in a regular authorization bill) legislation authorizing new U.S. contributions to the IMF or multilateral banks. Since 1980, all other IMF and MDB authorization measures have been included in complex omnibus measures, reconciliation bills, or foreign operations appropriations bills. In many instances, the authorization measures were placed in these bills

in ways which made amendment or deletion very difficult (because of the rules governing their consideration). Some people believe that the House action on the ADF/IFAD authorization bill signals that the base of congressional support for IFI measures has broadened. Others believe that the upcoming congressional action on the IDA 13 authorization bill will be a more true measure for the level of congressional support.

The Administration reports that the new ADF funding plan includes several provisions which respond to prior congressional concerns. The ADF will allocate resources in the future on the basis of country performance, stressing fiscal performance, good governance, and anti-corruption measures. A plan to strengthen support for core labor standards has been approved. An agreement has been signed with the World Bank to improve coordination and minimize overlap and duplication. U.S. relations with the other ADF donors are somewhat strained, however. The United States was successful during the ADF negotiations in its efforts to achieve several important changes in ADF policies and procedures. At the same time, however, the U.S. is seriously in arrears in its contributions to the last ADF replenishment. While the other donors have largely completed their payments, the United States has yet to pay \$128 million of the \$300 pledged towards the last replenishment. successfully for the adoption of several changes in ADF policy and procedures

As approved by the House, H.R. 2604 includes a number of policy initiatives requiring the Administration to seek a broad range of policy or procedural changes in IFAD and the regional development banks. These include initiatives concerning transparency, user fees, HIV/AIDS, projects that include dams, international terrorism, privatization of government-held industries, opposition to reducing minimum wages below internationally recognized poverty levels, and arsenic in drinking water in South Asia. None of these can be implemented without the broad consent of most other member country governments. In some instances, it appears that other countries do not support as stated the goals of the legislation. In other instances, it appears that some policy changes sought in H.R. 2604 have already been approved by some of the regional banks. The Administration must report periodically on the steps take and success achieved in pursuit of these goals.

It might be noted that Section 588 of the fiscal 2002 foreign operations appropriations act authorizes the United States to contribute \$30 million to the fifth replenishment of IFAD, the same purpose of language in H.R. 2406. That bill contains several policy initiatives, however, which are not in the earlier legislation.

International Development Association. As noted earlier, negotiations are still pending on a plan for a new replenishment (IDA 13) of the International Development Association, the World Bank's concessional assistance facility. The Administration proposed that half the assistance which IDA provides to very poor countries should be grants. Other donors disagreed. On July 1, representatives of the donor countries agreed on a new IDA replenishment plan. The new plan would reportedly total about \$22.6 billion, of which about \$12.5 billion would come from new donor contributions and most of the rest would come from money received as repayments for earlier IDA loans. According to World Bank documents, IDA is scheduled to receive about \$5.1 billion in loan repayments during the three years (2003-2005) of the new replenishment plan. About 20% of the new money would come from the United States.

The IDA donors agreed that IDA would provide about 20% of its assistance in the next three years in the form of grants. The Administration wanted grants to be used to fund programs for education, health, sanitation, and related programs. The other donors agreed to broaden the scope of the grant program to include assistance for HIV/AIDS and post-disaster or post-conflict reconstruction. There appears to be some disagreement as yet between the United States and key European countries as to whether the grant program is a three-year experiment or a permanent change in IDA operations. The donor countries have reportedly agreed to provide additional funds to cover the cost of the new grant program, but some of the specific measures have yet to be resolved.

Table 1. Appropriations for Multilateral Development Banks
(Budget authority; millions of paid-in U.S. dollars)

