

DEVELOPMENT BANKING IN TRANSITION:
SUSTAINABLE DEVELOPMENT AND THE WORLD BANK

by

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ABSTRACT

In recent years, the World Bank, the biggest international development lender in the world, has paid considerable attention to the issue of sustainability in its lending activity, publishing many reports on its progress. Nonetheless, private criticism over its decision-making and international resistance to many of its development projects continues to grow. The current public furore over the Bank's decision to continue funding the Sardar Sarovar Dam project in India's Narmada Valley, despite a condemnatory report which the Bank itself commissioned, is only the most recent illustration of this contradiction. This thesis explores the background to this dilemma for the World Bank, in an attempt to explain this contradiction and suggest the direction for its remedy.

Beginning with a discussion of the term "sustainable development", the first chapter concludes that, while a precise definition is still lacking, certain fundamental principles have emerged from the debate which can be considered to form the essence of a working definition. These principles effectively give voice to the call for a more contemporary development theory, for a more meaningful system of measuring human welfare than provided by gross national product (GNP) statistics, and for recognition of the importance of local control of resources and freedom from debt in maintaining self-sufficiency and a decent standard of living.

Given these basic tenets, the discussion then turns to a brief historical review of the

economic conditions leading to the formation of the World Bank in an attempt to understand its original mandate. This then forms the basis for appreciating the evolution of that mandate as the World Bank responded to changing international economic conditions, then later, the debt crisis of the early 1980's and environmental pressures toward the end of that decade.

The operation of that mandate, the Bank's lending policies and practices, are the next focus of discussion. Turning first to the project lending which has always represented the majority of disbursements, the thesis highlights both the rationale behind the energy and forestry loans which form the backbone of the lending programme, and the documented weaknesses of schemes like the Tropical Forestry Action Plan. The need to ensure debt repayment following the oil price crisis of the late 1980's led to the emergence of "structural adjustment" programmes, the effects of which conclude the discussion of the changing face of World Bank lending.

In the final section the thesis delineates the various pressures on the World Bank today which challenge its ability to deliver on its mandate. These pressures range from increasing public criticism of the human consequences of large development projects, to the growing unpopularity of investments requiring large capital outlays and long waits for returns, and include the potential exposure of the World Bank to the emerging lender liability issue. None of these challenges seem likely to diminish in the near future.

To deal with these challenges effectively, the thesis concludes, the World Bank must go

beyond developing strategic responses to them. It must begin, instead, to examine its implicitly Western view of progress which assumes an industrial "route to advancement" and an instrumentalist approach to nature. Rather than advocating the continuous and rapid conversion of natural resources to tradeable goods in order to create a "permanent" wealth to improve living standards, the Bank must pay attention to the growing wealth of data illustrating the human misery and environmental degradation that are the result. Sustainable development cannot be an "add on" to present World Bank operations, but must rather redefine the entire context in which the organization functions. Unless and until this occurs, the World Bank, with its public commitment to the alleviation of poverty and ecological responsibility, will face growing evidence of its failure to meet those commitments.

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INTRODUCTION

It has now been twenty years since the first United Nations Conference on the Human Environment was held in Stockholm to establish the rights of the human family to a healthy and productive environment. The attendance of most of the world's government leaders at the most recent U.N. Earth Summit Conference at Rio de Janeiro, held in June 1992, and the heavy publicity it received are only the most recent evidence that the social, economic and environmental problems identified two decades ago are now recognized world wide as threatening to the very survival of that human family.

A new field of intellectual enquiry is beginning to emerge as a result of the ongoing and global search for a solution to the problems which threaten humankind's common future – the study of "sustainable development". Originally predicted to be only the fad of the moment, sustainable development has instead proven itself as enduring and vital, broadening from a dedicated focus to include all economic, political and ecological disciplines.

The conferences, courses and published materials that have proliferated on the subject as its seriousness becomes increasingly apparent have brought an understanding of the concept of sustainability much closer. Out of the discussion and analysis certain basic principles have emerged which, despite considerable

variations and different emphasis, all call attention to human, rather than monetary, values, and which are common to most "alternative" scholars of economic/ecological issues. These principles, for the most part, can be said to be quite contradictory to the historical approach which the institutions and government agencies of the industrialized world have taken to human development. The traditional approach – encourage trade which promotes growth, growth will be good for the environment, a sound environment will help growth which will encourage more trade – (Daly, 1992:4) largely ignores the environmental and social consequences of most development projects and policies. The emerging principles of sustainability, on the other hand, which promote the value of human development and biodiversity, local control and ownership and new methods of evaluating and measuring "progress", contend that only a revolutionary change in our understanding of the relationship between human economic activity, the ecosystem and our perception of the nature of human progress can resolve the deepening global crises (Korten, 1991:158).

Despite the growing empirical evidence which supports the logic of these principles of sustainability, defenders of the neo-classical development approach continue to resist the challenge to the efficacy of export-driven, market-oriented solutions to the problems facing the less developed countries (L.D.C.'s). For this reason, despite the effort expended and resources dedicated, little progress has been made in implementing the principles which would move world development in a sustainable direction. Maurice Strong commented on the lack of headway on

this issue at the close of the Rio conference. "I am not a doomsayer by nature", he told reporters, "but the world is on a course that leads to tragedy" (Abramson, 1992:4).

This thesis will examine that phenomenon, arguing that the traditional economic approach to development as understood and practised by the dominant provider of multilateral development finance – the World Bank – is fundamentally inconsistent with the principles of sustainable development. Representative of a still-pervasive view of poverty and environmental degradation as problems of under-production and over- population, the Bank continues to try to bring its operations in line with the dictates of sustainability without effectively confronting the underlying beliefs, systems and dominant values which govern its decision-making. Nor has it yet dealt with an internal organizational structure and project evaluation process which puts it at odds with an emerging grassroots/community oriented, decentralized model. Consequently, despite considerable allocation of resources, the World Bank is increasingly the target of international criticism as well as member government pressure for better performance.

The difficulties being experienced by the world's largest lender are illustrative of the challenges being faced by all development agencies and institutions born of a particular economic paradigm, the tenets of which now advocate global integration in an urgent search for macroeconomic stability. But the next

paradigm, with sustainability as its base, is already unfolding and will continue to mount primary challenges to "old order" institutions like the World Bank as it evolves.

CHAPTER 1: THE CONCEPT OF SUSTAINABILITY

The past decade has seen the term sustainable development go from an obscure expression understood only by deep ecologists, to popular jargon, common to every speech, conference or written word on any subject related to development or the environment. Despite the appearance of widespread acceptance and understanding, a survey of the literature reveals a considerable lack of consistency in interpretation. This has perhaps contributed to the general acceptance of the term by the political mainstream, and the difficulty in transcending superficial policy-making in this area. For sustainable development to have a long term, fundamental impact, this ambiguity must be eliminated in favour of a set of non-contradictory principles which set out clearly the nature of the relationship between development, poverty and environmental degradation and the manner in which that relationship must be changed.

While the concept of sustainability originated long before the dawning of environmental awareness¹, the first documented use of the term sustainable development appears in a document entitled "World Conservation Strategy", prepared by the International Union for the Conservation of Nature and Natural Resources in 1980 (Lele, 1999:613). At that time, use of the phrase was limited to the "conservation of living resources", with no reference to economic, political, cultural or population issues. This reflects the original conception of the

"sustainability" idea in the context of renewable resources, a definition which Lele refers to as "ecological sustainability":

"the existence of the ecological conditions necessary to support human life at a specified level of well-being through future generations" (1991:609).

Redclift then makes the connection to issues of development:

"(sustainable development) means a definition of development which recognizes that the limits of sustainability have structural as well as natural origins" (1989:199).

This idea was given greater specificity by the widely publicized definition of the World Commission on Environment and Development in their 1987 publication "Our Common Future":

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs (WCED, 1987:43).

In their 1992 sequel to "The Limits to Growth", Donella and Dennis Meadows and Jorgen Randers simplify the definition even further in "Beyond the Limits":

"A sustainable society is one that can persist over generations, one that is far-seeing enough, flexible enough, and wise enough not to undermine either its physical or its social systems of support" (1992:209).

All of these definitions, or variations of their ideas, appear with such frequency

in publications of all major world aid and world development organizations that they seem to reflect a common understanding of meaning. Used in this way, sustainable development increasingly appears as another mainstream form of rationalizing continued economic growth rather than as a challenge to the orthodox economic paradigm.

World Bank senior economist Herman Daly is critical of such general interpretations of the term. Nowhere in the mainstream literature, he charges, is a distinction made between "growth" and "development". This is a vital distinction to make and yet the two terms are often used interchangeably:

"Growth should refer to quantitative expansion in the scale of physical dimensions of the economic system, while development should refer to the qualitative change of a physically nongrowing economic system in dynamic equilibrium with the environment " (Daly & Cobb, 1989:71).

