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International Law and Justice Working Papers

IILJ Working Paper 2005/10
Global Administrative Law Series

Reform of IMF Conditionality:
A Proposal for Self-Imposed Conditionality

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ISSN: 1552-6275
© Ofer Eldar
New York University School of Law
New York, NY 10012
U.S.A.



Cite as:
IILJ Working Paper 2005/10
(Global Administrative Law Series)
(www.iilj.org)

**REFORM OF IMF CONDITIONALITY –
A PROPOSAL FOR SELF-IMPOSED CONDITIONALITY**

Journal of International Economic Law
Volume 8, Number 2, June 2005
[URL Link to be provided shortly]

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ABSTRACT

The IMF has faced criticism of its expansive use of conditionality. The paper proposes a new procedure for IMF lending designed to meet these criticisms by arguing for the legalization and formalization of the procedure for IMF lending in the light of legal concepts derived mainly from national administrative laws. The gist of the procedure is that, rather than have the IMF determine loan conditions following informal negotiations with member countries, countries seeking Fund assistance will design the conditions themselves. The IMF will have specified powers under which to review these conditions. Apart from other procedural requirements, conditions will have to meet the standard of reasonableness. Subject to reasonableness, the IMF will have to lend on the conditions proposed by the country approaching it. Submissions to the IMF, IMF decisions and the reasons for them will be published. This proposal promotes transparency and accountability of the IMF and the participation of developing countries. It induces countries to initiate effective economic reforms while maintaining their economic sovereignty. Finally, I argue that self-imposed conditionality is not more costly than the current procedure and that legalization and transparency will not disrupt the operation of the IMF.

REFORM OF IMF CONDITIONALITY – A PROPOSAL FOR SELF-IMPOSED CONDITIONALITY

*Ofer Eldar**

I. Introduction

The International Monetary Fund has undergone various changes in the past decades. One notable change has been its increased use of conditionality, the practice whereby the Fund attaches conditions to loans it makes available to member countries in financial distress. During the 1990s the Fund has dramatically increased both the number of conditions and the degree to which these conditions are related to the internal affairs of member countries. The increased use of conditionality has attracted a great deal of criticism in recent years. In particular, it has been argued that conditions infringe on the sovereignty of countries, that the Fund is exceeding its jurisdiction, and that conditions have not been effective in inducing economic reform.

In this paper I attempt to deal with these criticisms by proposing a new mechanism for designing conditions in loan agreements, and by arguing for the legalization and formalization of the procedure for IMF lending in the light of concepts and ideas derived mainly from domestic administrative laws.¹

The gist of the proposal is that, rather than have the Fund determine the conditions in loan agreements following informal negotiations with member countries, member countries will

* B.A. (Hons), Cambridge University; LL.M., NYU School of Law. I thank Professor Richard Stewart for his encouragement, insights and advice in writing this article. I also thank Professor Andreas Lowenfeld, Professor Henry Hansmann, Professor William Easterly, Professor Kevin Davis, Omer Kimhi, Jan Yves Remy, Eran Eldar, the participants at the NYU Colloquium on Globalization and its Discontents, and the Editorial Board of JIEL for helpful comments and suggestions. Most of all, I am grateful to my mother for her love, support and dedication.

¹ For a discussion of the potential for drawing on American administrative law for the development of global administrative law, see Richard Stewart, 'US Administrative Law: A Resource for Global Administrative Law?', *Law & Contemp. Probs.* (forthcoming), available at <http://www.law.nyu.edu/kingsburyb/spring04/globalization/program.html> (last visited 15 June 2004); See also Benedict Kingsbury, Nico Krisch & Richard Stewart, 'The Emergence of Global Administrative Law', *IILJ Working Paper* 2004/1 (Global Administrative Law Series), at http://www.iilj.org/publications/wp_globadminlaw.htm (last visited 15 January 2005).

design the conditions themselves. Thus member countries will effectively choose to impose conditions on themselves. The Fund will have the power to review these conditions pursuant to specified grounds of review. If the conditions withstand these grounds of review, the Fund will have to extend the loan on the conditions designed by the member country. If the conditions do not withstand these grounds of review, the Fund will step in and propose its own conditions as under the current system.

Section II of this paper deals with the criticisms of conditionality. I will show that there are no easy solutions to the problems that conditionality raises. The main conclusion of this section is that a balance has to be struck between the interests of the Fund and the interests of member countries. In Section III, I set out the proposal for self-imposed conditionality, describing the main features of the proposal and its main advantages in the light of the criticisms discussed in Section II. I also discuss the content of the grounds of review and the application procedure. Section IV deals in detail with potential problems that the proposal entails and possible solutions to these problems. Finally, in Section V I will discuss the consequences of legalization and formalization of conditionality and the implications that the proposal may have for the role of the Fund.

It should be noted that this paper does not deal with many questions that concern the Fund's activity, such as, whether it makes sense to unify the Fund and the World Bank, whether it makes sense to maintain the Fund at all given its current function as lender of last resort,² or the moral hazard problem.³ It also does not deal directly with more specific criticisms regarding the composition of the Fund's staff and the alleged control of the major shareholders over Fund

² Stanley Fischer, 'On the Need for an International Lender of Last Resort', in Stanley Fischer, *IMF Essays from a Time of Crisis* (The MIT Press, 2004), 7.

³ For a discussion of the moral hazard problem, see Martin Feldstein, 'Refocusing the IMF', *Foreign Affairs*, Vol. 77, No. 2 (March/April 1998), 20; Stanley Fischer, 'The IMF and the Asian Crisis', in Stanley Fischer, *IMF Essays from a Time of Crisis* (The MIT Press, 2004), 67, available at <http://www.imf.org/external/np/speeches/1998/032098.HTM> (last visited 10 October 2004); Fischer, *Ibid.*

resources.⁴ I do not challenge the Fund's role as a lender of last resort to countries in financial distress, which are exclusively developing countries in practice.⁵

II. Increasing Criticism of IMF Conditionality

The manner in which the Fund has formulated conditions in loan agreements and the substance of those conditions has been subject to fierce criticism. Recent financial crises, especially the Southeast Asia Crisis and the crises in Russia and Argentina, have led the Fund to impose stringent and expansive conditions in loan agreements, extending far beyond the traditional ambit of the Fund's powers. Conditions have increased both in number and in the degree of intervention in the internal affairs of member countries.⁶ They have come not only to include general macroeconomic factors, but to involve direct interference in issues, such as, for example, tax rates, banking regulation and even prices of commodities. There has been a shift from pure macroeconomic factors to microeconomic structural reforms. As pointed out by Lowenfeld, '...the boundary between international and internal concern seems to have largely disappeared.'⁷

It is important to discuss the main criticisms of conditionality, as they set the background for my proposal.

⁴ See Ngaire Woods, 'The United States and the International Financial Institutions: Power and Influence within the World Bank and the IMF', in Rosemary Foot, S. Neil MacFarlane, and Michael Mastanduno (eds), *US Hegemony and International Organizations* (Oxford University Press, 2003), 92.

⁵ There is no guarantee that developed countries will not be in need of the Fund's resources. Before 1977 the UK, France and Italy were among the countries that had to apply for loans to the Fund. Although developed countries have not applied to the Fund since then, recent discussion regarding the enormous trade deficit of the United States, currently amounting to approximately \$550 billion, suggests that the role of the Fund may well change in new, albeit unexpected, circumstances.

