Canadian Council on International Law

Conseil canadien de droit international

The Measure of International Law: Effectiveness, Fairness and Validity

Prendre la mesure du droit international: effectivité, équité et validité

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KLUWER LAW INTERNATIONAL

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Bringing the Disenfranchised to the Table – The Lessons of Conditionality

Ross Leckow[1]

I. Introduction

For the International Monetary Fund (the "Fund"), the plight of the poor is a subject of growing importance. Fund financial assistance is devoting greater attention to the Fund's poorest member countries and their populations. This growing emphasis has affected the structure of economic reform programs implemented by these countries, and the manner in which the Fund provides them with financial assistance. It has also transformed the role which civil society plays in the design of Fund-supported economic reform programs in much of the developing world. At several different levels, Fund financial assistance is serving as an effective mechanism for "bringing the disenfranchised to the table."

This paper examines the role of Fund financial assistance and conditionality in addressing the needs of the poorest developing countries and their populations. It first discusses the basic features of Fund financial support before examining their application to the Fund's poorest members. The paper then reviews recent trends in Fund financing that seek to address the needs of the poorest elements of the

1. Assistant General Counsel, International Monetary Fund. The views expressed in this paper are those of the author and not necessarily those of the International Monetary Fund.

populations in these countries. Finally, it draws a number of lessons from the Fund's experience.

A. Background – Fund Financial Assistance and Conditionality

The provision of financial assistance to member countries is an important activity of the Fund that is closely linked to the institution's central role in preserving the stability of the international monetary system. Unlike the World Bank, the Fund is not a development agency and it does not finance development projects in member countries. Rather, the Fund provides financial assistance to members to help them address balance of payments difficulties.[2] Fund resources are normally disbursed to the central bank or the government for use in the making of international payments or the strengthening of the country's foreign exchange reserves. Financial support is intended to help the member resolve its balance of payments problems "without resorting to measures destructive of national or international prosperity."[3]

Fund financial support has historically been provided to members from the "general resources of the Fund." These resources consist principally of the pool of currencies and other assets (for example, Special Drawing Rights[4] or "SDRs") that countries contribute at the time of membership, and subsequently in the context of periodic reviews of their "quotas."[5] A member's use of the Fund's general resources takes the form of a purchase and repurchase of monetary assets.[6] A member that represents that it has a balance of payments need will be allowed to use its own currency to purchase SDRs or a currency such as U.S. dollars and, after a designated

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2. F. Gianviti, *The International Monetary Fund and External Debt*, in Recueil des Cours, 209, 226 (1989).
3. Articles of Agreement of the International Monetary Fund, art. I (v) [hereinafter Articles of Agreement].
4. The Special Drawing Right is an international reserve asset which was created under the Articles of Agreement to supplement members' existing reserve assets (official holdings of gold, foreign exchange, and reserve positions in the Fund). It is valued on the basis of a basket of key international currencies. *See Special Drawing Rights; a Factsheet* (2003) available at <http://www.imf.org/external/np/exr/facts/sdr.htm>.
5. Gianviti, *supra* note 2, at 218-219. The quotas of members are calculated on the basis of the respective importance of the members in international economic and monetary relations. Quotas are periodically reviewed and adjusted. A member's quota: (i) determines a member's voting rights in the Fund; (ii) the size of the member's subscription; (iii) the size of its access to the Fund's general resources; and (iv) its share in any allocation of Special Drawing Rights.
6. Richard Edwards, International Monetary Collaboration 223 (1985).

period, must repurchase its own currency with SDRs or a currency specified by the Fund. Members pay charges for the use of the Fund's general resources.[7]

Before making its resources available to a member, the Fund must be satisfied that: (i) the financial support will assist the member in solving its balance of payments difficulties; and (ii) there are "adequate safeguards" in place to ensure that the member will be able to repay the Fund.[8] The Fund generally meets these two requirements by making its resources available to members only if they are prepared to implement programs of economic reform to address the underlying economic problems that led to their balance of payments difficulties.[9] These programs are designed by the authorities of member countries in consultation with the Fund and usually range from one to three years in length.