Some of the confusion in the terminology, Daly argues, stems from the recommendations and discussion in the widely read "Our Common Future", which rationalizes:

"more rapid economic growth in both industrial and developing countries" so that a "five to ten fold increase in world industrial output can be anticipated by the time world population stabilizes some time in the next century" (WCED, 1987:213).

This linking of the concept of sustainability to large scale revitalization of industrial activity and economic growth has contributed to a superficial characterization of

the problems of ecological and social degradation which denies the real problems

- a fundamentally inequitable world economic order, unrestrained and unsustainable patterns of consumption and accumulation in the North and prejudicial development models being perpetrated on the South.

A working definition which attempts to address this historical linkage is put forward by Costanza:

"sustainable development is a relationship between dynamic human economic systems and larger dynamic but normally slower-changing ecological systems in which 1. human life can continue indefinitely, 2. human individuals can flourish and 3. human cultures can develop; but in which effects of human activities remain within bounds so as not to destroy the diversity, complexity and function of the ecological life support system" (Costanza, 1991:8).

Costanza emphasizes the importance of examining the socio-ecological implications of current economic policy; otherwise, he argues, solutions will continue to be sought within the current economic growth paradigm.

For "alternative" development thinkers like Costanza (1991), Goodland (1987), Daly (1989) and others, the need to confront these implications has become urgent; for, regardless of intentions:

"no amount of ethical axiology, or legal, policy and technological engineering is going to solve problems that are misunderstood. A lot of work in changing beliefs and behaviours is necessary before sustainable development is

really meaningful"² .

Much of that work involves confronting the mechanistic world view and sets of beliefs that have become embedded in mainstream development thinking.

THE BIAS OF DEVELOPMENT

The term "development" was first given its contemporary interpretation in January, 1949, by then President Harry Truman during his inaugural speech before Congress (Sachs, 1990:42). Truman spoke of the non-Western regions of the world as "underdeveloped", and needing assistance to achieve "a higher standard of living", which was the responsibility of the "advanced" nations to provide. For the first time, the world was defined in economic terms, and the supremacy of the Western productivist model was simply assumed. The degree of "civilization" of a culture was no longer to be measured in terms of language or artistic/architectural achievement or even culture in the main; rather, the level of production had become the determining factor.

Truman's remarks were at the same time giving voice to the ambitions of a United States which had emerged from the Second World War as the dominant world power. By defining most of the world as in need of "economic development", a combination of foreign investment and aid was then prescribed as the route to greater prosperity and a higher standard of living through

industrial activity and production. This view, as it emerged, necessitated the creation of organizations and agencies to design and implement economic development models. Thus institutions like the United Nations and the World Bank implicitly contained the perspective of the world's most powerful nation, the United States.

Sachs explains:

"..the hegemony of the West was logically included in the proclamation of development. It is no coincidence that the preamble of the U.N. Charter (" We, the peoples of the United Nations...") echoes the Constitution of the U.S. ("We, the people of the United States..."). To talk about development means nothing more than projecting the American model of society onto the rest of the world" (Sachs, 1990:44).

As other political analysts have drawn out, implicit in this world vision is a dominant position for the United States in the global economy, and certain assumptions about the role that the industrialised nations would have in controlling the flows of capital, trade and technology to the developing world. In this manner, the solution to the spate of economic, health, population and education problems of the lesser developed countries also met the capital growth requirements of the West – continuous expansion and the creation of new markets.

Continuous growth equates to growth without limitations, as if the flows of energy and material necessary to keep the economy moving, what Meadows and

and material necessary to keep the economy moving, what Meadows and Randers refer to as "throughput", can continue forever. This approach results in:

"exponential growth, which is the driving force causing the human economy to approach the physical limits of the earth" (Meadows & Randers, 1992:14).

Unlike linear growth, in which the amount of increase is constant in a given time period, exponential growth increases in proportion to what is already there. When the concept of exponential growth is applied to capital formation, in which it is structurally inherent, the result is a rising level of materials and energy consumed as economic throughput. As Daly (1992) points out, this ignores the more realistic conception of the economic system as a subset of the wider ecological system – which is closed and finite.

The production of something, in other words, involves the inversion, consumption and destruction of other things³. Production therefore must be understood AS consumption, not as its opposite, which is the traditional economic viewpoint. Nowhere in that conventional view

"is there recognition that sustainability requires that growth must not exceed the capacity of the larger system to regenerate resources and absorb wastes at sustainable rates and without disrupting other vital natural services, such as photosynthesis, nitrogen fixation, etc". (Daly, 1992:13).

This is described by Rees (1989) as explained by the Second Law of Thermodynamics, which states that:

"in any closed, isolated system, available energy and matter are continuously and irrevocably degraded to the unavailable state"⁴.

Rees concludes that since the global economy operates within what is essentially, a closed system, this Second Law (known as the Entropy law) is in fact the ultimate regulator of economic activity, and that:

"sustainable development must be development that minimizes resource use and the increase in global entropy" (1989).

Rees also makes the point that the continual consumption of ecological resources such as forests, fish stocks and soil fertility will eventually exhaust those resources if not only the annual production of the ecosphere (the "interest") is consumed but the standing stock ("the capital") is eroded. For some time the key indicators have signalled that both the interest and the ecological capital are being consumed under current practices, which Rees views as the "inevitable consequence of exponential material growth in a finite environment."

The first principle of sustainable development then, is to recognize the Western bias implicit in the approach taken to development so far, and to redesign the process so as to take into account the limitations placed on production/consumption by the larger eco-system.

NEW SYSTEM OF MEASUREMENT

Since the early 1980's, national and multilateral institutions and regulatory bodies have experienced a rising awareness that current national accounting systems do not adequately evaluate natural or human resources. This has led to the realization that development strategies which are reliant upon standard income accounting techniques may not result in sustainable development (Lutz and Munasinghe, 1991:19). Attention is now turning to better understanding the value of these resources, and incorporating that value into measurement systems.

The current United Nations System of National Accounts (SNA), for example, has no effective means of accounting for environmental resources or negative impacts of industry on human settlements. Forests are valued as harvestable timber, rather than in terms of habitat, recreation or aesthetic worth. Fish stocks are evaluated as potential catch, and soil fertility as the worth of future yield. The SNA, originally published in 1968, is still heavily reliant upon the Gross National Product (GNP) measure, originally a means of emphasizing and measuring post-war production activity. Never intended as a total measure of health or welfare, or even wealth, it is still used as the primary indicator by development agencies around the world, including the World Bank, despite continuing attempts to mitigate its use since 1983 (1991:20)⁵.

Having alternative measurement indicators in operation is one of the most

important principles of sustainable development; indicators which would not distort the development process away from human development and welfare (Daly 1992). The South Commission Report in their 1990 study of the development record of the South, emphasized the delusion of equating GNP growth with true human-oriented development:

"Not only the growth of the national product but what is produced, how and at what social and environmental cost, by whom and for whom – all this is relevant to people-centred development and should be taken into account" (Report of the South Commission, 1990:13).

According to Lester Brown (1990 State of the World Report), the contention that GNP growth, and hence economic growth, is positively correlated with improvements in living conditions and standards is fundamentally incorrect. Brown observes that the four decades since the 1950's have seen unprecedented levels of global economic growth, accompanied by equally unprecedented levels of increase in numbers of the absolute poor and levels of environmental destruction (Goodland & Ledec, 1987:167). Daly goes further to suggest that the impetus for economic growth in less developed countries is usually foreign investment, where expected rates of return on investment or equity often demand environmental or social concessions not in the interest of the host country's people. In fact, Daly points out that an alternative approach to development would dictate the opposite of foreign investment – local control and ownership of resources. Local control would, in turn, facilitate a more sustainable use of both renewable and non-renewable resources than present designed-for-export policies allow.⁶

LOCAL CONTROL AND SELF-SUFFICIENCY

Along with re-designing the approach to development and the measures to be used to gauge success, is the related issue of examining the level at which development should take place. There is now considerable literature which presents the argument that community economic development, i.e., development at the level of the local economy, will be the driving force of the future, even though the pattern of economic development throughout the world to date has been the reverse.

Local self-reliance has long been discussed in terms of conservation and wise use of resources (Sachs, 1990:333), but is currently enjoying a rebirth of interest. The environmental movement and many Third World non-governmental organizations (N.G.O.'s) have focused attention on the negative consequences of being dependent on the investment activity of other countries for prosperity, and the idea of returning control of an economic future to communities and away from foreign owners holds promise for the balancing of social responsibility with enterprise.

A locally focused economic order increases the possibilities for citizens to participate in decision-making, an opportunity they are denied when resources and jobs are controlled by another country's government or a transnational

corporation (Daly & Cobb, 1989:173). A local model is better suited to taking human priorities and natural limits into account, as well as meeting another prerequisite for sustainable development – self sufficiency. As Korten explains:

"There is a broad consensus among alternative thinkers that decentralization and local accountability must be the key features of a sustainable eco-economy. This means that the larger global economy must be divided into a system of interrelated local economies that are for the most part self-reliant" (Korten, 1990:184).