⁶ Carlos Santiso, 'Good Governance and Aid Effectiveness: The World Bank and Conditionality', *Geo. Pub. Pol'y Rev.* Vol. 7 (2001), 1, at 10. As Santiso points out, '...from 1989 to 1999, the share of programs with structural conditions increased from 60 percent to 100 percent and the average number of structural conditions per program increased from three to 12.' See also Ariel Buira, 'An Analysis of IMF Conditionality', in Ariel Buira (ed), *Challenges to the World Bank and IMF: Developing Country Perspectives* (Anthem, 2003), 55, at 62. Buira notes that at the highest level, programs with Korea included 94 structural conditions, with Thailand 73, and with Indonesia 140 structural undertakings; for more detailed analysis, see Morris Goldstein, 'IMF Structural Conditionality: How Much Is Too Much?', Institute for International Economics Working Paper No. 01-04 (2002), at <http://ssrn.com/abstract=300885> (last visited 10 January 2005), at 31-44.

⁷ Andreas Lowenfeld, 'The International Monetary System and the Erosion of Sovereignty: Essay in Honor of Cynthia Lichtenstein', *Boston Col. Int'l & Comp. L. Rev.* (2002), 257, at 269.

A. Excess of Jurisdiction

It is argued that the Fund has exceeded its jurisdiction, as conferred on it by the Articles of Agreement. Critics of the Fund argue that the Fund does not have the power to require countries to undergo substantial internal reform that may involve significant cultural and infrastructural changes which lie beyond the ambit of the Fund's authority, and that the Fund's conditions should essentially be limited to macroeconomic measures.⁸ On the other hand, others have tried to defend a broader interpretation of the Fund's jurisdiction. For example, Hockett seems to argue that the words of the Articles of the Agreement give the Fund the scope to impose any conditions it considers appropriate,⁹ and that member countries can simply refrain from borrowing if they disagree with these conditions.¹⁰

Although this argument may be defensible on the basis of the wording of the Articles, Hockett downplays the public character of the Fund and its duties toward the international community. The Fund is not, as Hockett suggests, like any other creditor concerned with repayment of its debt. The Fund is a public institution that has a duty to serve certain specified public purposes,¹¹ the underlying rationale of these purposes being the maintenance and enhancement of international financial stability. Most importantly, the Fund has 'To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments

⁸ Joseph Stiglitz, *Globalization and its Discontents* (Penguin, 2002); Mary C. Tsai, 'Globalization and Conditionality: Two Sides of the Sovereignty Coin', *Law & Pol'y Int'l Bus.*, Vol. 31 (2000), 1317.

⁹ Article V, Section 3(a) of the *Articles of Agreement of the International Monetary Fund* (the 'Articles of Agreement'), done at Bretton Woods, 22 July 1944, 2 U.N.T.S. 39, 60 Stat. 1401, as amended, 31 May 1968, 30 April 1976, June 28 1990, available at <http://www.imf.org/external/pubs/ft/aa/>: 'The Fund shall adopt policies on the use of its general resources, including 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.'

¹⁰ Robert Hockett, 'From Macro to Micro to "Mission-Creep": Defending the IMF's Emerging Concern with the Infrastructural Prerequisites to Global Financial Stability', *Colum. J. Transnat'l L.*, Vol. 41 (2002), 153, at 178-180, 184-189. It is worth pointing out that Hockett concedes that the conditions that the Fund imposes may be unwise. Thus Hockett defends the legal authority to make the conditions rather than the substance of the conditions.

¹¹ Article I of the *Articles of Agreement*.

in their balance of payments without resorting to measures destructive of national or international prosperity.’¹² Therefore, when the Fund exercises its powers it has a duty to act within the proper scope of its authority as defined by the Articles of Agreement. Although loan conditions are not subject to any process of judicial review, their legitimate scope should not be defined solely on the basis of the Fund’s subjective judgment.

The problem is how to interpret the scope of the Fund’s jurisdiction, given its public purposes and the need to safeguard its interests. As pointed out by Lowenfeld, it is not clear how and where to draw the jurisdictional line in each case between matters which the Fund is entitled to take into consideration and matters which the Fund should refrain from dealing with.¹³ For this purpose, the distinction between macroeconomic and microeconomic structural conditions has been shown to be unhelpful.¹⁴ One suggestion has been to frame the jurisdictional line in simple terms, asking whether a proposed condition is truly necessary to restore the borrower country to capital markets and enable it to repay its debts.¹⁵ But leading economists may diverge on the question of what measures are actually necessary, and especially whether microeconomic measures are required.¹⁶ In some instances, simple measures are sufficient, and in other instances, more extensive and intrusive measures are necessary. Again, economists will diverge

¹² Article I(v) of the *Articles of Agreement*.

¹³ Lowenfeld, above footnote 7, at 269-271.

¹⁴ See Goldstein, above footnote 6, at 22-31. In particular, Goldstein shows that conditions requiring microeconomic measures may be necessary even if the mandate of the Fund is defined narrowly to include only assisting a country to get out of a current crisis rather than minimizing the chances of getting into future crises or inducing economic growth.

¹⁵ Feldstein, above footnote 3, at 27.

¹⁶ Lowenfeld, above footnote 7, at 269-271, cites the debate between two prominent economists. On the one hand, Feldstein argues that the Fund should require reform only when it is needed to restore the country’s access to international capital markets, and only if it concerns a technical matter that does not interfere unnecessarily with the proper jurisdiction of a sovereign government. Feldstein argues that the conditions imposed by the Fund do not withstand this test. Stanley Fischer, the then Deputy Managing Director of the Fund, on the other hand, replies that the wide reforms in the Asian Crisis were indeed necessary and that certain issues, such as banking sector reform, are highly technical, far more than the size of the budget deficit. See Feldstein, above footnote 3; Fischer, above footnote 3.

on these issues and only ex post analysis of economic developments following the loan can provide clearer answers.¹⁷

B. Infringement of Sovereignty

A second interrelated argument concerns the sovereignty of member countries. Critics of the Fund have argued that conditions in Fund loans infringe on the sovereignty of member countries.¹⁸ As mentioned above, conditions have included, *inter alia*, detailed reform in various fields, including corporate governance, banking regulation, tax reform, liberalization of trade, eliminating ceilings on foreign investments, permitting foreign banks and companies to establish subsidiaries and price controls, etc. These are all matters that are normally decided by the government in each country. Article 1 of the Charter of Economic Rights and Duties of States expressly says: ‘Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural systems in accordance with the will of its people, without outside interference, coercion or threat in any form whatsoever.’¹⁹

Conditionality is said to infringe on sovereignty because it constrains the power of sovereign governments to determine national policies. Feldstein, for example, says: ‘The legitimate political institutions of the country should determine the nation’s economic structure and the nature of its institutions. A nation’s desperate need for short term financial help does not give the IMF the moral right to substitute its technical judgments for the outcomes of the nation’s political process.’²⁰ Similarly, Tsai says that conditionality handicaps the debtor nations’ ability to develop their own solutions to economic disasters, and that they are forced to abandon the

¹⁷ Nonetheless, it is important to note that in many cases the conditions were clearly not strictly necessary to enable the borrower country to recover from financial distress. Goldstein, above footnote 6, at 86, points out that the Fund staff itself regarded only 30-40 percent of all structural reforms included in Fund programs as critical to achieving the program’s macroeconomic objectives. This indicates that structural conditionality has become excessive.

¹⁸ I use the term sovereignty loosely to mean the traditional authority of governments to determine domestic policies. For an analysis of the changing meaning of the concept of sovereignty, see John H. Jackson, ‘Sovereignty-Modern: A New Approach to an Outdated Concept’, *Am. J. Int’l L.*, Vol. 97 (2003), 782; Kal Raustiala, ‘Rethinking the Sovereignty Debate in International Economic Law’, *JIEL*, Vol. 6, No. 4, (2003), 841.