The principal mechanism through which the Fund provides financial assistance is an "arrangement." An arrangement is a commitment of resources to a member by the Fund for a designated period (normally the same length of time as the member's program) and up to a specified amount.[10] As Fund financing is intended to support the successful implementation of a member's program, an arrangement makes resources available gradually as the objectives of the program are achieved.[11] The arrangement establishes the conditions—or the "conditionality" of the arrangement—that must be met before each disbursement will be made available to the member. These conditions consist primarily of "performance criteria" based on key macroeconomic targets and structural measures drawn directly from the

7. Gianviti, *supra* note 2, at 227.

8. More specifically, the Articles of Agreement require the Fund to "adopt polices on the use of its general resources, including policies on stand-by or similar arrangements, and may adopt special policies for special balance of payments problems, that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund." Articles of Agreement, *supra* note 3, art. V, sec. 3(a).

9. Gianviti, *supra* note 2, at 252-253.

10. The most well-known form of Fund arrangement is the "stand-by arrangement." The Articles of Agreement define a stand-by arrangement as "a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specified period and up to a specified amount." Articles of Agreement, *supra* note 3, art. XXX (b). *See also* Edwards, *supra* note 6, at 248.

11. Joseph Gold, The Stand-by Arrangements of the International Monetary Fund 120 (1970).

member's program, and periodic reviews of the program conducted by the Fund's Executive Board.[12]

Two important features of this approach should be noted. First, the program of economic reform that an arrangement supports is the member's and not the Fund's. The program's design and implementation are ultimately the responsibility of the member. The Fund's new *Guidelines on Conditionality* recognize that a program's success depends largely on the member's sense of commitment or "ownership."[13] Second, it is frequently the case that a member will not meet all of the conditions established for a particular disbursement. Where the relevant condition is a performance criterion, the Fund will often grant a "waiver" for the nonobservance of the condition and allow the disbursement to be made if satisfied that the member's program will still be successfully implemented.[14]

B. Fund Financial Assistance and the Fund's Poorest Members

Access to the Fund's general resources, although an important source of financial support for the institution's entire membership, is not always provided on terms that are the most attractive for the Fund's poorest members. Under several of the Fund's "policies" governing the use of its general resources, the applicable repayment or "repurchase" period may be too short, and the rate of charge too high for poorer developing countries. For example, the Fund's "credit tranche policies" prescribe a repurchase period of three and one-half to five years[15]; while the "adjusted rate of charge" for purchases in the credit tranches, as of May 5, 2003, was only 2.36 percent, the rate has historically been higher and surcharges apply in certain circumstances.[16] It has been recognized that developing countries implementing

12. Gianviti, *supra* note 2, at 255-256.

13. *See Guidelines on Conditionality,* Decision No. 12864-(02/102), adopted September 25, 2002, Section A, para. 3 reprinted in *Guidelines on Conditionality* (IMF Board Paper, 25 September 2002) available at <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf>.

14. Edwards, *supra* note 6, at 268.

15. International Monetary Fund, Annual Report 2002 42 (2002). While members are obligated to make repurchases within this period, they are, for purchases made after November 28, 2000, also "expected" to make repurchases even sooner; the Fund may, upon the request of a member, extend these repurchase "expectations" if satisfied that the member's external position has not improved sufficiently for repurchases to be made.

16. *See SDR Interest Rate, Rate of Remuneration, Rate of Charge and Burden Sharing Adjustments* available at <http://www.imf.org/external/np/tre/sdr/burden/2003/050503.htm>. A surcharge of 100 basis points applies to the Fund's holdings of a member's currency exceeding 200 percent of the member's quota arising from purchases made under the credit tranches and the extended Fund facility after 28 November 2000;

long-term programs of economic and structural reform often require financial support with longer repayment periods and lower rates of charge.