Daly and Cobb emphasize the importance of this point:

"There can be no effective national economy if a people cannot feed themselves and otherwise meet their essential needs. Hence a national economy for community will be a relatively self-sufficient economy" (Daly & Cobb, 1989:173).

The current practice of some development agencies of encouraging developing countries to grow crops for export rather than local food production is one of the factors which can be blamed for the decline in food production growth, as well as soil erosion and other environmental degradation (Goodman and Ledec, 1987:31).

At the moment, the enormous burden of debt repayment has locked Third World countries securely into the international market system, where crops for export are often a necessity. Self-reliance, especially with respect to basic needs – food, clean water, housing and basic social services can only be achieved when less developed countries are free from the crippling yoke of debt that threatens

to dictate a future that resembles the past. The fact that these countries are capable of feeding themselves has been well documented for several decades, but foreign aid and investment forces actively work against this possibility (Lappe, Collins and Kinley, 1980).

For less developed countries to become self-sustaining dictates that advanced industrial countries must do the same and restructure their economies to no longer rely on the cheap labour, goods and resources provided by the countries of the South. A recognition will have to occur that, rather than underdevelopment being at the root of poverty and hardship in the South, consumption and accumulation patterns in the North are central to the problem.

Foreign investment is one of the mechanisms the North has devised to maintain these patterns, along with international trade and monetary structures. But if Third World countries are to achieve a degree of self-control over their economies and thus the standard of living of their populations, a decentralized system of local control and ownership must be the fundamental direction, not the wholesale advocacy of global economic integration that industry and national governments are currently pursuing. Local ownership and self-sufficiency as well as freedom from debt and dependency are essential if problems of over-population, poverty and environmental pollution are to be successfully overcome by the countries of the South.

In summary, the minimum conditions for achieving sustainability would appear to include:

- * a revitalized and redirected approach to development on the part of the institutions and agencies of the industrialised countries
- * a new system of measurement with indicators of human health and well being, and which takes environmental factors into account
- * a mechanism for ensuring self-sufficiency, particularly in the ability to provide sufficient food, drinking water and energy for communities in both the North and the South
- * a system which facilitates local control and ownership of resources, to ensure sustainable use of both renewable and non-renewable resources
- * relief from the crippling effects of debts on countries of the South.

These principles are particularly important for global institutions like the World Bank, which directly affects economic policy, and indirectly the environmental and social consequences of those policies in the developing world. Let us now turn to an examination of the operations and philosophy of the Bank in light of these tenets of sustainability.

CHAPTER 2: THE EVOLUTION OF THE WORLD BANK

To appreciate the dilemma faced by the World Bank today demands an examination of the circumstances under which it was formed and the role it was originally intended to play.

Established in 1945 as the International Bank for Reconstruction and Development after the 1944 Bretton Woods Conference, the World Bank's original mandate had been twofold. Initially it was to co-ordinate the funding that would be required to repair war damage in Europe following the war, and then it was expected to turn its attention to making development loans "to develop the resources and productive capacity of the world, with special emphasis to the less developed countries" (Mason & Asher, 1973:1). Capital would be provided primarily from private sources guaranteed by the Bank, mainly from the United States, and from selling its own securities on capital markets. The International Monetary Fund (I.M.F.), established at the same time, would assist with balance of payment lending and with the removal of impediments to international trade such as import quotas, barriers and tariffs. Three large regional banks were later created specifically to focus on the special needs and problems of Africa (African Development Bank) Asia (Asian Development Bank) and Central and South America (Inter-American Development Bank) together forming the World Bank Group.

Almost from the beginning, the anticipated mission for the Bank had to be adjusted as

the postwar period took shape. Initial reconstruction needs were much greater than imagined, with the U.K. borrowing \$5 billion from the U.S. and Canada directly on a government to government basis; and the funding needed to rebuild inventories and import basic necessities like foodstuff and fuel being provided by the United States directly through the Marshall Plan.

Within a fairly short period of time, the Marshall Plan in fact effectively took over most of the reconstruction lending required for all of Europe. With the arrival of Eugene Black as President in 1949, the World Bank moved more definitively in the direction of lending to developing countries.

In the early days, the Bank permitted no bad debts, charged standard commercial interest rates and demanded prompt repayment (Sampson, 1981:88). Loans were made on a project basis either to facilitate foreign investment in a particular country or to create the infrastructure necessary for such investment, generally considered to be low-risk type loans. This conservative approach was important to establish the reputation and financial integrity of the Bank, and would allow it to maximize its leveraging potential as it gained legitimacy.

The problem of lending to less creditworthy but politically important countries like India was dealt with in 1960 with the creation of the International Development Agency (I.D.A.) as part of the World Bank Group. This institution made "soft" loans, where normal lending ratios and requirements are adjusted to take into consideration the special

circumstances of the borrower, often with interest rates as generous as three or four percent per year, to be repaid over as long an amortization period as fifty years. Nineteen advanced industrial countries, led by the United States, lent huge sums of money in this manner, in the process accomplishing the dual objective of assisting with the increasing liquidity problem of these multilateral banks, and effectively relieving the World Bank of any "charitable" obligations (Sampson, 1981:90).

By the end of the sixties however, many of the high expectations for Third World lending and aid programs were fading. In 1967, then Bank President George Woods proposed a twenty year assessment of aid and lending programs, and a commission was formed under the chairmanship of Lester Pearson to "propose policies which will work better in the future" (Sampson, 1981:98).

Their report, "Partners in Development" concluded that, while the rate of growth in gross domestic product (GDP) of the developing countries had outstripped that experienced by the developed world through the 1950's and 1960's, that in fact the poverty level was rising and the gap between the rich and poor countries was still widening. Too much aid, it reported, had gone astray and too much had been spent on industry while agriculture had been neglected. The report emphasized the benefits of private enterprise, and predicted a time when capital markets and direct investment would take over most development. In the meantime, what was needed was expanded world trade:

"The richer countries must reduce their import duties, help to finance "buffer Stocks" of commodities, and abolish their quotas for manufactures from the Third World" (Sampson, 1981:100).

After MacNamara assumed the presidency in 1968, the World Bank picked up many of these ideas, becoming almost as much of a development agency as it was a Bank and moving deeply into Third World development lending throughout the 1970's. Although MacNamara understood the paradoxes that were leading to greater impoverishment in the Third World, and delivered an apparently stinging speech at the U.N. Conference on the environment in Stockholm in 1972 in which he attacked the "endlessly spiralling consumer economy of the richer nations" (Sampson, 1981:272) his analysis of the enduring problem of poverty paralleled that of the Pearson report. The answer was to be found in the "low productivity element" of the poor. More resources must be put into increasing productivity levels. Return on capital was still the paramount measure; while much more money was spent on education, for example, it was not to be used to finance "any education project that is not directly related to economic growth" (Sampson, 1981:274).

These policies were adhered to throughout the 1970's, but with no improvement in either the alleviation of poverty, to which the Bank was apparently now dedicated, or levels of economic growth. Over the next two decades these problems only deepened, and were joined by an additional issue of global importance – the environmental crisis. These serious developments over time made clear the inadequacy of Bank policy and triggered a series of major internal changes in an attempt to meet these new challenges.

THE PROBLEM OF DEBT

A significant part of the immobility of the less developed countries in effectively handling the social and environmental problems facing them now is the serious indebtedness that they labour under. The recently published World Debt Tables for 1991–1992 put out by the World Bank, reported a total external debt of all developing countries at the end of 1991 at \$1.35 trillion (U.S.), essentially unchanged from a year earlier. Then World Bank Vice President and Chief Economist Lawrence Summers introduced the tables with the vague comment:

"...the debt problem muddled along in 1991, with progress in some areas but regress in others" (Economic Review, 1991:130).

This kind of accompanying commentary, kept on the level of description, ignores the moderate economic success in the 1960's and early 1970's enjoyed by many Third World countries, and is silent on the factors which lead up to the debt crisis.

These factors included the creation of a Eurodollar market which effectively freed international financial institutions of regulatory restraints; the OPEC governments depositing of oil revenues into Eurodollar assets; the resulting liquidity crisis of 1973–1974 which necessitated new loan markets; the subsequent granting of loans to L.D.C.'s at extremely low but floating interest rates; the subsequent combination of monetary contraction and fiscal expansion on the part of the U.S. government which had

the effect of pushing interest rates domestically up to 8% (the equivalent of 20% for some Third World countries); the election *circa* 1980 of neo-conservative governments in several industrialised countries (UK, USA, FRG) with objectives of putting monetarist doctrine in place as quickly as possible.