¹⁹ Charter of Economic Rights and Duties of States, G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, 2315th plen. mtg. at 52, U.N. Doc. A/9631 (1974).

²⁰ Feldstein, above footnote 3, at 27.

course of economic development chosen prior to the crisis and to accept the vision for economic development chosen by the IMF. The economic changes that are imposed are not temporary and are meant to last after the financial crisis has elapsed, in circumstances where there may be other, alternative regulatory and economic choices.²¹ Although a country may well choose not to borrow money from the Fund and thereby exercise its sovereignty,²² in many cases, where the costs of not accepting conditionality are very high – especially the costs of default – there is no real choice and countries may be compelled to accept the dictates of the Fund.²³

On the other hand, conditionality has important legitimate purposes. As Hockett correctly argues, ‘...it seems doubtful that the Fund could legitimately lend to troubled members *without imposing* conditions reasonably calculated to ensuring monetary stabilization within their jurisdictions...Irresponsible lending, “throwing good money after bad”, would be illegitimate behavior on the part of the [Fund]...whose members supply the borrowed funds. Conditional lending, therefore, is not only legitimate, but is affirmatively required.’²⁴ Thus, although conditions may infringe on some aspects of a country’s sovereignty, it is clear that responsible lending requires the Fund to impose conditions when it lends money to countries in financial crisis. Even some of the Fund’s most prominent critics argue that sometimes it does not intervene enough. Stiglitz argues that the Fund should have required some countries to undergo land reform.²⁵ Likewise, Feldstein argues that the Fund should have required Argentina to undergo

²¹ Tsai, above footnote 8, at 1326.

²² For example, Malaysia chose to not follow the Fund’s prescriptions during the East Asia Crisis and pursued its own recovery policy. Malaysia managed to recover from the financial crisis despite, and some argue because, it did not follow the Fund’s recovery plan. See Stiglitz, above footnote 8, at 122-125; Tsai, above footnote 8, at 1328.

²³ See Buira, above footnote 6, at 60.

²⁴ Hockett, above footnote 10, at 186-187 [my emphasis].

²⁵ Stiglitz, above footnote 8, at 80-82.

significant tax reform.²⁶ In some instances, too much deference to domestic policies has aggravated a country's financial situation.²⁷

In essence, the conditions are designed through a process of informal negotiations between the Fund and the country. The Fund offers financial support in exchange for the government's commitment to make certain changes to its policies. The problem is that countries, especially small ones, may have very little leverage vis-à-vis the Fund in crisis situations, and they can therefore be compelled to accept the Fund's dictates. Recent reports of the Independent Evaluation Office of the IMF (the 'IEO') confirm that although in some instances conditions reflected national choices, the Fund did use its leverage to pursue long term policies that were not critical to crisis resolution.²⁸ Buira persuasively argues that the political strength of each country has been a major factor in determining the extent to which the Fund is able to pressure countries to accept its policies, and moreover, that conditions have too often reflected the political interests of donor countries.²⁹

The Fund is not unaware of the above criticisms. The most recent *Guidelines on Conditionality* strongly emphasize the importance of countries' ownership of their economic and financial policies. The *Guidelines* expressly state that '...the Fund will be guided by the principle that the member has *primary* responsibility for the selection, design, and

²⁶ Feldstein, above footnote 3, at 218-219.

²⁷ A good example is the Fund's support for Argentina's unsustainable policy of fixed exchange rates. See Independent Evaluation Office, IMF, 'The IMF and Argentina, 1991-2001' (2004) (hereinafter referred to as IEO (2004)). All reports of the Independent Evaluation Office of the IMF are available at <http://www.imf.org/external/np/ieo/pap.asp>.

²⁸ See Independent Evaluation Office, IMF, 'Evaluation of Prolonged Use of IMF Resources' (2002) (hereinafter referred to as IEO (2002)); Independent Evaluation Office, IMF, 'The IMF and Recent Capital Account Crises: Indonesia, Korea, Brazil' (2003) (hereinafter referred to as IEO (2003a)). Countries that suffered from weak ownership of conditionality include Pakistan, the Philippines and Indonesia. IEO (2003a) seems to endorse Feldstein's criticism and expressly states at 43: 'The crisis should not be used as an opportunity to seek a long agenda of reforms just because leverage is high, irrespective of how justifiable they may be on the merits. This should be the approach even if reformist groups within the government are keen to use the leverage of the program to push reforms.'

²⁹ Buira, above footnote 6.

implementation of its economic and financial policies.’³⁰ Moreover, the *Guidelines* emphasize that conditions must be critical to achieve the goals of Fund programs and should be limited to the minimum necessary for this purpose.

Although some progress has been made, it is questionable whether these guidelines materially change the balance of power between the Fund and member countries.³¹ Given that the negotiation process remains essentially informal and confidential, there are no effective institutional means for ensuring that the Fund will follow its own guidelines and that its intervention is, so far as possible, consistent with the political, social and economic aspirations of member countries.³² The test for the ‘criticality’ of conditions under the new *Guidelines* remains the product of an unreviewable, informal and confidential process and therefore does not provide an adequate safeguard for countries’ sovereignty and ownership of policy.

C. One-Size-Fits-All: Should the Fund Pursue Economic and Legal Convergence?

The Fund has been accused of applying the same prescriptions to every country, whatever the problems encountered may be and irrespective of its social, economic and political characteristics. Stiglitz, for example, has accused the Fund of imposing its ‘economic ideology’

³⁰ Section A(3) of the *Guidelines on Conditionality*, IMF, 25 September 2002, at <http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf> (last visited 11 October 2004) [my emphasis].

³¹ See Tony Killick, Overseas Development Institute, *The ‘Streamlining’ of IMF Conditionality: Aspirations, Reality and Repercussions* (April 2002), at http://www.odi.org.uk/iedg/Projects/imf_conditionality.pdf (last visited 25 January 2005). Killick points out that since the formulation of the new *Guidelines on Conditionality*, the number of conditions in Fund loans has been reduced by approximately one quarter and conditions tend to focus more on the Fund’s core areas of expertise. But, in many loans the number of conditions remains very high and the evidence on the level of country ownership is inconsistent. In addition, it seems that conditions dropped from Fund loans are being taken up in the World Bank programs. See also Eurodad, *Streamlining of Structural Conditionality – What Has Happened?* (May 2003), at <http://eurodad.org/uploadstore/cms/docs/Streamliningfinal.pdf> (last visited 23 January 2005); Angela Wood, World Vision International, *One Step Forward, Two Steps Back: Ownership, PRSPs and IFI Conditionality* (2004), at [http://www.global-poverty.org/PolicyAdvocacy/pahome2.5.nsf/gereports/00D3C4F30C7E423E88256E7F000CB054/\\$file/One%20Step%20Forward.pdf](http://www.global-poverty.org/PolicyAdvocacy/pahome2.5.nsf/gereports/00D3C4F30C7E423E88256E7F000CB054/$file/One%20Step%20Forward.pdf) (last visited 23 January 2005). A major critique in these reports is that the Fund does not seriously consider the policy alternatives proposed by developing countries.

³² It is noteworthy that the old *Guidelines on Conditionality* drafted in 1979 were not materially different from the recent version and required that conditionality be largely limited to macroeconomic variables. These guidelines were practically ignored by the Fund in the 1990s. See Buira, above note 6, at 67-68.

of ‘market fundamentalism’ on developing countries.³³ While Stiglitz’s accusation is very debatable,³⁴ there are strong indications that conditionality has suffered from a bias towards particular policies.