	FY2001 Final	FY2002 Final	FY2003 Request	FY2003 House	FY2003 Senate*	FY2003 Final
World Bank Group	*committee					
Intl Bank for Reconstruction and Development (IBRD)	–	–	–		–	
Global Environment Facility	108.0	100.5	177.8		177.8	
Intl Development Assoc (IDA)	775.0	792.4	874.4		837.3	
Intl Finance Corp (IFC)	–	–	–		–	
Multilateral Investment Guarantee Agency (MIGA)	10.0	5.0	3.6		2.63	
Intl Fund for Agric Development	5.0	20.0	15.0		15.0	
Regional Development Banks						
African Development Bank	6.1	5.1	5.1		5.1	
African Development Fund	100.0	100.0	118.1		108.1	
Asian Development Bank	–	–	–		–	
Asian Development Fund	72.0	98.0	147.4		127.4	
European Bank (EBRD)	35.8	35.8	35.8		35.8	
Inter-American Development Bank Ordinary Capital	–	–	–		–	
IDB Fund for Special Ops (FSO)	–	–	–		–	
Inter-American Investment Corp	25.0	18.0	30.4		18.4	
Multilateral Investment Fund	10.0	–	29.6		29.6	
N. American Development Bank	–	–	–		–	
TOTAL, all MDBs	1,146.9	1,174.8	1,437.2		1,357.3	
Total arrears if bill passed thus	498.6	533.9	na			

Appropriations

Fiscal 2002 Appropriations. On July 24, 2001, the House approved a bill (H.R. 2506) which appropriates \$1,169.4 million for MDB programs in FY2002. This is about \$40 million less than the Administration's request. (See **Table 1.**) On September 4, the Senate Appropriations Committee reported its version of this bill, appropriating \$1,178 million for MDB programs. The Administration did not request any funds for FY2002 to help clear the \$499 million in overdue payments (arrears) to the MDBs. In addition to the arrears noted earlier from the ADF, the United States is behind \$204 million to the Global Environment Facility (GEF) and \$88 million to the Multilateral Investment Fund. The FY2002 bill continued the policy requirements for HIPC, which Congress approved for FY2001 (see below). The House approved the conference report on H.R. 2506 on December 19 (357-66), while the Senate adopted it by voice vote on December 20. The President signed it into law on January 10, 2002 (P.L. 107-115).

Fiscal 2003 Appropriations. In January 2002, the Bush Administration requested (as part of its budget submission) that Congress appropriate \$1,437.2 billion for MDB programs for FY2003. This is the largest appropriations request for MDBs since at least FY2000. It includes an increase in U.S. contributions to the IDA. It includes substantial funding for the ADF and GEF, to help reduce the large arrears in payments the U.S. has accrued for those programs. It also includes enough funding for the MIF -- the small program attached to the IDB which provides grants for microenterprise, small business, job training, and other similar programs -- to cover the U.S. arrears and prevent other countries from withdrawing their contribution pledges. Without a U.S. payment to retire arrears, the program would possibly be forced to close. Most countries would blame the United States for that situation. This might have negative effects for U.S. leadership in other IFIs.

On House Foreign Operations Appropriations Subcommittee held hearings on the Administration's FY2003 MDB budget request on April 24, 2002. On July 24, reversing the usual order in which these appropriations bills appear, the Senate Appropriations Committee reported out its version of the FY2003 foreign operations appropriations bill (S. 2779).

Current MDB Issues

Reforming the IFIs

Since the Asian Financial Crisis began in 1997, major discussions have been underway in the IFIs and among their major member countries about possible changes in the basic architecture of the international financial system. This includes possible shifts in the policies and priorities of the IFIs, the relationships among them, and the relationships between the IFIs and the private sector. The IFIs have adopted a number of policy changes aimed at improving their operations. The IMF in particular has adopted a series of voluntary guidelines which seek to help countries improve the stability of their financial and monetary systems and the effectiveness of their policies. The IFIs have adopted procedures which provide more information to the public on their policies and on conditions in their member countries. However, few major alterations have occurred in the basic structure or function

of the IFIs. A broad consensus of the membership is necessary to effect basic change. The leading member countries disagree about the kinds of change which might be needed.

Since at least 1998, leading Members of Congress have tried through legislation to effect fundamental changes in the structure and the policies of the IFIs. Several strong recommendations were included in the 1998 legislation approving U.S. participation in the most recent increase in IMF quota resources and in the fiscal 2001 foreign operations appropriations act. It is important to note, in this regard, that the United States cannot make the IFIs adopt changes in their policies and procedures. The United States does not have the votes to make the IFIs take action and (except for the IMF) it does not have enough votes to block IFI funding plans from going into effect over its objection. Change in the IFIs must be accomplished by persuading other countries that the U.S. proposals are good ideas that they also should support. If the G-7 countries agree on a proposal they have (or can influence) enough votes to put it into effect. However, most other G-7 countries do not agree with many of the initiatives in recent U.S. legislation or U.S. policy initiatives.