The first indication of the possible depths of the crisis became evident on August 12, 1982 when Mexico's minister of finance Jesus Silva Herzog contacted the chairman of the U.S. Federal Reserve Board and the head of the IMF to advise them of Mexico's inability to meet the \$11 billion interest payment due on its foreign debt by the end of that year (Steinberg, 1989:75). This event is retroactively recognized as signalling the beginning of the debt crisis. "The world was different after that", Mr. Herzog said later, of the chain of events which followed.⁷

Given the percentage of shareholder equity tied up in U.S. commercial bank loans to Mexico, to allow Mexico's default could have triggered the collapse of the U.S. banking system. Instead, the near disaster in Mexico was averted at the last moment by a "bail out" cash infusion from the IMF and the US Federal Reserve in return for the Mexican government agreeing to certain conditions – sharp cuts in real wages, elimination of subsidies for basic goods and the reduction of public spending to ensure the domestic government would be in a position to honour its debt payment obligations (Sampson, 1989:76). But the fact that the debt crisis occurred when it did appears to have come as a surprise to all of the multilateral lending institutions, including the World Bank.

In fact, as late as 1977, then President of the Bank MacNamara made the argument in a speech in Washington that the recent significant growth in commercial lending to developing countries did not make a debt crisis "inevitable", and that it could no doubt be "staved off" if it threatened to develop, but that a larger threat loomed in the unmatched excess liquidity of the American commercial banks which must be dealt with immediately (Mosley, Harrigan and Toye, 1991:22).

It took three more years before MacNamara in his 1980 Presidential address agreed that what happened had:

"represented a permanent change in the world economy, not a temporary phenomenon,...hence the need for developing countries to structurally adjust their economies" (Mosley, Harrigan and Toye, 1991:23).

Not only did the Bank fail to anticipate the consequences of excessive borrowing and escalating interest rates on a poor country like Mexico, it insisted along with the IMF, that the remedy lay in "structural adjustment to the new reality" on the part of the Mexican government. As a result, the imposed currency devaluation to improve the balance of trade caused rapid inflation, and reduction of various government subsidies bankrupted hundreds of Mexican companies and threw thousands of people out of work. Imports were slashed so dramatically that Mexico ended up running a trade surplus for the year; yet between 1982 and the end of 1988 its \$80 billion debt grew even larger to \$110 billion, despite \$50 billion in payments to creditors and declining indicators of social, physical and environmental health (Steinberg, 1989:79).

Recent assessments of the debt crisis and the effectiveness of the structural adjustment measures taken by the Bank have generally been quite critical of this approach to the problem, citing the benefits being enjoyed by the industrialised countries as a result of the misery of the Third World countries. In particular the 1990 Report of the South Commission noted:

"Between 1983 and 1987, the net transfer of resources (new loans less capital repayments and interest payments) associated with World Bank lending was almost insignificant. It turned negative for the first time in 1986, with the Bank receiving from developing countries more than it was lending" (Report of the South Commission, 1990:231).

In its recommendations, the Commission calls for a depoliticization of the operations of institutions like the World Bank, and the removal of ideology from its lending decisions.

The Bank's assessment of the causes of the crisis and the effects of changes in lending policies differ quite significantly. The 1991 World Development Report presents the debt crisis experienced in the Third World as being related to imprudent spending decisions of their governments:

"a debt problem that would be transmitted worldwide unfolded in the 1970's as many developing countries borrowed to increase consumption, invest in doubtful projects, and finance imported oil (which was then subsidized)" (World Development Report, 1991:18).

This could only be corrected by, among other actions like debt relief, debt-service reduction – "the implementation of comprehensive adjustment programs" (World

Development Report, 1991:9).

Not only did the World Bank interpretation of the debt crisis differ from the "alternative" viewpoint that domestic policies undertaken by the less developed countries were a minor factor and the macroeconomic linkages between them and the OECD countries a major one, but the Bank also, perhaps not surprisingly, continues to see the solution differently. Even when considering the possibility of reducing the excessive debt burden to the L.D.C.'s, it advocates the continuation of lending to facilitate the promotion of international export and trade. Specifically, the 1991 Development Report's "Priorities for Action" recommends that the developing countries need to:

"Open economies to international trade and investment – This calls for far fewer nontariff restrictions on trade and investments, substantially lower tariffs, and a decisive move away from discretionary forms of control" (World Development Report, 1991:11).

For critics like Herman Daly, this perspective does not hold much potential for finding future solutions;

"While advocacy of debt reduction is good, it is distressing that the system of deregulated international commerce (free trade) that gave rise to these unrepayable, unsustainable debts is so critically embraced as the key to future "sustainable" development" (Daly, 1991:4).

BANKING ON THE ENVIRONMENT

Another major issue that has confronted the Bank in recent years has been the growing criticism of Bank financed ecological debacles.⁸

In October, 1989, a hearing took place in the U.S. Congress to hear testimony from both donor and borrower countries involved with the World Bank, concerning alleged violation of the Bank's own environmental and social policies in the Sardar Sarovar dam in north central India. Just prior to the hearing, more than 60,000 people had protested against any further construction at the dam site – the largest development project protest in the history of India (Rich,1990:306).

The protest and subsequent hearing came two years after a public declaration of "greening" by then President Barber Conable, and was therefore a surprise and a disappointment to many Congressmen who had believed the Bank was making substantial improvements to its environmental record. Sardar Sarovar was only the most recent in a long series of controversial, environmentally damaging projects connected to the World Bank through the 1970's and 1980's. As a consequence, the Bank came to represent the negative aspects of development, with bank officials continuing to justify projects on the basis of economic benefits irrespective of environmental and social costs.

The importance of these criticisms was finally acknowledged in May of 1987, when

Conable announced an intended new direction for the Bank. At a speech in Washington, D.C., Conable conceded that the Bank may have been "a part of the problem in the past", but it was now about to become a "strong force in finding solutions for the future" (Sarokin and Schulkin, 1991:12).

Subsequent bank publications reinforced this message with statements like "the bank has had to change.....while environmental issues have not been ignored altogether in the past, we have not given them sufficient attention" (Sarolin and Schulkin, 1991:13). On the American public affairs program '60 Minutes' which featured the Polonoroeste project in Northern Brazil, Conable expressed the view that the project had indeed been a "sobering example of an environmental project which went wrong", and that the Bank had "misread the human, institutional and physical realities of the jungle and the frontier" (Adams, 1991:30).

One of the first outcomes of Conable's 1987 "going green" speech was the hiring of additional environmentally trained employees and consultants to staff the Department of Environmental Affairs, which had been comprised of a single environmental advisor since 1969. By 1990, the number of environmental staff had increased tenfold. In addition to more hiring, the manner in which projects were to be assessed from an environmental standpoint was revised, and a new action plan was created. Staff were now to prepare environmental issues papers and discussion documents identifying environmental problems of various projects in developing countries (Rich, 1990:307), and designing approaches to address the underlying causes. Where appropriate,

environmental action plans were then to be undertaken in conjunction with local governments, attempting to integrate environmental considerations into national economic and social development plans and raise public awareness of the issues.

More complex sectoral problems were to be the focus of major studies, sometimes on a regional basis. This was the case in the "Capital Cities Clean-Up Project for the Asian Region", and projects like the "Environmental Program for the Mediterranean" undertaken in conjunction with the European Investment Bank (Warford & Partow, 1989:6). As part of the reform process, Conable also committed the Bank to consulting more closely with local groups, including environmental activists and representatives of aboriginal peoples, in all countries of proposed World Bank projects.

As well as hiring more staff and devising a new assessment process, more money was to be spent to finance a much greater proportion of environmentally beneficial projects than had been done in the past. During 1988, the Bank's Board of Directors approved more than 100 projects, representing 35% of the total, containing important environmental considerations, and 60% of all agricultural sector projects approved also contained environmental elements (Conable, 1989:5). Support for "free standing" environmental projects such as an environmental protection and research loan to Brazil were anticipated to cost more than \$1.3 billion from 1990–1993. Funding to carry out these new initiatives has not been an issue; the Bank heavily lobbied its major donors during the late 1980's for more capital, resulting in a cash infusion in excess of \$75 billion. This has enabled the Bank to increase its annual lending, at least in theory, by

50% throughout the mid 1990's (Rich, 1990:318).

The extensive re-structuring and re-allocation of resources that accompanied Conable's public commitment to address the environmental and social consequences of funded projects more adequately has met with some positive results. The general trend of the past two decades of World Bank association with harmful environmental and social side effects of development has not, however, substantively abated. In some cases – the recent critical report of the Sardar Sarovar project, the well-publicized proposed Three Gorges Dam project in China and links to rainforest destruction projects in the Amazon as well as the contentious Tucurai Dam project in Brazil–the Bank's image has lost ground in spite of its efforts.

Despite the apparent environmental bias, however, the Bank's efforts are effectively confined to the same philosophical framework of its inception almost 50 years ago. The Bank's 1991 World Development Report, "The Challenge of Development", presents its conclusions after more than four decades of development experience:

"that accelerated economic growth and integration of the world economy are the keys to human progress" (Korten, 1991:163).