The Fund has put in place financing facilities and mechanisms that are specifically designed for its poorest members. They do not grant access to the Fund's general resources but to amounts that are provided from a variety of sources and are administered by the Fund as trustee.

The Fund's principal mechanism for financial support to its poorest members is the Poverty Reduction and Growth Facility ("PRGF").[17] Its resources are only made available to members with a per capita income below a specified level (currently a 2001 per capital gross national income of US$ 875); as of April 2003, 77 countries were eligible for assistance.[18] PRGF resources are committed under a three-year arrangement in support of a program of economic reform of the same period. Resources are provided at a concessional rate of interest (0.5 percent per annum) and are subject to a repayment period of five and one-half to ten years.[19] Programs supported under the PRGF seek to "strengthen substantially and in a sustainable manner" the balance of payments positions of the relevant members "and to foster durable growth, leading to higher living standards and a reduction in poverty."[20] In 2001, the Fund approved new commitments of US$ 2.7 billion under the facility—a record high.[21]

Another important mechanism for assistance to the Fund's poorest members is the Initiative for Debt Relief for Heavily Indebted Poor Countries ("HIPC").[22]

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the surcharge rises to 200 basis points with respect to the Fund's holdings of the member's currency above 300 percent of the member's quota arising from such purchases. Any such surcharges are adjusted for the purposes of "burden sharing." See: Id. at 43.

17. *Instrument to Establish the Poverty Reduction and Growth Facility Trust* attached to Decision No. 8759-(87/176)ESAF, adopted 18 December 1987, as amended, reprinted in Selected Decisions and Selected Documents of the International Monetary Fund, Twenty-sixth Issue 44 (31 December 2001) [hereinafter Selected Decisions].
18. *See The IMF's Poverty Reduction and Growth Facility (PRGF); a Factsheet* (2003) available at <http://www.imf.org/external/np/exr/facts/prgf.htm>.
19. *Instrument to Establish the Poverty Reduction and Growth Facility Trust, supra* note 17, Section II, para. 4. *See also* Annual Report 2002, *supra* note 15, at 43.
20. *Instrument to Establish the Poverty Reduction and Growth Facility Trust, supra* note 17, Section I, para. 1.
21. Annual Report 2002, *supra* note 15, at 46.
22. *Instrument to Establish a Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations* attached to Decision No. 11436-(97/10), adopted 4 February 1997, as amended, reprinted in Selected Decisions, *supra* note 17, at 81.

Designed and implemented in cooperation with the World Bank, the HIPC Initiative provides debt relief to those of the Fund's poorest members whose external debt position is, under the terms of the initiative, considered to be "unsustainable"; HIPC assistance is designed to lower the member's external debt position to a sustainable level.[23] Under HIPC, the Fund provides debt relief to eligible members that successfully implement programs of economic reform and meet specified performance-related conditions.[24] Parallel debt relief is provided by the World Bank and official and commercial creditors.

C. Conditionality and the Poor

How does Fund financial assistance affect the poor in the developing world? The programs of economic reform that receive Fund financial support are designed to improve conditions in member countries and, over time, to raise living standards. PRGF-supported programs place particular emphasis on measures that will foster economic growth and reduce poverty.[25]

Concern for the poor has also affected the nature of the conditions which the Fund attaches to its financial support. Under HIPC, for example, conditionality seeks to ensure that the savings in public spending generated by debt relief will result in higher levels of social spending for the poor.[26] In particular, members have been called upon to allocate budgetary resources to ensure specified levels of spending on education and health care.[27]