The 1998 IMF legislation created a congressionally-appointed commission to review and make recommendations regarding change in the basic structure of the IFIs. The commission (headed by Professor Alan Meltzer) released its recommendation in March 2000. The Clinton Administration agreed with some of the Meltzer Commission's proposals and it opposed others. The Commission said countries should qualify in advance by adopting major reforms in their financial reporting, financial institutions, and government budgetary practices. The Administration said countries should be able to borrow, even if they do not meet these standards beforehand, and the IMF should use its conditionality to bring about needed reforms. The Commission said the IMF should charge penalty rates of interest, above existing market rates. The Administration said this would be counterproductive. In 2001, Treasury Secretary O'Neill filed a report with Congress that was also strongly critical of the Meltzer Commission's policy recommendations for the IFIs.

The Meltzer Commission said the World Bank should lend only to the poorest countries and it should stop lending to countries which have access to private capital. It should also devolve most of its loan functions to the regional MDBs, becoming a grant-making institution focused on global public goods. The Clinton Administration said the World Bank should still make loans to countries which have some access to private capital but it should take care that its loans not supplant the private sector. It said the Bank should focus primarily on poverty alleviation, social programs, and institutional or policy reform. Both the Administration and commission agreed that the IFIs should forgive substantial amounts of debt owed them by the poorest countries. They also agreed that the United States and other donors should substantially increase their contributions for MDB concessional aid. The Bush Administration's views were discussed at the beginning of this issue brief.

The FY2001 appropriations act included several provisions which required the IFIs to consider possible reforms (see below). However, they did not require that the IFIs must implement these reforms before the U.S. could contribute any money (as was proposed—but ultimately not enacted—in 1998). Rather, they say the Secretary of the Treasury must advocate certain reforms in the IFIs and report to Congress any steps they have taken towards achieving those goals. Congress did not adopt any language in the FY2002 appropriations act seeking major reforms in the IFIs.

Section 588 of the FY2002 law said that 10% of the money appropriated for each IFI shall be withheld and not contributed until the Secretary of the Treasury certifies that it has adopted certain procurement and management reforms. These include procedures for requiring annual independent audits of all new investment loans, for requiring independent audits of the central banks of all countries which borrow from the IMF, for assessing the risks of corruption in borrower countries before they get new loans, for establishing new transparency and anti-corruption procedures in borrower countries, and for creating a new fraud and corruption investigative unit in each IFI. The Secretary must report on steps the IMF has taken to achieve these goals.

The Act directed the Secretary to seek stronger procedures in the MDBs improving their loan monitoring procedures in order to limit corruption in borrower countries, to strengthen governance and reduce bribery and corruption in those countries, and to punish any corrupt practices by MDB staff. It required GAO to report annually regarding the adequacy of IFI audit procedures. It directed the U.S. representatives at the IFIs to oppose any loans for primary education or primary healthcare if the projects imposed user fees on people receiving assistance from them. It also said that the Secretary of the Treasury should seek agreement with other countries that any new aid which IDA provides to countries receiving HIPC debt relief (see below) should be provided through grants rather than new concessional loans.

Section 801 said the MDBs should adopt a series of new rules or guidelines. In particular, the banks should require that all new lending to a country would cease if it used loan funds for purposes other than those originally intended. The MDBs should adopt new procedures to prevent their loans from supplanting private financing. The banks should not disburse money if a borrower country has not adopted the specific policy reforms mandated by a loan agreement. The MDBs should also adopt new standards for measuring the progress countries are making towards graduation from eligibility for concessional loans. The new law said that the World Bank should adopt policies aimed at minimizing the number of projects that would displace a population involuntarily or would be detrimental to the people or culture of the people to which the displaced population would be moved. It also said that the IMF should adopt policies which would vigorously promote open markets and trade liberalization in its borrower countries.

Section 804 said that it would be the policy of the United States to work for the adoption of reforms requiring the IMF to lend mainly for short-term BOP finance. Medium-term loans should be available only in certain circumstances and the IMF should charge a premium on most of its loans in order to discourage use and encourage countries to rely more on private sector finance.