Only through economic growth can the necessary resources for investment in environmental protection be generated, it states, and the key to overcoming poverty is to increase the incomes of the rich to create more demand for the products of the poor. The market continues to be seen as the key to that growth, and the Bank calls on

governments

"to complete the integration of their national economies into the global economy, invest more in social and physical infrastructure, and allow international market forces to play themselves out without government interference" (Korten, 1991:169).

CHAPTER 3: PROJECT LENDING IN PRACTICE

For the World Bank, large scale infrastructure loans have long been the lending vehicle of choice; firstly, because much of the funding leveraged from other commercial lenders is raised on the assumption that the Bank will put up the funds required to facilitate the investment (Dixon, Talbot and Le Moigne, 1989:178). Secondly, the constant pressure on the Bank to place high volume loans on the books is more easily alleviated by multi-million dollar hydro-electric projects, for example, than several smaller scale loans. In addition, many of the large infrastructure loans are multi-purpose, or can be seen to be providing a range of benefits. In the case of hydroelectric power production, for example, dam construction not only meets that need but can also assist with flood control, provide drinking water and irrigation systems and improve navigation.

The Bank's early lending for large irrigation, railway, road, telecommunication and steel projects proceeded primarily on the basis of highly subjective estimates of gross benefits compared with expected costs, and few detailed land use studies or impact assessments. For the most part, little attempt was made to standardize the methodology between projects, and assessment was made on the basis of expected value of gross benefit in comparison to expected gross costs over the anticipated life of the project, with the resulting average annual net benefit related to the proposed volume of investment (Mason & Asher, 1973:241). Nor was any effort made to determine the present value of benefit or costs at different points in time in the future. Certainly for the first

twenty-five years of project lending, scant attention was given to environmental or social costs, and the "discounted cash flow" technique of estimating anticipated returns was not used at all until the 1960's. More recently, particularly since 1987, the Bank has attempted to integrate environmental and social factors into traditional economic assessments; however, the rough valuations that take place through the cost/benefit approach are still the most common valuation method used by all major lenders, including the World Bank (Stein and Johnson, 1979:18).

A major weakness in the cost/benefit approach is that it strongly favours projects with short term benefits and long term costs, even though those same projects almost inevitably result in negative environmental and/or social effects. This can be seen in the inherent preference which cost/benefit analysis demonstrates for example, for large scale hydro-electric projects. The requisite high investment but low operating costs make them attractive to World bank lenders; the reverse of low investment but high operating costs associated with thermal plant alternatives have meant they have often simply not been investigated by the Bank as a serious possibility (Mason & Asher, 1973:237). The abundance and low per unit cost of energy provided by these huge dams attracts energy-intensive industry like steel production, petrochemical and heavy machinery production to an area, and the anticipated monetary benefit appears as part of the economic justification for the project. The resulting environmental degradation, often permanent as is the case with rainforest destruction; the monetary and social cost of dislocation of indigenous peoples; the irrationality of producing low per-unit cost energy when governments around the world are trying to reduce energy consumption, and the

loss of control over the rate of power production or usage on the part of the host country's citizenry are not usually considered as "measurables" and simply left out on any cost-benefit calculation.⁹

The high number of hydroelectric dam and forest extraction programme loans in the Bank's current portfolio, according to its own development reports, reflect the Bank's enduring assumption about the relationship between these types of projects and economic development and the prerequisites for a higher standard of living, utilizing industrialised country criteria as a measurement.

ENERGY LENDING

The long established patterns of energy lending at the Bank, have, therefore, almost always centered on the provision of low unit cost, highgrade electrical energy to supply industrial demand and centralized urban requirements. Rural needs, until recently, were either ignored or relegated to secondary status. The downsides of the mega dam approach – disruption of indiginous populations, loss of forest land, threat to wildlife and tropical vegetation, increased sedimentation and salinization of soil, erosion, proliferation of water-borne diseases like schistosomiasis, etc. have been minimized in order to rationalize proceeding with construction, even against the recommendations of the Bank's own advisors.

In an analysis of several dam projects funded by the Bank within a ten year period, Dixon, Talbot and Le Moigne conclude:

"the most important single issue in the Bank's entire dam project process is the determination of whether the dam should be built in the first place. Decisions are based on economic justification; however, it is not evident that the basis for that economic determination includes an economic analysis of environmental factors which can affect the sustainability, costs and benefits of the project... environmental considerations are brought in too late to have adequate impact on the design of the project.... consistency in application is still lacking; until recently a high percentage of dams still received little recorded environmental consideration. (Dixon, Talbot & Le Moigne, 1989:10).

In analyzing the weaknesses in the Bank's process for project assessment, Mason and Asher (1973) point out the near impossibility of any "arms length" business relationship between the potential borrower and the Bank, due to the latter's understandable concern that it is going to be repaid. In the process of assessing creditworthiness of the potential borrower, Bank staff offer assistance with the preparation of the loan application where necessary. This leads to provision of advice on the particular project, and information concerning the kind of specific data the Bank requires in approving such applications – in general, helping to "shape" the project. Particularly because of the inevitable long delays between project inception and loan funding, bank staff often come to know the details of a particular project very well, and often end up presenting the application to other staff as part of the assessment team.

Examples of this weakness in the Bank's analytical process include the Sobradinko Dam on the San Francisco River in Brazil,

"...loan work-up documents reveal that ecological reconnaissance followed the loan and did not begin until after construction had commenced...the results of the study were added to the loan agreement after the fact" (Stein and Johnson, 1979:98).

This shortcoming is borne out by the remarks of Bradford Morse and Thomas Berger, in charge of the Independent Review Commission on the Sardar Sarovar project.

Remarking on the failings of the appraisal process used, they commented:

"the Bank's first in-depth attempt to evaluate the social impacts of the project came after the appraisal was completed and it was clear that the project would proceed" (Report of the Independent Review Commission, 1992:43)

and that

"the history of the environmental aspects of the Sardar Sarovar is a history of non-compliance; there is no comprehensive impact statement...this work should have been done by others before the Project was approved" (Report of the Independent Review Commission, 1992:xxi, in Letter to President).

FORESTRY LENDING

Similarly, the Bank's preference for large scale projects has resulted in a high ratio of forestry project loans – \$727 million was spent on forestry investment between 1983 and 1987; that figure was doubled for the period 1988–1992 (Rich, 1990:309). The foundation for the World Bank approach on forestry is set out in a publication entitled

"Tropical Forests, A Call To Action", written together with the United Nations Development Programme, the World Resources Institute and the Food and Agriculture Organization in 1985. The action plan articulated in this document, later to be formalized as the "TFAP", states the Bank's view:

"many of the solutions to deforestation must come from outside the forestry sector...the Bank's emphasis is on helping countries strengthen their abilities to manage their forest resources" (World Bank Publications, 1989:29).

The lack of local consultation and involvement resulting in this approach has led to charges that the Bank is simply furthering the interests of large, foreign owned forestry companies which will only accelerate deforestation and related problems. Critics of the TFAP have referred to it as a "lumbering Frankenstein" (Adams, 1991:310), which is mobilizing billions of dollars for tropical forestry projects around the world. Even Prince Charles was critical of British involvement with the TFAP, referring to the programme in February of 1990 as "little more than a plan to chop down trees" (Rich, 1990:310).

An example of the consequences of this approach to lending can be found in the \$23 million World Bank scheme that will assist in road construction through and around 106,000 hectares of pristine rainforest in Guinea, two thirds of which is to be opened up for timber production (Rich, 1990:310). Another TFAP project sponsored by the Bank in north-east Thailand is setting up commercial timber plantations of eucalyptus trees, but is criticized by Thai villagers because of the damage to soil and water, and

the fact that forest dwellers will be pushed off their communal lands and deeper into the forests. Ghana has received substantial financial support for its timber industry from the World Bank in the past, and its forests are now being cut at more than double the sustainable rate by the World Bank's own estimates. Moreover, under the TFAP budget for Ghana, logging tenders must be at least 10,000 hectares in size and are granted to the highest bidder, indirectly ensuring that this rate of cut does not decline (Leggett, 1990:452). Yet another TFAP program supported by the World Bank intends to make Cameroon the largest forest product exporter in Africa by the end of the decade. To facilitate this, a major road to the sea will be built to open up for timber extraction fourteen million hectares of pristine tropical forest in the southeast (Leggett, 1990:454).

Those who stand to profit by this approach to non-renewable resource extraction – multinational corporations, foreign commercial lenders, host country firms and host governments – will no doubt continue to exert pressure for continued Bank support for these types of projects. And pressure from within the Bank itself to build up large loan portfolios and move large sums of money mitigates against conservation and resource management-type projects. The direct commercial benefits of wood and wood products cannot be realized when forestry loans contain social and environmental objectives, and the benefits derived from a more selective or cautious approach are broadly disbursed to an entire region or even country, rather than to the tree growers. As well, good management practices may restrain a host government's ability to grant special concessions to extracting companies, often a rich source of funds for a government (Stein and Johnson, 1979:118). Indeed, attempts which have been made to encourage

host governments to take a more long-term approach on forestry issues have often met with great resistance, financial hardship dictating short term gains over long term investment.