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23. More specifically, the Fund provides HIPC assistance in the form of grants or interest-free loans to service part of member countries' debt to the Fund. Under the terms of the HIPC Trust Instrument, "debt sustainability" is defined as "the achievement of a sustainable level of external debt which shall be 150 percent for the present value of debt-to-exports ratio calculated on the basis of data available at the decision point [that is, the point at which HIPC resources are committed by the Fund]. In the special case of a country that has, at the decision point, (i) an exports-to-GDP ratio of at least 30 percent, (ii) a fiscal revenues-to-GDP ratio of at least 15 percent, a "debt sustainability" target of below 150 percent for the present value of debt-to-exports ratio at the decision point may be set with the specific target determined so as to reduce the present value of debt-to-revenue ratio to 250 percent at the decision point." *Instrument to Establish a Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations, supra* note 22, Section I, para. 1(v).
24. *See* Id. at Section III, para. 2 (c).
25. Annual Report 2002, *supra* note 15, at 49.
26. *See Debt Relief under the Heavily Indebted Poor Countries (HIPC) Initiative; a Factsheet* (2003) available at <http://www.imf.org/external/np/exr/facts/hipc.htm>.
27. D. Andrews et. al., Debt Relief for Low-income Countries; the Enhanced HIPC Initiative 16 (1999).

PRGF-supported programs and the supporting financial arrangements typically include measures that strengthen public institutions so that public resources will be managed for the public good.[28] These measures often seek to ensure that the government's revenues and expenditures are subject to an open and transparent budget-making process, are channeled through a central treasury, and are properly accounted for through accepted accounting practices.[29] For example, the authorities of Cameroon, under their PRGF-supported program, have stated their intention to introduce a fully-integrated computer-based fiscal and accounting information system for managing all government revenues and expenditures.[30] Under Niger's PRGF-supported program, the authorities have begun, at the end of each fiscal year, to report to the Court of Accounts and to Parliament on the extent to which the government has adhered to the provisions of the annual budget approved by Parliament.[31]

Fund conditionality has directly confronted problems of corruption in developing countries where they have a significant macroeconomic impact. The Fund has recognized that high levels of corruption will discourage foreign investment and make it less likely that public resources will be used for the public good.[32] Under Kenya's PRGF-supported program, the authorities established an

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28. Annual Report 2002, *supra* note 15, at 50.
29. *See Aligning the Poverty Reduction and Growth Facility (PRGF) and the Poverty Reduction Strategy Paper (PRSP) Approach; Issues and Options* 13 (IMF Board Paper, April 25, 2003) available at <http://www.imf.org/external/np/prsp/2003/eng/042503.pdf>. *See also Review of the Fund's Experience in Governance Issues* 10 (IMF Board Paper, March 28, 2001) available at <http://222.imf.org/external/np/gov/2001/eng/gov.pdf>.
30. *See Cameroon: 2002 Article IV Consultation, Third Review under the Poverty Reduction and Growth Facility, and Request for a Waiver of Performance Criterion- Staff Report; News Brief and Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Cameroon* 13 (IMF Country Report No. 02/258, December, 2002) available at <http://www.imf.org/external/pubs/ft/scr/2002/cr02258.pdf>.
31. *See Niger: 2000 Article IV Consultation and Request for an Arrangement under the Poverty Reduction and Growth Facility – Staff Report; and Public Information Notice and Press Release on the Executive Board Discussion* 16 (IMF Country Report No. 01/15, January, 2001) available at <http://www.imf.org/external/pubs/ft/scr/2001/cr0115.pdf>.
32. *See Review of the Fund's Experience in Governance Issues*, *supra* note 29, at 5.

independent public body vested with the power to investigate and prosecute case of corruption in the public sector.[33]

The Fund's growing concern with the poor has affected not only the nature of conditionality but also the process under which programs of economic reform under the PRGF and HIPC are designed. Historically, the Fund dealt only with the authorities of a member country and not with its population. The Fund did not insist that any aspect of program negotiations be made public. It has since been recognized that this approach may exclude important elements of civil society – including the poor – from the process of program design and may make it less likely that the program will have the broad political support necessary for success.[34]