Most countries seem willing to consider proposals for reform on their merits, but few appear willing to acquiesce to unilateral demands. If the United States had tried to make the implementation of reforms a prior condition to any U.S. payment, other major IFI member countries would have likely objected. In 2001, for example, Senators Gramm and Helms sought to make U.S. contributions to HIPC conditional on the IFIs adopting major changes in their policies and procedures. Congress ultimately chose not to adopt that language. Many analysts doubt that the goals of their initiative would have been realized even if it had been adopted into U.S. law. Few countries seem willing to accept broad permanent changes in the IFIs simply in order to get a modest one-year HIPC contribution from the United States. Major reform in the IFIs will come only when there is a broad consensus on the part

of most countries that particular changes are more desirable than the status quo. Many of the proposals currently being considered in the United States and other countries are not mutually compatible. A major challenge facing the United States in future years will be the development of such a consensus in support of policy changes which the Administration and Congress will support and other countries will find acceptable.

MDBs and Developing Country Debt

Many of the poorest MDB borrowers have had serious difficulty servicing their international debts in recent years. Estimates suggest that the 41 most heavily indebted poor countries (HIPC) pay only about 40% of their annual debt service obligations. As a whole, the total foreign debt of the HIPC countries was nearly 122% the size of their combined Gross National Product (GNP). For many countries, the share is even higher. Over half this debt was owed to bilateral lenders and 35% was owed to MDBs. The MDBs are the only lenders who are being paid (and the only ones making new loans). In 1998, for instance, \$1.8 billion, or half of HIPC country repayment of principal went to multilateral creditors. Only \$0.8 billion was paid to bilateral lenders. The HIPC countries are more than \$15 billion in arrears to their creditors for unpaid interest due on their long-term debt.

During the height of the international debt crisis in the 1980s, the United States and other major countries used the MDBs as principal vehicles for helping debtor countries. The major concern at the time focused on heavily-indebted middle-income countries, who owed most of their debt to private lenders. Many analysts feared that the stability of the world financial system was at risk. In 1985, then-Treasury Secretary Baker said the IMF, World Bank, and IDB should lend \$20 billion over several years (along with \$20 billion more from commercial lenders) to help the 17 largest middle-income debtors cope with their problems. In 1989, then-Treasury Secretary Brady said the MDBs and IMF should help middle-income countries finance voluntary debt-reduction plans involving commercial creditors. Between 1989 and 1994, the World Bank and other multilateral agencies lent \$7.9 billion to 12 middle-income countries, helping them negotiate a \$63 billion forgiveness of the \$193 billion owed to these lenders. Similarly, the IDA Debt Reduction Facility helped 7 low-income countries extinguish through debt buy-back schemes (at about 14 cents to the dollar) \$815 million owed to commercial creditors. IDA has also made loans (via its "Fifth Dimension" program) to help poor countries finance payments for old IBRD-rate loans.

In October 1996, the World Bank and IMF approved a plan offering debt relief to heavily-indebted poor countries (HIPC). It aims to reduce the debt burden of these countries to "sustainable" levels — i.e., a debt load equal to 200-250% the value of a country's annual exports — in two stages. First, the MDBs would be ready to forgive up to 90% of the debt owed them by HIPC countries and they asked bilateral and commercial creditors to provide the same. (Bilateral creditors said that 80% was the most they would do; private creditors have not volunteered to participate.) Meanwhile, the debtor country would pursue a 3-year program of economic policy reform. Second, at the end of that period, the Bank and Fund determine if the country's debt burden was "sustainable." If not, it would be declared eligible for HIPC terms, and after a period of up to 3 more years, the Bank would retire enough debt owed it to bring the country's debt burden to a manageable level. The Bank would reimburse itself for the retired debt with money set aside from its annual net income or contributed by individual donor countries.

Critics argued that the plan's criteria for eligibility are too restrictive and the period of time it took to qualify for possible debt relief was too long. In June 2000, at the Cologne Economic Summit, G-7 leaders agreed that HIPC should be expanded and the time period shortened. At the World Bank annual meeting in October, Bank member countries agreed that the HIPC program should seek to qualify 20 countries for debt relief by the end of the year. The United States insisted that standards should not be weakened and countries should still be required to undertake major market-oriented economic reforms in order to qualify. World Bank officials estimate that the G-7 initiative would double — to \$4 billion — Bank expenses and represent a commitment they could not meet out of existing resources. Some critics assert, however, that the Bank could provide more debt relief if it were willing to use IDA loan resources for this purpose. (For more information on the HIPC program, see CRS Report RL30214, *Debt Reduction: Initiatives for the Most Heavily Indebted Poor Countries.*)

In 1999, the President sought \$50 million for a U.S. contribution to the World Bank's program to help Heavily Indebted Poor Countries (HIPCs). HIPC is a multilateral arrangement providing debt relief for nations that maintain strong economic performance records. Although the Bank and Fund will finance their own participation in HIPC, some MDBs, such as the African Bank and Fund must have help from the HIPC trust fund if they were to extend debt relief to their debtors.