The importance of tropical forests as a carbon dioxide "sink" to offset the global warming impact of greenhouse gases and on the biological diversity issue is gaining attention; the involvement of Western countries in tropical deforestation was a major item on the agenda at the 1992 Earth Summit Conference in Rio de Janeiro. The World Bank has, it seems, now admitted that its past lending policies have sometimes harmed tropical forests, and committed in June 1991, to stop all financing of commercial logging in virgin rainforest. The controversial TFAP, as a result of the negative publicity received by the Bank concerning its involvement with the plan, has been revised and its objectives redrafted. According to World Bank spokesmen, the new guidelines will end the confusion that has existed in the past between encouraging forestry and encouraging forest conservation.

CHAPTER 4: THE DYNAMICS OF POLICY-BASED LENDING

Some of the strongest and most widely publicized criticism of the Bank's operations in recent years has centered on its shift to policy-based lending, referred to by the Bank as "structural adjustment lending".

"Structural adjustment" is the term given to the set of macroeconomic policies advocated by the Bank for the achievement of development. These policies are linked together and, according to Bank policy, to be implemented simultaneously. These are summarized in the Bank's 1992 World Development Report:

- * domestic policies which curb spending, raise revenues, control borrowing and money supply, and maintain a competitive currency;
- * promotion of small-scale efficiency by freeing prices, deregulating markets, abolishing licencing systems and similar barriers to market entry, safeguarding property rights and investing in infrastructure;
- * liberalization of trade by ending protection for domestic industry, opening national markets to imports and foreign investments, and removing restraints on exports;
- * making the necessary social investments that the market system will not provide in essential social services such as primary education and health care (World Development Report, 1992:x).

While these policies are described in the 1992 Report as part of the "emerging consensus " on how development can be achieved in the current highly competitive global economy, conditional World Bank lending is not new; many of the project loans of the 1960's contained some degree of mandatory policy change requirement, such as a revision to power rate structure to accompany a hydropower loan, where the Bank's lenders felt it necessary to ensure debt servicing (Mosley, Harrigan and Toye, 1991:27). The move in this direction was solidified by the introduction of "programme lending", which specifically separated "investment funds" from "general support funds" (such as assistance with a deficit balance of payments debt). This type of loan often made the fulfillment of particular conditions mandatory for full funding of the loan, and while they were primarily sectoral in nature, did on occasion broaden to include macroeconomic concessions.

The move to Structural and Sectoral Assistance Loans (SALS) came in the early 1980's after the second oil shock of 1979. The Bank had been slow to recognize the severity of the global debt crisis, and was ill prepared for the sudden and rapid deterioration of several less developed countries' current accounts that resulted from oil price hikes and U.S. fiscal and monetary policy. It also found itself

"facing a situation in which new commercial bank lending to developing countries suddenly almost ceased while the interest rate on existing debt rose dramatically. Net transfers to developing countries reached zero by mid 1983, and reverse transfers from developing countries reached \$30 billion by 1987, the same year that the Bank began for the first time to receive more in financial inflows from developing countries than it was able to lend to them (Mosley, Harrigan and Toye, 1991:47).¹⁰

The macroeconomic policies of many L.D.C. governments were in disarray as well, as a general result of the unforeseen high costs of debt service now imposed on them. This occurred at a time when World Bank relations with developing countries was overwhelmingly project-based (Mosley, Harrigan and Toye, 1991:28), typically with five year development cycles to run. The resultant price instability made it much more difficult for the Bank to identify and appraise viable projects to support; in addition, the financial hardship for L.D.C. governments made domestic support of World Bank projects difficult or impossible, and the important ongoing maintenance of projects was frequently neglected as a result.¹¹

Given these conditions, the management of the World Bank concluded that if loans were not to dry up completely, a new type of development plan was necessary despite the reluctance of the Executive Board to move in this direction.

The World Bank Annual Report for 1988 explained that "SALS were needed to assist countries to undertake a program of adjustment to meet an existing or to avoid an impending, balance of payments crisis" (World Bank Annual Report, 1988:22) but went on to predict that this type of lending would be limited to ten percent or less of the total loan portfolio. The deepening financial crisis, however, led to a rapidly increasing utilization of structural adjustment lending as a means of convincing more Less developed countries' governments to change their economic policies, and had reached 30% of total lending by 1990 (Mosley, Harrigan & Toye, 1991:63).

Structural adjustment lending, then, became much more widely used in the Bank as a result of the urgency of financial pressures expressed by commercial lenders. Political pressure was applied too from major shareholders, particularly the United States, to lend for non-economic reasons. A clear example of this was the major loan granted Argentina in 1988, despite that country's 41.25 billion debt to both U.S. commercial banks and other World Bank loans (Harrigan and Mosley, 1989:48). In spite of the Bank's reluctance to advance further funds, it did so on the urgings of then U.S. Treasury Secretary Baker, who was concerned about potential "turbulence in the Southern cone" during the upcoming U.S. Presidential election (Harrigan and Mosley, 1989:60).

A consequence of this kind of high risk lending, due to the requirement of portfolio balance, is that the Bank must lend more to low risk, low indebtedness countries like India, Thailand and Botswana. This has led to criticism of a different sort; that the Bank has become involved with and supportive of authoritarian regimes with poor human rights records.

One quarter of the Bank's loans in 1979, for example, were allocated to four governments generally recognized as violators of human rights – Brazil, Indonesia, South Korea and the Philippines (Lappe, 1980:31). During the 70's decade, four countries that had suffered either military takeovers or the imposition of martial law received a sevenfold increase in World Bank lending – Uruguay, Chile, the Philippines and Argentina. Zaire, which had received more than \$468 million from the World Bank

in various forms by mid 1979, stands as a good example of this problem. Despite enormous mineral wealth, 90 percent of the total population is classified as poor and are underfed; the per capita supply of protein is among the lowest in the world and infant mortality rates, at 160 per 1000 births, are among the highest in the world (Lappe, 1980:34).¹² Following the massacre of 700–1000 anti-government villagers in a 1978 uprising, the World Bank, with U.S. support, granted the "moderate" Mobutu regime another project loan to rehabilitate oil-palme plantations managed by Unilever Corporation and two Belgian multinationals (Lappe, 1980:32). World Bank support of the South Korean government has also been criticized –

"the south Korean government is a dictatorship bent on modernization which has succeeded in spreading the social costs of adjusting to a position in a world economy through repressive political mechanisms " (Altvater, 1991:7).

The Bank has persisted in rationalizing the need for this type of approach, despite the documented negative impact on the citizens of less developed countries receiving these loans, on the basis that the conditions were necessary to improve the balance of payments, and accelerate the growth of exports and hence GDP. But analysts of these policies and their consequences have generally conceded them to be largely unsuccessful.

A study done in 1991 by two World Bank advisors found

"a disappointing impact....on GDP growth rates, and an alarming trend in terms of effect on investment and hence possibly future growth.....a favourable impact in terms of the balance of payments

and current account, brought about by the stimulation of exports and curbing of imports, but this contrasts sharply with the expectations of Bank staff...plus disturbing signs that the adverse effects on GDP growth will persist for years to come" (Mosley, Harrigan and Toye, 1989:64).¹³

In addition, the Canadian House of Commons Standing Committee on External Affairs and International trade commented in 1990 on the effectiveness of Bank policies in Ghana such that:

"even after five or six years of active structural adjustment programs, the country has not progressed very far in the recovery process, which we would call the move back into a sustainable growth scenario" (House of Commons Standing Committee Report, 1990:43)

This suggested that the World Bank may itself be reviewing the "wisdom" of the structural adjustment approach, following its announcement in 1990 of a shift back toward its traditional emphasis on long-term project funding.

Faced with growing criticism over the impact, both intentional and unintentional, of this type of lending, plus the evidence that it has been largely a failure on the purely economic front, the World Bank has begun to retract from the structural adjustment arena, announcing in 1990 that the next decade would see a reduction in the 30% of total loans it had been making in this manner. Given the pressures on the Bank, however, the element of conditionality is not likely to disappear altogether.

CHAPTER 5: CHALLENGES AND CONTRADICTIONS

GLOBAL ECONOMIC PRESSURES

While the World Bank continues to publicize the progress it is making on various social and environmental issues, and detractors continue to point out the shortcomings and errors of their operations, there seems to be agreement that the future is likely to bring increasing pressures on the institution, representative as it is of an economic order besieged.

One of the most obvious and urgent of those pressures originates from the difficulties being encountered by that economic order at the moment. Growth rates, seen as critical to this perspective, have begun to slow amongst the advanced industrial countries; even nations thought to be somewhat immune to the vagaries of the marketplace, such as Japan, are experiencing recessionary conditions. Economists in Britain are now referring to the recession in that country as a "slump", and the German Bundesbank has found it necessary to raise interest rates to a sixty one year high in order to protect its exports. Corporate profitability almost everywhere in the world is on the decline, and business bankruptcies are at the highest level since the Great Depression of 1929. Financial institutions have redefined the notion of "risk" as a result of large scale collapses such as the Robert Maxwell and the Olympia and York empires, and the Savings and Loan debacle in the United States continues to place an enormous strain on the resources of

the Federal Reserve Board in that country.