For example, Feldstein argues that the Fund applied virtually identical prescriptions to Russia, Korea and Thailand, even though these countries were undergoing essentially different crises.³⁵ Russia was a country emerging from a communist regime that needed structural adjustments to a capitalist economy, whereas Thailand suffered from a large account deficit, and Korea was undergoing temporary illiquidity. Nonetheless, they all had to follow similar prescriptions, including: privatization, trade and capital market liberalization, conditions facilitating foreign direct investment, corporate laws facilitating hostile takeovers, conditions requiring more central bank independence and general austerity measures, such as higher tax rates, less government spending and higher interest rates. Likewise, a recent IEO report suggests that Fund policies are sometimes tainted by contractionary bias and tend to overestimate the beneficial effects of austerity measures.³⁶

Apart from concerns regarding the appropriateness of the Fund’s measures, these standard prescriptions raise the question of the extent to which countries share, or should share, a unified understanding of good economic policy-making and regulatory approaches. Although there may be benefits to a convergence of understandings,³⁷ we have yet to reach such a state of affairs, even if we consider exclusively countries with western, capitalist and democratic backgrounds.

³³ Stiglitz, above footnote 8.

³⁴ For counter views see Jagdish Bhagwati, *In Defense of Globalization* (Oxford University Press, 2004), at 256-261; Martin Wolf, *Why Globalization Works* (Yale University Press, 2004), at 288-295.

³⁵ Feldstein, above footnote 3.

³⁶ Independent Evaluation Office, IMF, ‘Fiscal Adjustment in IMF-Supported Program’ (2003) (hereinafter referred to as IEO (2003b)), at 6-7. This report concludes, however, that the charge that the Fund applies a one-size-fits-all approach to fiscal measures in its loan programs is not founded. In addition, Kenneth Rogoff, a former Chief Economist of the IMF, argues that the Fund puts excessive pressure on countries to reduce their inflation rates. See Kenneth Rogoff, ‘The Sisters at 60’ *The Economist*, 22 July 2004.

³⁷ For example, reducing transaction costs.

First, despite unanimity as to certain basic principles, economists diverge substantially as to the required measures for economic recovery. One clear example concerns inflation rates. Whereas some economists consider the reduction of inflation as a necessary step towards economic recovery, others maintain that a temporarily high inflation rate may be conducive to recovery because it encourages growth and prevents unemployment. Similar disagreements pertain to other measures, such as the reduction of budget deficit and government spending, foreign direct investment, and trade and capital market liberalization. Although all economists agree that these are generally desirable measures, there is ample disagreement with regard to issues such as timing, sequencing, prioritizing, and the degree to which these measures should be pursued.

Second, even within the prosperous economies there are significant divergences in approach towards issues such as privatization, corporate governance, banking regulation, etc. For example, the role of government in promoting social welfare in some countries, such as Sweden, is substantially larger than in other Western countries, such as the United States. The level of independence of central banks in different countries varies, and their goals may be defined differently.³⁸ In some countries corporate laws facilitate hostile takeovers while in other countries they are generally discouraged. Whether Anglo-American models – however efficiently they may work in some countries – are suitable for developing countries is an issue far from being resolved,³⁹ and the relevance of culture and path dependence to designing efficient solutions has not been fully explored. Therefore, it does not make sense to allow the Fund to impose its own views, when there are other legitimate alternative forms of regulatory framework.

Several observations can be made at this stage. First, there are some elementary economic ‘truths’ upon which all nations seem to agree. For example, all agree that long-term high

³⁸ For example, legislation can limit the discretion of the central bank to achieving price stability, but it may also allow central banks to take into account employment and social issues in exercising monetary policies. In fact, the mandate of the Federal Reserve, the Bank of Japan and (at least formally) the European Central Bank is not limited to price stability.

³⁹ For a critique of applying the Anglo-American corporate governance model to developing countries, see Ajit Singh, ‘Corporate Governance, the Big Business-Groups and the G-7 Reform Agenda: A Critical Analysis’, *Seoul Journal of Economics*, Vol. 15, No. 2 (2002), 103.

inflation is inefficient. Second, for many economic and regulatory issues, there is a range of legitimate and reasonable structures. For example, a country may temporarily limit foreign direct investment because domestic actors need to be strengthened before they can sustain competition with foreign actors; the government can decide to maintain some short-term inflation to prevent excessive unemployment; corporate laws may require mandatory tender offers in takeover situations, etc.

Accordingly, when conditions are being designed, there may be several options that fall within the range of reasonable economic policies. All of these reasonable policies are in principle ex ante adequate to meet the Fund's broad objectives of ensuring that the borrower country repays its debt, maintaining stability in international capital markets, and helping the country return to capital markets. But within this range of reasonableness, countries should be left to make their choice of policy in accordance with their own cultural, political and economic aspirations.

It is possible, in theory, that with an already growing convergence of economic factors and economic standards, the range of reasonableness in economic policy-making will become narrower to the extent that there will be only one economic solution to each problem. But such convergence must be reached through a process of deliberation, experimentation and participation of all stakeholders in the process – not through conditions imposed in loans to countries in financial crisis.

D. The IMF's Prescriptions Have Been Ineffective

In many instances, the Fund's prescriptions have been ineffective in restoring confidence and financial stability. One of the main consequences of the ineffectiveness of conditions is that countries have repeatedly failed to recover from ongoing financial distress and continue to seek Fund assistance over a prolonged period. Although this failure is attributable in large part to the countries' policies and external economic conditions, there is nevertheless considerable evidence

of misguided policies in the Fund's prescriptions. The IEO reports criticize the Fund for several failures, including: failure to address vulnerabilities in countries' economies; failure to take into account the political feasibility of Fund programs and implementation capacity constraints; over-optimistic assessments of the effects of conditionality; inadequate prioritization; insufficient focus on key structural issues, leading to confusion in implementation and distraction from critical reforms; and insufficient attention to social concerns and the need for adequate safety nets.⁴⁰

In some instances, it appears that conditions actually aggravated the financial situation. Conditions requiring member countries to privatize state-owned enterprises before they had effective competition laws led to the creation of predatory private monopolies.⁴¹ Similarly, in some societies the lack of safety nets to assist domestic workers who might lose their jobs following privatization or policies of cutting-off food subsidies were a source of acute social and political unrest.⁴² Moreover, trade liberalization and foreign direct investment, albeit beneficial in principle, may cause severe unemployment when prematurely imposed on developing countries.⁴³

Concerns have been raised about the Fund's insufficient expertise in two main respects. First, the Fund is somewhat limited in its capacity to understand the complex social and political circumstances of member countries.⁴⁴ Domestic experts with lifelong familiarity with local politics, conditions and trends may be better informed than the Fund's staff in this respect.⁴⁵ Second, structural conditionality has focused on several areas which lie significantly beyond the Fund's main expertise in monetary and fiscal issues. For example, between 1996 and 1999 about

⁴⁰ See IEO (2002), above footnote 28; IEO (2003a), above footnote 28; IEO (2003b), above footnote 36.

⁴¹ Stiglitz, above footnote 8, at 57; Goldstein, above footnote 6, at 55.

⁴² Stiglitz, above footnote 8, at 57, 119-120.

⁴³ *Ibid.*, at 59-73.

⁴⁴ IOE (2003b), above footnote 36, at 9, 59.