In 2000, the Administration asked Congress to authorize a \$600 million contribution to the HIPC trust fund and to appropriate funds for FY2000, FY2001, FY2002, and FY2003. The Senate Foreign Relations Committee included this authorization in its bill, S. 2382, which also included authority for the U.S. representative at the IMF to vote for a resolution allowing the IMF to use for HIPC the "profits" realized last year when it sold 5 million ounces of gold. Authority to use income from an earlier sale of 9 million ounces was approved in 1999. Congress included authority for the HIPC trust fund contribution and use of the gold proceeds in the final FY2001 foreign operations appropriations act. It appropriated (in Title II) \$225 million for contribution to the HIPC trust fund in FY2001 and (in Title VI) a supplemental \$210 million for contribution in FY2000. In the FY2002 foreign operations appropriations act, Congress appropriated another \$224 million for HIPC.

The money for HIPC carries several conditions. The Secretary of the Treasury may not disburse funds to HIPC for the benefit of any country that engages in a consistent pattern of human rights violations or in international military or civil conflicts which would undermine its ability to develop and institute effective measures for poverty-alleviation. The two acts said that the Secretary may not disburse any money to HIPC for the benefit of Sudan or Burma unless democratically elected governments has taken office in these countries. The two laws specified that U.S. funds for HIPC debt relief could only be used for assistance to countries which agree not to accept market-rate loans from any IFIs that received debt relief funds from the HIPC trust fund. The 2002 act specified that U.S. contributions to the HIPC trust fund could only be used to pay off loans owed to the IDB, AFDB, AFDF, and Central American Bank for Economic Integration (CABEI). Countries could only receive U.S. funds through the HIPC trust fund if they agreed not to accept any market-rate loans from IFIs that accorded them HIPC debt relief for two years and only if they documented their commitment to direct the budgetary resources that would have been otherwise used for international debt payments towards programs to alleviate poverty and promote economic growth.

Unlike most other IFI accounts, the HIPC trust fund does not mix together the money contributed by donor countries. Rather, the funds from each donor are held separately and can only be used with the donor's permission. Therefore, despite contrary precedents in all other IFI accounts, the United States can control the way its contributions to HIPC are used.

MDBs and Poverty

Initially, the MDBs' main strategy for the alleviation of poverty emphasized the efficient use of resources to promote growth and raise income levels in borrower countries. During the 1970s and 1980s, the MDBs put increased emphasis on projects designed to target benefits directly to needy persons. In the past decade, however, more emphasis is again being given activities that promote growth. In 1991, the World Bank adopted a two-part strategy aimed at eliminating the worst forms of poverty in developing countries by the year 2000. Part one stressed the need for increased growth. The Bank would encourage countries to adopt incentives and policies that encourage broad-based economic growth and it would finance the construction of infrastructure and other necessary facilities. Part two said that growth must be supplemented with clearly defined poverty-alleviation programs, to ensure that the poor both gained from and contributed to growth. The Bank said the volume and composition of its lending would be linked to the borrowers' own efforts to reduce poverty. In 1993, the Bank announced plans for cutting in half in the next 20 years the share of the world's population facing hunger. It also said it would put more emphasis (via microenterprise lending) on activities designed to meet the credit needs of poor borrowers who are normally not considered creditworthy. The Bank has acted to expand its support for microenterprise. The World Bank annual report for 1994 (the first issued after the 1993 announcement) did not mention the goal of cutting the level of world hunger in half and the issue has not been raised in subsequent annual reports.

There is considerable debate whether the MDBs are doing enough to fight poverty. Today, the controversy seems to focus less on whether they are funding enough anti-poverty projects and more on whether the gains from these loans are offset by the possible injury done to the poor by MDB adjustment programs. Many critics say U.S. contributions should be cut as long as the MDBs continue to promote adjustment and as long as they continue to support top-down decision-making procedures that give average citizens in borrower countries little say in the policy process.