As a result, the Fund now seeks to ensure that the programs supported under the PRGF and HIPC are formulated by members through a fully-participatory process of public consultations that include elements of civil society. Each program is now based upon a Poverty Reduction Strategy Paper ("PRSP") that is formulated by the authorities of the member country in consultation with external development partners, including the Fund and the World Bank. The PRSP describes the key features and objectives of the member's poverty reduction strategy and benefits from a fully participatory process of consultations between the authorities and interested members of civil society. [35] The PRSP process is designed to ensure that national poverty reduction strategies are country-driven, results-oriented, comprehensive, and long-term in perspective, and that they foster domestic and external partnerships that improve the effectiveness of development assistance.[36]

D. Conditionality – The Challenges for the Future

Experience shows that conditionality can be used in many different ways to help the poor in member countries. Significant progress has been made in focusing conditionality on issues of direct relevance to the poorest segments of the population.

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33. *See IMF Approves Poverty Reduction and Growth Facility Loan for Kenya* (IMF Press Release No. 00/45, July 28, 2000) available at <http://www.imf.org/external/np/sec/pr/2000/

34. pr0045.htm>. *See also Moi Weighs Tough Corruption Probe*, Financial Times of London (28 July 1997); *IMF Rules Out Early Loan Agreement with Nairobi*, Financial Times of London (19 February 1998).

35. *See Poverty Reduction Strategy Papers – Progress in Implementation* (IMF and World Bank Staff Paper, September 11, 2002) available at <http://www.imf.org/external/np/prspgen/2002/eng/091102.pdf>.

36. Annual Report 2002, *supra* note 15, at 49.

37. Id. at 47.

At the same time, there are limitations. Most obviously, conditionality can only be used with respect to countries that request financial assistance from the Fund. It cannot be applied to countries that do not seek Fund financial support.

Conditionality cannot be used to force a country to adopt particular measures. The conditions which the Fund attaches to its assistance do not take the form of legal obligations. A member for which a financial arrangement has been approved is under no legal obligation to meet the performance–related conditions specified in the arrangement. The only legal consequence which flows from the failure to meet such conditions is that the member will be unable to request a disbursement from the Fund. [37] Ultimately, the member may abandon its program and a Fund arrangement at any time.[38]

Certain types of measures may not be made the subject of conditionality. As an international organization with a primarily monetary and financial mandate, the Fund avoids involvement in purely political questions even where they are of direct relevance for the poor. The Fund's *Guidelines on Conditionality* require the Fund, when establishing conditions for the use of its resources, to "pay due regard to the domestic social and political objectives" of members. [39] The Fund is, for example, precluded from making the human rights record of a member the subject of conditionality. Fund policy also prohibits the establishment of conditions that deal with a member's military spending.[40] Notwithstanding its obvious macroeconomic impact, the level of a country's military spending is considered to be too inherently political for Fund involvement.

There are also limits on the extent to which the Fund has involved civil society in the process of program design. While the Fund, under the PRGF and HIPC, seeks to ensure that members' poverty reduction strategies are put in place through a fully participatory process involving civil society, it has not developed specific criteria with which to determine whether the process followed by a particular member is "fully participatory."[41] Rather, it has assessed the nature of the process followed by

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38. Gianviti, *supra* note 2, at 256.
39. *See* Joseph Gold, Interpretation: The IMF and International Law 363 (1996).
40. *Guidelines on Conditionality*, *supra* note 13, at Section A, para. 4.
41. *Concluding Remarks by the Acting Chairman, Military Expenditures and the Role of the Fund, Executive Board Meeting 91/138, 2 October 1991*, reprinted in Selected Decisions, *supra* note 17, at 478.
42. At the same time, the Fund's Executive Board has noted that "participatory processes were beginning to take hold in PRSP countries but that the process needed to be strengthened to include a broad range of domestic stakeholders and development partners. In particular, while government leadership must be respected, there was greater scope for including parliaments, the business community, trade unions, and other