The slowing world economy has been worsened by the unimproved indebtedness of the less developed countries, which has steadily decreased the purchasing power of those countries. Markets for advanced industrial countries' products are correspondingly reduced, causing the loss of more than 1.6 million jobs in the U.S. alone in 1986 according to the Joint Economic Commission of Congress (Steinberg, 1989:79). Shrinking markets cause exporting countries to take refuge in ever more protectionist measures, which was confirmed by the findings of the U.N. sponsored study of twenty-four industrial countries in 1991. Twenty were found to be more protectionist than they were ten years ago (U.N. Human Development Report 1992:68).

For World Bank members, the tightening financial marketplace imparts many more restrictive conditions on foreign lending. Projects will be scrutinized much more seriously for flaws or indications that return on investment may be in jeopardy, and risks will be carefully examined. Several World Bank projects have already become victims of this new financial reality, and in fact the entire "mega" project approach favoured by the Bank may be threatened, due to the heavy capital outlays they require and the lengthy period of return on investment.

THE GROWTH OF POVERTY

Arguably, a principal consequence of the historical World Bank approach to development is the steady deepening of a dependency relationship between the North and the South.

The Bank's first turn toward addressing issues of poverty was in the early 1970's under MacNamara, who had become preoccupied with causes and possible solutions to poverty and population issues. This mandate has persisted, and the Bank's approach to the problem has been relatively consistent through the years.

In the days of MacNamara, the conclusions about the causes of poverty were reflected in the policies of the Bank – that people were poor because they were insufficiently productive. The 1990 World Development Report published by the Bank reflected the resurgence of concern over the plight of much of the World's population by detailing a strategy to alleviate poverty which echoes this sentiment, outlining policies which will "promote the productive use of the poor's most abundant asset – labour" (World Development Report, 1990:3).

The 1991 Report reiterates this theme that the poor must produce more, and emphasizes the route to improve that productivity –

- * market is the key to growth
- * integration into the global economy is essential
- * sound strategies are export-led
- * the door must be open to imports and foreign capital

Poverty, according to the World Bank, is related to environmental issues in that the poor "overtax the sustaining ability of their already impoverished environments, breeding more poverty, etc." (World Development Report, 1991:5).

This directly conflicts with the view of sustainable development theorists. The World Commission on Economic Development's 1987 publication "Our Common Future", for example, presents considerable evidence of the built-in inequity of the international trade and investment system, and the connection between dependence on that system and the endurance of poverty. As Korten argues:

"the pressures, for example, on non-industrial countries to increase their exports of primary commodities under export-led development strategies have increased environmental stress and depressed international commodity prices. The more prices are depressed, the worse the terms of trade the country faces, and the greater the pressure to export still more simply to maintain established levels of foreign exchange earnings. The only certain beneficiaries are the transnational corporations that dominate the international commodity trade (Korten, 1991:170).

This same criticism of the Bank view is levelled by Robert Goodland in "Building on Bruntland":

"While many nice things can be said about liberalizing and thus increasing trade, the structure of trade, as we know it at present, is a curse from the perspective of sustainable development because of the drive for efficient resource use in the presence of significant environmental externalities and other market imperfections. The only resolution to this dilemma is to require full cost pricing of resources which, in a regime of free trade, would cause countries which practiced this to lose out to those which did not" (Korten, 1991:168).

Even the World Bank's own reports admit their policies have had no impact to date on the eradication of poverty ideal. And in the final analysis:

"equating pollution to poverty introduces definitional confusion in an intent to divert resources from one priority to another. We cannot avoid the truth that sound development is totally dependent on a sustaining environment" (Stein and Johnson, 1979:15).

LENDER LIABILITY

Lender liability for financial institutions encompasses two issues. The first is that of credit risk that might result in an inability to repay the debt to the lender if the borrower has incurred expensive environmental clean-up costs, or where the value of property previously pledged as security against a loan is degraded as a result of environmental damage. The second category is direct liability risk, where the lender becomes directly liable for the cost of the clean-up.

The emergence of lender liability increases the credit risk associated with loans made to potentially polluting enterprises; it also raises questions about business previously considered low-risk. While loan analysts are generally experienced in assessing risk against the value of a loan, in the case of environmental damage there are often no precedents to assist in such valuation.

Many banks in Europe, Canada and the United States have already implemented policies and practices designed to encourage greater environmental responsibility on the part of borrowers, but this has not to date made them immune to third party liability prosecution in the event of loan default of a polluter.

In the United States, the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), and its later amendment, the Hazardous Substance Response Trust Fund (known as "Superfund") were not designed as equitable legislation, but intended to identify "responsible parties" to pay clean-up costs of environmental damage. Lenders have not traditionally considered themselves "responsible parties", but in the landmark case of *U.S. vs. Maryland Bank and Trust Co.* (632 F.Supp. 573 (S. Md. 1986)) a financial institution was held liable for the first time for the costs of cleaning up hazardous waste contamination of property to which they assumed title after a loan default (Karlsson, *Understanding Site Assessments*, p.42).

Subsequent cases such as the *PanAmericana de Bienes y Servicios vs. Northern Badger Oil and Gas Co.* (1991) (W.W.R. 577) in Canada, where the Alberta Court of Appeal

set the legal rights of a secured creditor behind that of the environmental requirement for clean-up; or the case of Kemtec Petrochemical Corporation case in Quebec, Canada, where five financial institutions "lent a total of \$64.7 million and collected only 15% of that amount after bankruptcy proceedings threatened to involve them in a costly clean-up" (McKenna, 1991:B16), are causing concern among lenders around the world.

As a consequence, analytical tools are being developed in banking institutions including the World Bank, to augment the traditional performance measurements used in loan appraisal. Innovations such as the index of pollution intensity and future regulatory exposures, usually calculated as the volume of toxic emissions divided by revenues, are being developed by the U.S. Investor Response Research Centre, and the re-design of loan application forms, the increasing use of technical consultants to prepare reports on the state of a property and more frequent insistence on environmental audits are all becoming more common.

The other probable side effect, already voiced by banking associations like the Canadian Bankers Association, is an increasing restriction of credit access to certain types of industry, obviously resource extraction industries in particular.¹⁴ The possibility for environmental damage is automatically assessed in North American lending review now, and unless governments comply with financial institutions' demand for protection from legal action, spokespeople from the industry are predicting a much greater reluctance to fund this type of loan in the future.

This issue has the possibility of being a serious one for the World Bank, where so much of the lending is allocated to facilitating resource extraction either directly or indirectly. The possibility of being held liable, or even partially liable, for pollution, rainforest destruction or other forms of environmental degradation may prove to be a deterrent both for the World Bank itself and the commercial banks of its members in making what were previously thought of as "low risk" loans.

GROWING CRITICISM

As well as the potential heavy costs that may result from the lender liability issue, the World Bank's mega-projects also stand to incur growing public condemnation and criticism as a result of its support and involvement in some of these projects. The Nam Choan Project in Thailand and the Silent Valley project in India were both halted by public pressure after the environmental costs became known. More recently, the Sardar Sarovar dam project on the Narmada River in Gujarat state in India, which would displace more than 100,000 people to construct 150 medium-sized dams and 3000 small ones at a cost of more than \$11 billion has come in for such heavy criticism that a special study was commissioned by the Bank's Executive Director. The study, headed by American Bradford Morse and Canadian Thomas Berger, was completed in June of 1992, concluding that the negative consequences of the construction were such that the

project should not proceed. The fact that the World Bank commissioned an independent review of this project, to which they apparently provided full access of information, is to be commended, and is perhaps proof of the degree to which it feels it must respond and open its decision-making process to public scrutiny.

But public scrutiny can be extremely damaging, as the World Bank discovered in February of 1992 when an internal memorandum, written by then Chief Economist Lawrence Summers, was leaked to The Economist and subsequently published. The document matter-of-factly measured the cost of health-damaging pollution in terms of the value of the life lost or severely compromised, reasoning that since lives in low wage countries were worth less, a rational decision would locate polluting companies there. Mr. Summer's strongly worded statements, such as:

"I think the economic logic behind dumping a load of toxic waste in the lowest-wage country is impeccable, and we should face up to that....I've always thought that under-populated countries in Africa are vastly under-polluted....while production is mobile, the consumption of pretty air is a non-tradable.....shouldn't the World Bank be encouraging more migration of the dirty industries to the L.D.C.'s?" (The Economist, February 8/92:66).

caused the magazine to receive a flood of angry protest letters in response. Despite hasty disclaimers by the World Bank denying that these statements represented Bank position or policy, critics of the Bank's operations claim the memo represented exactly that. At a time when the Bank is already under heavy fire for their continued involvement in environmentally risky projects, this kind of publicity only worsens its public image.