⁴⁵ Stiglitz, above footnote 8, at 41.

two-thirds of the structural policy conditions involved financial-sector policies, tax and expenditure reforms, public enterprises and privatizations.⁴⁶

But again the problem is more complicated. First, some of the Fund's prescriptions have been very successful and, when adequately followed, yielded desirable results. For example, the austerity package which Mexico committed to implement in 1995 has proved extremely successful, and Mexico was able to pay its debt to the Fund even before it became due.⁴⁷ Second, in many instances the Fund may be better placed than domestic governments to pinpoint inefficiencies in the domestic economy, partly because of its professionalism and expertise, and partly because in many cases a third-party observer may be a better judge and critic of a stagnant and inefficient system. It must be remembered that not infrequently domestic governments significantly contribute to, or even precipitate, a financial crisis.

E. Conditionality is a Poor Incentive for Economic Reform

Many studies have concluded that conditionality in loan agreements is a poor incentive for inducing economic reform. Conditionality fails to create an incentive system sufficient to induce governments to implement policies they would not otherwise undertake, or would undertake more gradually.⁴⁸ The IEO has consistently stressed the importance of ownership to effective implementation and economic recovery.⁴⁹ Thus, the best results have been achieved in circumstances where the member country was committed to implementing Fund policies. For

⁴⁶ Goldstein, above footnote 6, at 35.

⁴⁷ Andreas Lowenfeld, *International Economic Law* (New York: Oxford University Press, 2003), at 590.

⁴⁸ Tony Killick, Ramani Gunaratika & Ana Marr, *Aid and the Political Economy of Policy Change* (London Routledge: 1998), at 163-165.

⁴⁹ See IEO (2002), above footnote 28; IEO (2003a), above footnote 28. Ownership is difficult to define and even more difficult to identify. IEO (2003a) says that assessments of ownership require a careful understanding of political economy issues. In the context of Indonesia, the symbolic signature of the President on the Letter of Intent, intended to signal true ownership, proved to be misleading. Ownership implies not only the support of senior government officials, the central bank and finance ministry, but also the support of parliament, the bureaucracy, stakeholders and civil society – that is *sufficient* (although not complete) to implement the relevant policies.

example, Korea implemented a set of far-reaching structural reforms⁵⁰ largely because these reforms enjoyed strong political commitment. The worse results have been obtained in countries, as Indonesia, where program ownership was weak.⁵¹ A country which resists a specific reform is unlikely to implement it effectively and promptly.⁵² More strikingly, a recent report of the IEO expressly states:

When action in areas that are not macro-critical is nevertheless deemed to be important, a “second-best” policy package that is strongly owned may be more likely to help restore confidence than a “first-best” package that is painfully negotiated and over which there are substantial domestic reservations.⁵³

In addition, there is strong evidence that the rates of compliance with conditions have fallen sharply as the Fund increased the number and breadth of loan conditions, especially those concerning structural reform.⁵⁴ One of the main reasons for this is that the increase in the number of non-critical structural conditions has distracted attention and focus from those which are vital to economic recovery. Moreover, the more structural conditions there are, and the more detailed they are, the less likely it becomes that they will be owned by governments and enjoy domestic political support.

⁵⁰ The reforms in Korea included: regulation of merchant banks, adopting internationally accepted accounting standards, removing restrictions on foreign ownership of domestic corporations, allowing foreign banks to open subsidiaries, and several corporate governance reforms.

⁵¹ See IEO (2003a), above footnote 28; Statement by Montek S. Ahluwalia, Director, Independent Evaluation Office of the International Monetary Fund at the General Assembly of the Club de Madrid, *IMF Operations and Democratic Governance: Some Issues* (2003), at <http://www.imf.org/external/np/ieo/2003/sp/110103.htm> (last visited 20 December 2004).

⁵² Santiso, above footnote 6, at 9, cites a study conducted by Miles Kahler showing a positive association between government commitment to reform and program implementation in relation to conditions imposed by the World Bank. In 9 out of 16 programs with high implementation levels, prior government commitment was strong. In 8 out of 11 poorly executed programs, government commitment was low.

⁵³ IEO (2003a), above footnote 28, at 43.

⁵⁴ Buira, above footnote 6, at 65, points out that ‘...with the increase in structural conditionality observed in the 1990s, the rate of compliance declined markedly after 1988, and dramatically in 1993-7, when only 27.6 per cent of 141 arrangements could be considered in compliance.’ Compliance is defined here as disbursement of 75 percent or more of the total loan. See also Goldstein, above footnote 6, at 45-48.

As discussed above, the recent *Guidelines on Conditionality* are designed to address some of these problems; but again, they seem to have brought only modest changes, and there is no institutional means to monitor and review their application.

F. Lack of Accountability and Transparency

The increase in the effect of conditionality on the economies and political structure of developing countries calls for greater accountability of the Fund to its stakeholders and the public at large, and for better transparency of its decision-making processes. As Stewart says, as the intensity of regulatory authority by international regime continues to grow, there is a need for an effective legal institutional mechanism of accountability and transparency.⁵⁵ Several problems with conditionality are particularly pertinent.

First, the Fund is insufficiently accountable to developing countries. The day-to-day work of the Fund is overseen by its Executive Board. However, developing countries have no effective representation on the Board and it is dominated by the major shareholders.⁵⁶ Moreover, the Fund's staff exerts substantial control over the Fund's policies and the Board's supervision is weak.⁵⁷ The major shareholders have substantial influence over the staff's decision-making via informal avenues, and decisions have often been taken without consulting the Executive Board.

Second, the review process of the Fund's decisions is conducted by the Fund itself via various internal and external evaluations. The internal evaluations are confidential, but the external evaluations are generally published.⁵⁸ Until recently, external reviews have had little

⁵⁵ Stewart, above footnote 1.

⁵⁶ See Ngaire Woods, 'Making the IMF and the World Bank More Accountable', *International Affairs*, Vol. 77 (2001), 83; Ariel Buira, 'The Governance of the IMF', in Ariel Buira (ed), *Challenges to the World Bank and IMF: Developing Country Perspectives* (Anthem, 2003), 13.

⁵⁷ Woods, *Ibid*; See also IEO (2004), above footnote 27; IEO (2003a), above footnote 28.

⁵⁸ Ngaire Woods & Amrita Narlikar, 'Governance and the Limits of Accountability: the WTO, the IMF and the World Bank', *International Social Science Journal*, Vol. LIII, No. 170 (November 2001), 569, at 575.

influence and few ex post assessments were undertaken by the Fund.⁵⁹ With the establishment of the IEO in 2002, external evaluations are expected to gain more importance, and they have already been helpful in improving the Fund's operations. However, their effectiveness in inducing follow-up changes is limited because they are not required to be taken into account in the Fund's daily operations, and because there is no institutional mechanism for supervising and monitoring proposed reforms. The IEO itself stresses the importance of systematic ex post reviews and the study of past cases for the effectiveness of Fund programs.⁶⁰

Finally, the Fund's decision-making process suffers from a lack of transparency. Several defects have been identified by the IEO. There is often uncertainty regarding the reasons for particular decisions and the facts on which they are based. For example, a recent IEO report on Argentina states: 'There was also a lack of clarity as to why a particular decision was made. The absence of clear rules led to excessive reliance on discretion, which in turn created an environment of great uncertainty and unpredictability as to what the IMF would do next and encouraged the Argentine authorities to pursue questionable measures in an attempt to gamble for redemption.'⁶¹ The rationale for the Fund's decisions is not brought out in the Fund's documents, and there is insufficient explanation of proposed policies and the assumptions that underlie them.⁶² There is also great uncertainty regarding the extent to which political

⁵⁹ For example, IEO (2002), above footnote 28, at 12, says: '*Relatively few systematic ex post assessments of programs were undertaken* (and with the exception of the Philippines) there was generally limited discussion from prolonged program involvement.'