The growth and poverty effects of economic reform are complex issues. Among the strongest critics are non-governmental organizations (NGOs), which argue that adjustment programs encourage borrower countries to change policies and reduce spending on programs that benefit needy people. A coalition of NGOs announced plans in 1994 (the Fifty Years is Enough campaign) to seek cuts in U.S. contributions to the World Bank until it altered its approach to policy reform and put more emphasis on poverty alleviation. Proponents of economic reform argue that countries in economic trouble may have few real alternatives but to reform their policies and to change the structure of their economies. They say that, over the long run, poor people can be hurt more by inflation and other effects of bad economic policy than they are by the effects of policy reform. They say the burden of adjustment actually falls most heavily on the middle class and government employees, not the poor. The MDBs have increased their funding for "safety-net" programs to help mitigate any negative effects their economic reform programs may have on the poor during the transition process.

Congress has passed several laws directing the USEDs to urge the banks to put more emphasis on poverty alleviation. In 1989, for example, it directed the U.S. representatives at the MDBs to propose that poverty alleviation be made a key goal of MDB operations. It also said the banks should help their borrowers develop national strategies aimed at eliminating the causes of poverty and they should give preference in their lending to countries undertaking effective action in that regard. In 1990, Congress directed the USEDs to encourage more lending for population, health, and nutrition programs in borrower countries. MDB and U.S. officials say the banks have been responsive to these congressional concerns. The House Banking subcommittee included a number of initiatives to promote poverty alleviation in its 1997 authorization legislation (H.R. 1488).

Access to MDB Information

In 1989, Congress enacted legislation (the Pelosi Amendment) directing the Secretary of the Treasury to seek MDB policy changes giving member country governments and private citizens more access to information on MDB operations. It also said the MDBs should adopt procedures requiring that environmental impact assessments (EIA) be done on all projects that might negatively affect the environment. It said the USEDs could not vote for any MDB loans for which EIA studies were not available to them and to the public at least 120 days in advance of the vote. The MDBs have all since adopted EIA and information access policies acceptable to the U.S. government.

The IFIs now publish much information about their activities, making their operations more transparent. See [<http://www.worldbank.org>]; [<http://www.ifc.org>]; [<http://www.miga.org>]; [<http://www.iadb.org>]; [<http://www.afdb.org>]; [<http://www.adb.org>]; [<http://www.ebrd.org>]; and [<http://www.imf.org>]. Critics want the MDBs to release more information, including the full text of proposed loan plans before they are approved by MDB executive boards and transcripts or detailed minutes of board deliberations. The IFIs believe that they need a certain amount of privacy and discretion in order to do their work and broker necessary agreements on sensitive issues. The IFIs Articles of Agreement say that information about a country's internal conditions may be released only with its consent. Ironically, recipient country governments are often the greatest barrier to release of the types of information sought by critics. Increasingly, the IFIs are making countries' exercise of this right more obvious rather than taking the blame for non-disclosure themselves. Many people believe that this may prompt more countries to release information about their economy and the content of their IFI loan programs, particularly those countries wanting more access to private capital.

As noted earlier, the House Financial Services Committee has proposed legislation requiring the United States to seek increased transparency on the part of the regional MDBs and the IFAD. Similar legislation was adopted in 1988 (with little permanent effect) for the IMF. As in 1998, the new language would not require the MDBs to adopt expanded measures for accountability, but would require the U.S. to actively seek the adoption of such measures. Proponents believe that greater openness will help make the IFIs accountable to the public, so their actions cannot be hidden behind a screen until it is too late for civil society and the persons affected to have any impact on MDB decisions about loans or policy.

Others argue, however, efforts to make the meetings and documents of the international agencies public in this manner will simply drive the decision making process into other

rooms. They say that decisions would be made and debates would be scripted beforehand by the major players. Executive directors who are not in the room would be left out of the real decisional process. The international agencies would be then less accountable, not more, even though the final action took place in the full light of public view. Also, critics note, any efforts towards greater transparency will need to be balanced against the rights countries have under the Articles to block the unwanted release of information (including information in MDB documents) about their internal affairs.