ORGANIZATIONAL STRUCTURE

According to Bank critics, at a time when the World Bank needs grassroots public input and involvement more than ever, it is functioning with a structure reminiscent of the 1950's corporation – heavily administrative and hierarchical, with poor communication and a lack of accountability on the part of the Bank's senior management, as well as a difference in style and philosophy on the part of the Executive Board and the management team.¹⁵ The ever-present pressure to move money quickly continues to tilt the balance in favour of large scale projects, and the loan review process continues to lag behind public awareness and desire for participation.

Like the IMF, the World Bank is run by a 20 member board to which each member country delegates a governor and a vice-governor. The fact that these delegates represent, almost in entirety, the rich, industrialised countries is increasingly a subject of criticism, particularly from non-governmental organisations. Not only is the developing country often not at the table where decisions are being made about its future, they charge, but the highly centralized nature of the Bank's operations makes wide and unrestricted access to current information about local ecological and social conditions quite unlikely (Rich, 1990:319).

The final decision with regard to problems arising from international agreements rests with the Board of Governors, meaning that interpretations are made by the industrialized

countries with two thirds of the votes. With regard to this structural inequity, nothing has substantively changed since 1971, when the then finance minister of India commented in a speech to the Bank Group:

"There is a feeling among millions of people in the developing world that the kind of partnership we have so far secured through our international economic institutions is a grossly unequal one...the international institutions we created in the wake of the Second World War, such as the World Bank and the International Monetary Fund, reflected a philosophy which appears totally out of date today to most countries which have had very little to say in the shaping of those institutions...the big powers who won the war..reserved for themselves a predominant position in the governing bodies of the international institutions." (Reid, 1973:22).

Certainly the issue of American influence also continues to appear with regularity in criticism of Bank decision-making. The fact that the President of the Bank is appointed by the Board from a nomination by the President of the United States makes the issue of non-partisanship a fairly obvious one, although in general the intensity of the American influence has probably been diminishing since the 1960's (Reid, 1973:19). Nevertheless, the World Bank is often associated with U.S. policy-making.¹⁶ Given the negative image of the U.S. on many high profile social and environmental issues, such as the official position on greenhouse gas emission reductions at the Rio conference, the association is for the most part not a positive one.

CONCLUSIONS

Until the beginning of the 1970's decade, no one involved in what was known as "Third World Development" questioned the basic assumption that the industrial development model that had been so "successful" in the "advanced, northern economies" was the one to follow. Partially because the anticipated expansion of markets was something the First World required, and partially because there was little to challenge the efficacy of the industrial development model, development institutions proceeded to adhere to the conservative economic theories which had created them.

Because development finance institutions tend to be conservative, they are also slow to respond to changing circumstances and new ideas. Signs that trickle-down and other theories of the same ilk were not working should have been obvious by the late seventies, if not earlier. By the time the debt crisis erupted into full bloom, serious questions should have been asked about the applicability of this model to the less developed countries. Instead, twenty years later the World Bank still clings to its notions about the Third World having been left out of the development process and this being responsible for the declining standard of living in those parts of the world.

By now, alternative development theory dictates, the conclusion should be obvious – that problems of poverty, over-population and environmental degradation are not related to under-development of the less developed countries, but to over-development of the

advanced industrial nations. It is the wasteful and exploitative consumption and accumulation patterns of the North which are largely responsible for the plight of the people of the South, and until this basic fact is recognized and admitted, the erroneous belief that it is possible for the whole world to emulate the standard of living in the rich industrialised world, persists.

As McKibben concludes in "The End of Nature" –

"We live at a radical moment in history, when the essential character of the world is changing" (McKibben, 1989:101).

The World Bank is in many ways at the centre of the sustainable development issue. It has also undergone many major changes since its inception, and seen several transformations in its purpose and mandate. As Escott Reid described it:

"the history of the past twenty five years indicates that the World Bank is a vigorous organism, capable of healthy growth and adaptation to change" (Reid, 1973:138).

Since then the pace of change, certainly on the environmental front, has increased dramatically.

The challenges posed by the dictates of truly sustainable development are formidable, and in many cases directly contradict the dominant philosophy that still prevails at the World Bank. Unless the conventional approach to development can be transformed by the application of ecological economics to meet these challenges, then that institution

will no doubt see its pivotal role in world development eclipsed. But the possibility also exists for the World Bank to lead the way in deciding that we will go no further along on the economic development path, in following that imperative toward endless and inhuman growth.

ENDNOTES

1. The ecology-economy interface was broached by theorists like Pigou as early as 1912 – see Principles and Methods of Industrial Peace, MacMillan, London, 1912, and Economics of Welfare, MacMillan, London, 1962 – but the underlying ideas can be traced back to writings of nineteenth century philosophers.
2. This quote, from Rees, W. "The Ecological Meaning of Environment-Economy Integration" appeared originally in Drengson, A. "Protecting the Environment, Protecting Ourselves: Reflections on the Philosophical Dimension" in R. Bradley and S. Duguid (eds.), Environmental Ethics, Vol.II, Simon Fraser University, Vancouver, 1989.
3. For a discussion of the limiting nature of non-genetic factors such as resource materials and different forms of energy, and the importance of these limitations in attaining a genetic potential see Boulding, K. "What Do We Want To Sustain? Environmentalism and Human Evaluations" in Costanza, R., Ecological Economics, pp. 22–31.
4. See Georgescu-Roegen, N., "The Steady-State and Ecological Salvation: A Thermo-dynamic Analysis", in Bioscience 27, No.4, 1977, pp.266–270.
5. For a full discussion of the limitations of G.N.P. as a measure, see Herman Daly's essay in the World Bank's Environment Department working paper "Environmentally Sustainable Economic Development: Building on Bruntland", July 1991, 85 pp.
6. For a more detailed discussion of alternative indicators of human progress than strictly economic ones, see "The Indicators Crisis", Chapter 6, in Henderson, H., Paradigms in Progress, Knowledge Systems Inc., Indiana, 1991.
7. Mexico, it soon became apparent, was only the tip of the iceberg; by the middle of the decade more than 70 developing countries were in serious debt difficulties. Africa, for example, has gone from a \$5.8 billion debt in 1970 to more than \$143.7 billion by 1990. House of Commons Standing Committee on External Affairs and International Trade, June 1990, pp. 7–12.
8. In fact this discontent with the Bank's lending activities resulted in the publication in September 1987, of a booklet entitled "Financing Ecological Destruction: The World Bank and the International Monetary Fund" by 28 environmental and indigenous peoples' groups, presented at the World Bank's Annual General Meeting that year.
9. In addition, since the technological opportunity for energy efficiency is still largely ignored by the Bank, many of its projects vastly overestimate future

energy requirements, establishing efficiency level targets that were, in some case, reached many years ago. Even though studies commissioned by the Bank itself have indicated that between one third and one half of the new demand for electricity in countries like Brazil and India through the year 2000 could be provided through energy conservation and end-use efficiency, the proportion of World Bank conservation and efficiency loans represents on average less than 2% of all energy and industry loans.

10. The World Bank Annual Report for 1988 calculates World Bank net transfers during that year from loans to Africa, Asia, Europe, Latin America and the Caribbean to total \$711 million (U.S.)
11. For a more detailed discussion of the problem of linking project aid allocations to general indicators of economic performance see Mosley, P., Harrigan, J. and Toye, J., Aid and Power – The World Bank and Policy-Based Lending, Routledge, London, 1991, pp. 29–32.
12. For a comprehensive examination of the political economy of Zaire and its historical relationship with the World Bank see Gran, G. (ed.), Zaire: The Political Economy of Under-Development, Praeger Press, New York, 1979.
13. For a fuller discussion of the strong adverse effects of adjustment as a whole on distributional and social welfare indicators, see Cornia, G., Jolly, R. and Stewart, F., Adjustment with a Human Face: Protecting the Vulnerable and Promoting Growth, Clarendon Press, Oxford, 1987, referred to in Harrigan and Mosley, 1989.
14. For an explanation of the issues as perceived by the banking industry and a discussion of the implications of current Canadian law and U.S. legislative approaches to environmental liability, see the Canadian Bankers Association position paper, "Sustainable Capital: The Effect of Environmental Liability in Canada on Borrowers, Lenders and Investors", November 1991.
15. One of the frequent criticism of Bank operations centers around its restriction of access to information concerning its activities. This is sometimes taken to extremes, as when the U.S. Executive Director Patrick Coady requested in early 1990 a draft appraisal report for a forestry loan proposed for the Ivory Coast, from bank staff. The request was denied. See Rich, B., "The Emperors's New Clothes", p. 316.
16. For example, refer to comments of former World Bank Vice President and General Counsel Aron Broches regarding the leading role the U.S. wishes to play in the formation of the Bank for European Reconstruction and Development in American Society of International Law, Proceedings of the 84th Annual Meeting, Washington, March 28–31, 1990.

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