⁶⁰ IEO (2002), above footnote 28. IEO (2002), at 13 reads: 'The IMF ability to learn from experience is hampered by (i) the relative scarcity of systematic ex post assessments of programs and (ii) the slow pace of at which lessons learned in the context of cross-country policy reviews – which are often insightful – permeate operational practices. Moreover, many of the most candid internal assessments and debates on alternative policy strategies in individual countries were not reflected in subsequent Board papers.'

⁶¹ IEO (2004), above footnote 27, at 73; IEO (2002), above footnote 28, at 12, similarly says: 'Many programs had difficulty in dealing with uncertainty, in part because program documents often did not analyze the key risks to a program and specify how policies would broadly respond to those risks.'

⁶² See IEO (2003b), above footnote 36, at 5, 11.

considerations and interests affect the Fund's decision-making and their interaction with technical judgment.⁶³

G. Intermediate Conclusion

It is useful to summarize the above observations before setting out my proposal for self-imposed conditionality. First, it is virtually impossible to rely solely on a formal distinction to define the extent to which conditionality can interfere with a country's internal affairs. Distinctions between microeconomic and macroeconomic criteria, or between internal or international criteria, are not practical for the reasons specified above. Moreover, what is necessary to solve economic crises is a subject of substantial disagreement.

Second, there is at least some trade-off between conditionality and sovereignty. Countries that approach the Fund must recognize that they will have to cede some sovereignty and control over domestic policy-making in exchange for the Fund's assistance. However, the Fund should not impose conditions beyond what is warranted to achieve the goals of Fund programs.

Third, in many instances of financial crisis there may be a range of reasonable effective solutions to which different economists may subscribe. Member countries should be able to make their policy choices within this range of possible solutions. A mechanism which allows member countries to make these choices would enable countries to exercise maximum sovereignty without compromising the legitimate interests and concerns of the Fund.

Fourth, the Fund has no comparative advantage vis-à-vis developing countries in respect of certain issues, especially those that require a profound understanding of the cultural, social and political circumstances of the country. Conditions must take account of such circumstances in order to maximize the chances for their full implementation and for the country's economic

⁶³ IEO (2002), above footnote 28, at 12, 64. This report also notes that '...the lack of transparency can give rise to exaggerated perceptions of political pressures, which are likely to weaken the effectiveness of IMF-supported programs.' See also Wolf, above footnote 34, at 295.

recovery. Thus, more should be done to increase the participation of domestic experts and officials with relevant knowledge and information in designing Fund programs.

Fifth, there is a need for a better incentive system to get countries to adopt and implement reform policies. The ‘ownership’ concept embedded in ‘soft’ guidelines is insufficient without a meaningful, albeit imperfect, formal mechanism to induce countries to initiate reform proposals.

Finally, the development of conditionality, in particular its increasing effect and seemingly decreasing effectiveness, poses a challenge to the legitimacy of the Fund. There is a pressing need for more transparency and a better accountability mechanism.

III. A Proposal for Self-Imposed Conditionality

A. Outline of Self-Imposed Conditionality

At the heart of the proposal I set out below lies the need for a mechanism that gives greater weight to the economic sovereignty of member countries. Member countries should be able to choose from among a range of reasonable economic policies those that are most consistent with their national aspirations and traditions. The thrust of the proposal is procedural reform. Because the jurisdictional lines of the Fund’s authority are too difficult to draw and there is no review mechanism to ensure that the Fund does not exceed its jurisdiction, it is better to formulate a procedure that allows member countries a greater say in designing the conditions.

Accordingly, countries that apply to the Fund for a loan should be able to determine the type of conditions that that country is committed to implementing. The country will make a submission to the Fund detailing the conditions it proposes to include in the loan agreement, including the reasons and facts on which the proposal is based. Countries will thus have a right of ‘first proposal’ and the opportunity to impose conditions on themselves.

The Fund will have the power to review the submission made by the country, but it will have to accept that submission and make the loan on the proposed conditions unless they fail to comply with certain specified grounds of review. The Fund will conduct a swift procedure under

which it will determine whether the proposed conditions are consistent with specific standards. The main ground of review is reasonableness. Conditions proposed by member countries have to meet the standard of reasonableness. Countries will also have to satisfy certain procedural requirements: they will have to make adequate disclosure of the facts that form the basis for their policy proposals; they will have to state the reasons for the suggested conditions; and they may have to make specific consultations.⁶⁴ If the Fund decides that the proposed conditions fail to satisfy one of the grounds of review, then it can step in and propose its own conditions.⁶⁵

The Fund has to give reasons for its decisions and explain why they withstand or fail to withstand the standard of reasonableness. The reasons should include references to past cases of conditionality as well as ex post reviews conducted by the Fund (and also, presumably, by the IEO). The submissions made to the Fund, the Fund's decisions and the reasons for the decisions will be published. Thus, instead of a confidential process, the Fund's decisions will be open and susceptible to public and academic scrutiny.⁶⁶

Additionally, the Fund will have to provide countries with technical assistance as well as allow countries to use its resources and information data-base when making submissions. Finally, member countries will be able to waive their right to design the conditions in circumstances where it would be impractical for them to make a submission.

B. Advantages of the Proposal over the Current System

The proposal for self-imposed conditionality has several advantages over the current practice of conditionality, many of which address the specific criticisms raised above.

1. Economic Sovereignty

⁶⁴ The nature and extent of these grounds of review are discussed below.

⁶⁵ Of course, the country applying to the Fund can always decide not to use the Fund's resources or try to further negotiate with the Fund over the content of the conditions.

⁶⁶ The timing of publication is subject to further debate. See the discussion in section III(G) below.

The proposal creates a new balance between the sovereignty of member countries and the Fund's power to intervene in a country's internal affairs. The suggested process ensures that countries have the opportunity to design conditions as they consider best for emerging out of financial crises and regaining their credibility in financial markets. It ensures that if there are several reasonable and legitimate economic steps that can be taken to address the crisis, the affected country can choose the one that is consistent with its national aspirations and traditions. Subject to the Fund's review powers, countries also have a choice with regard to the scope of the proposed conditions. Conditions can equally include an extensive range of economic activities and reforms or minimal steps that concern only a narrow range of issues.⁶⁷ Accordingly, the proposal reflects the value of ownership as expressed in the *Guidelines on Conditionality* and gives it a formal underpinning.

2. Economic Plurality and Increased Participation

Subject to the Fund's review powers, the proposal assumes that different countries may choose to adopt different economic policies, even if the problems in those countries are similar in nature. The Fund will have to consider the countries' preferences of economic choices and will not be able to deny assistance merely on the basis of having different preferences. The Fund will review the countries' submissions and determine whether they are reasonable. Naturally, other countries will get some idea of how the grounds of review are applied. They can criticize the process, demanding more respect for their autonomy, or alternatively they may seek to improve their arguments to the Fund or distinguish their case from those of other countries.

The openness of the new procedure will create a deliberative process between the Fund and member countries based on emerging case-studies. This deliberative process will enhance mutual study of the economies of different countries and regions, of the feasibility of different economic solutions to commonly shared problems, and of the economic measures necessary in crisis

⁶⁷ If the country proposes too many conditions, the Fund may in its decision indicate which conditions it considers critical for the program.

situations. At present, deliberation and cross-learning are not strong, in the absence of accessible and regularized ex post review of Fund programs and the lack of a consistent record of submissions, negotiations and internal documents explaining the rationale of Fund programs. A deliberative process will also enhance the legitimacy of conditionality because of the increased participation of developing countries in designing and shaping the practice of conditionality. Thus developing countries will have an avenue of participation in the process of increasing global welfare and the study of economics, while the Fund's authority will be given a new source of legitimacy.

3. More Effective Prescriptions

The proposal is likely to strengthen the effectiveness of conditionality in two material respects. First, it mitigates the problem of the Fund's imperfect knowledge of countries' internal affairs. Governments that make submissions to the Fund may have a better knowledge of the nature of domestic political, economic and social problems and the political feasibility of potential economic reforms than the Fund's staff.⁶⁸ The proposal ensures that governments have the opportunity to present their solution in a formal and transparent manner. Of course, the external expertise of the Fund may be vital to inducing critical reforms, but the Fund's expertise will be given effect when it reviews countries' submissions. Second, the effectiveness of program design will also be enhanced by the gradual emergence of standards generated by the application of reasonableness and the extended scope for ex post review. From one case to another, it is expected that reasonableness review will develop into a more concrete and detailed range of standards pertaining to specific economic issues and situations. Such standards will guide countries that make submissions to the Fund and, more importantly, countries that wish to avoid

⁶⁸ As Stiglitz says, if conditions are likely to lead to social insurgence then the borrower country will clearly suffer in financial markets and fail to recover. See Stiglitz, above footnote 8, at 119-120.

financial instability. Third, ex post review of Fund programs is likely to be more effective than in the current system because of the availability of better records of countries' submissions, the Fund's decisions and the reasons and facts that underlie them. The Fund will also use such reviews and all relevant records in justifying and explaining the rationale for its decisions. A more reasoned decision-making process based on past cases and results will improve the quality of program design.

4. Better Prospects for Reform

As discussed above, owned policies have better chances of being implemented than externally-imposed policies. Policies submitted by governments without the Fund's direct intervention are likely to enjoy a higher level of ownership. Thus, the rates of compliance with Fund conditions are likely to increase. In addition, countries will have greater incentive than in the current system to engage in economic reform. Governments have an inherent incentive to maintain control over their economic policies. In order to do this, they would have to submit to the Fund a reasonable program. Thus, a government that wishes to retain control over the reform process will have an incentive to formulate reasonable programs that address the relevant issues that require reform. Understanding that they will have to commit to certain conditions anyway, governments may prefer to design the conditions themselves rather than let the Fund intervene in their affairs.⁶⁹

5. Greater Incentive to Disclose Information

The governments' interest in retaining control over the substance of proposed reform will also provide incentives to countries to disclose information to the Fund about economic conditions in these countries. The Fund will need sufficient information in order to be convinced of the reasonableness of the proposal. Countries making submissions to the Fund will have to provide the Fund with sufficient information to enable the Fund to review the proposal. For example, if a

⁶⁹ I deal below with the argument that the informality and confidentiality of the negotiation process is necessary to induce countries to agree to make reforms they would otherwise be unable to accept because of internal opposition to such reforms.

country proposes a change to its banking regulation, then the government will have to provide the Fund with information regarding the deficiencies in current regulation and why the government expects the proposed changes to solve the problems. Accordingly, countries are likely to release more information on their economic and regulatory frameworks.

6. Transparency and Accountability

The proposal improves the transparency and accountability of the Fund's decision-making process. Submissions made by member countries and the Fund's decisions, including the reasons for these decisions, will be published.

Transparency will no doubt facilitate and encourage criticism of the Fund's operation by all stakeholders involved in the process. Thus it is likely to enhance the accountability of the Fund to member countries, their citizens, and the public at large. The flow of information that the process will generate will be used by academics, practitioners, NGOs and civil society to assess the Fund's role. This process will also be aided by the increased use and effectiveness of ex post reviews of the Fund's operations – whether by the IEO, academics, or the Fund itself. Such reviews will further help in assessing the Fund's operations by professionals and laymen alike. Although there will be no judicial review mechanism of the Fund's decisions, the Fund is very conscious of its public image, and failure to follow due process or bad decision-making is likely to lead to external pressure on the Fund to change its course.

Transparency is also a powerful tool in building the credibility of conditionality. The IEO stresses the importance of communicating the logic of program design to the market and disclosing all relevant information both by the Fund and member countries. It specifically recommends the publication of staff reports supporting the countries' requests for use of Fund resources, i.e., the reasons and justifications for the program. Such publication will help achieve

broader domestic support and stronger ownership of program design during a crisis, as well as restore market confidence.⁷⁰

In addition, the credibility of program design will be strengthened because the political influence of major shareholders within a transparent procedure will be limited.⁷¹ The Fund will have to base its decisions on technical assessments of risks and trade-offs and its reasoning will be published. Although political considerations inevitably affect the process and the opinions of Board members, their influence will be constrained by the requirement to explain decisions by reference to specific standards.

Better transparency and accountability will increase the legitimacy of the conditionality process. Where the conditions proposed by the applying country withstand the Fund's review, they will clearly be perceived as legitimate, assuming the Fund is not too lenient in exercising its review. Where the Fund insists on its own conditions, the furnishing of reasons for its decision in accordance with specific standards and lessons learned from past cases will legitimate the Fund's intervention.

C. The Fund's Review Powers - the Grounds of Review

Reform of conditionality depends in large part on the content of the suggested grounds of review and on the manner in which the Fund would exercise them. The underlying rationale for these grounds of review and their exercise is twofold: on the one hand, they ought to ensure adequate

⁷⁰ IEO (2003a), above footnote 28, at 43-44, 50-51: 'In this effort of building credibility, transparency is a useful tool. In a capital account crisis, the IMF does not necessarily have more information than the private sector. Without disclosure of critical information for the investors, for example concerning the financing assumptions, or how policies might be adjusted to evolving developments, it is difficult to expect the markets to perceive the program to be credible.'

⁷¹ See IEO (2002), above footnote 28, at 15-16: 'The appearance of undue political intervention in the IMF's decisions to grant a country access to its resources undermines the credibility of programs. Procedures should be evolved so that political considerations, which are inevitably present in these decisions, are seen to be taken into account in a transparent manner, with decisions and accountability clearly at the level of the Executive Board on the basis of a candid technical assessment by staff of the risk and potential trade-offs.'

respect for countries' economic sovereignty and economic plurality; and on the other hand, they ought to ensure responsible lending and that the Fund is repaid its debt.

The suggested grounds of review are largely modeled on the typical grounds of review that exist in domestic administrative laws. Although there is no clear-cut distinction between procedural and substantive grounds of review, it is useful for the purpose of exposition to deal with them separately.

1. Procedural Grounds of Review

Procedural grounds of review are designed to ensure that decisions are made in an informed and reasoned manner. They are of great importance because of the inevitable uncertainty of substantive review of economic decision-making, and because they induce good policy-making and reduce the need for scrutinizing the substance of the proposed conditions. On the other hand, if the procedural requirements are too stringent and restrictive, they may lead to undue delays and administrative costs.

a. *Disclosure and sufficient factual basis:* Submissions to the Fund must be supported by relevant and accurate facts to enable the country to make an informed policy choice. For example, if the country proposes to make a cut in its budget, it will have to specify how this will be done, what kind of expenses are going to be reduced, and, where relevant, how the country will deal with these cuts, e.g., through increased efficiency and savings. The member country will also have to disclose relevant facts concerning its economy. Following the above example, it will have to disclose relevant figures regarding its budget in former years and why it considers the former budget plan to have been unsuccessful.

b. *All relevant considerations must be taken into account:* A country must give at least some weight to all relevant considerations. This is a standard ground of review in administrative law. The more difficult question concerns the weight that a country ought to give to each relevant consideration under the standard of reasonableness.

c. *Reasons*: A submission to the Fund must specify the reasons for the suggested conditions. The country will therefore have to justify its policy choices. It is important to emphasize again that the submission, including the reasons that underlie it, will be published.⁷² Thus they will form not only the basis for the Fund's substantive review of the submission, but also the basis for public, political and academic scrutiny of its content. Where the Fund does not accept the proposal, these reasons may be highly important in assessing the wisdom of the conditions which the Fund will later determine. Additionally, the Fund may pay regard to these reasons when formulating its own conditions even if it does not approve the country's proposed conditions - perhaps because they may direct the Fund to a new issue that it would otherwise not consider.

d. *Consultations*: Presumably, reasonable proposals will be prepared by professional economists of sufficient experience and education. In fact, member countries increasingly engage investment banks when dealing with the Fund. It is questionable, though, whether there should be a formal requirement to consult with qualified economists. If a submission is reasonable, then arguably it should not matter whether or not it was prepared in consultation with economists of sufficient pedigree. Nonetheless, there is merit in requiring each submission to be accompanied by a report or recommendation by economists that support the proposed conditions, including a formal certification that they consider the proposed conditions to be reasonable.⁷³ The main benefit of such a requirement is that it lends more force to the country's proposal. It will be more difficult for the Fund to claim that a proposal is unreasonable when qualified economists express a different view. It increases the chances that countries will meet the grounds of review, because such economists would speak the same language as the Fund and be better able to preempt its response.

There are, however, several difficulties with such a requirement. For example, some countries may not be able to afford prominent economists. More importantly, the question arises

⁷² I deal with the timing of publication in sub-section III(G).

⁷³ The exact wording of the certification is not significant for the present discussion.

as to which economists should serve this role and whose interests they should represent. The answer must start with a specification of professional requirements. Thus, economists must have certain relevant education and experience in economics. Naturally, this requirement will be supervised by the Fund. But it must be ensured that economists from developing countries educated in those countries are given a fair chance to meet the professional criteria, and they need not enjoy international acclaim and reputation.⁷⁴

Second, the Fund may maintain a pool of economists that specialize in macro-economic issues, especially emerging markets and developing countries. The question then will be, who will appoint these economists?⁷⁵ As stated above, sometimes domestic understanding of internal problems is essential for their resolution, and sometimes external intervention is necessary to bring about a shift in policy because domestic actors are reluctant to make desirable changes that militate against traditional norms. To give expression to both internal expertise and external scrutiny, such economists should include largely two groups: economists appointed by developing countries⁷⁶ and economists appointed by the Fund.⁷⁷ The question then would be,

⁷⁴ It is noteworthy international acclaim and the reputation of economic advisers has not been a guarantee for the success of economic policy-making. In the Russian crisis, the government retained a reputable consultancy firm; yet many of the reform initiatives turned out to be misguided or badly implemented.

⁷⁵ Another question is, who will pay their fees? Ideally, the Fund would be able to subsidize these fees so that developing countries with limited funds can use their services. But recent requests by the Fund for more financial support from member countries suggest that the Fund's resources may be limited. Possibly, they could be paid on a contingency fee basis, i.e., out of the benefits of economic recovery and subject to economic recovery. But such a solution can be very problematic; in particular, it may be an incentive for under-qualified economists to propose their services to developing countries.

⁷⁶ It is not essential for present purposes to decide how exactly this would be done. For example, the government may appoint economists when it approaches the Fund, or alternatively it may appoint them to the pool in advance and use their services when seeking the Fund's assistance.

⁷⁷ It may be argued that the Fund's review powers over the substance of proposed conditions are sufficient for the purpose of giving expression to external viewpoints. On this view, there should be no need for countries to consult appointees of the Fund. Member countries will enjoy the advantage of feeling as free as possible to formulate any policy they consider best without any external influence. On the other hand, consultation with the Fund may be important in the early stage. The Fund's appointees can raise various concerns that the Fund may have with regard to suggested conditions; they can help the domestic team understand the Fund's requirements; and they can be responsible for maintaining informal channels to the Fund. It is important to

what is the right ratio between Fund economists and economists appointed by developing countries? I leave this question open for future discussion, as it is not fundamental to the proposal.⁷⁸

Finally, it should be noted that if a process of making submissions and consultations is formalized and institutionalized, there will be greater incentive and demand for economists to engage in economic issues that concern developing countries. Moreover, developing countries will have an incentive to train more economists for this specific role in order to maintain their control over their economic policy-making. Alternatively, countries with sufficient means may continue to engage large investment banks and law firms in drafting submissions and negotiating with the Fund.⁷⁹

2. Substantive Grounds of Review - Reasonableness

The main ground of review is the standard of reasonableness. Member countries must propose conditions which are reasonable to achieve their aim. The traditional standard of reasonableness seeks to strike down only decisions which no reasonable authority would consider reasonable. Thus, in traditional administrative law the standard of reasonableness is designed to intercept only decisions that are so egregious as to amount to illegal acts. The underlying principle is that the reviewing body does not seek to substitute for the judgment of the decision-maker.⁸⁰

This proposal advocates a different and wider form of reasonableness review. The Fund should be able to substitute for the judgment of the applying country to a larger extent than is

emphasize that the Fund's appointees will be employed by the country and owe duties of care, diligence and confidentiality to the country rather than the Fund.

⁷⁸ My intuition, though, is that an appropriate ratio is 2:1 in favor of economists appointed by developing countries. The reason for this is that the Fund's economists will have an opportunity to make their impact anyway in reviewing the country's proposal.

⁷⁹ That some countries can afford to engage large investment banks when dealing with the Fund raises concerns about equality. Arguably, countries with insufficient means to engage prominent institutions will receive less deferential treatment by the Fund. The idea of maintaining a pool of economists appointed by developing countries, whose employment is subsidized by the Fund, is likely to solve this problem.

⁸⁰ Although this principle has to some extent been compromised in domestic systems, such as the US and the UK, and judges do tend to encroach upon administrative powers.

permitted pursuant to traditional notions of administrative law. The reason for this is simple. There is hardly any question concerning the legality of economic policy-making. Rather, the Fund has a duty to ensure the sufficiency of the steps undertaken by the countries that seek its assistance. The crucial issue therefore is whether the proposed conditions are substantively justified and whether they are likely to achieve the aims for which they were formulated. In other words, the Fund will examine whether the country's proposal gives due weight to all relevant considerations, and not merely whether it is egregious.

The reasonableness standard begs the question of reasonable as to what, or in other words, what are the aims of conditionality? The new *Guidelines on Conditionality* define the aims of Fund programs as primarily (1) solving members' balance of payment problems and (2) achieving medium-term external viability while fostering sustainable growth.⁸¹ Presumably, these aims will continue to apply. In any case, whatever formal definition of the aims of conditionality is adopted, it is extremely important that these aims be clearly defined and that

⁸¹ Section A(6) of the *Guidelines on Conditionality*. Note that the wording of the *Guidelines* is somewhat ambiguous as to whether fostering growth is an independent aim of conditionality, or merely incidental to achieving medium-term external viability. Whereas solving balance of payments problems and reducing vulnerability to future crises are generally uncontested goals of conditionality, the goal of fostering sustainable growth has been particularly questionable. Potentially, almost anything can be included within the goal of fostering sustainable growth. Goldstein, above footnote 6, argues that conditionality should be directed only towards solving the current crisis and reducing vulnerability to future crises. Whether or not fostering growth is part of the Fund's mission is not fundamental to the proposal set out in this paper because the essence of the proposal is procedural reform. However, it should be pointed out that this issue will clearly have a significant effect on the balance of power between the Fund and member countries. A good case can be made for an expansive definition of the goals of conditionality here because members will have a right of first proposal. On the other hand, others see growth issues as outside the ambit of the Fund's expertise. In practice, however, the Fund already routinely engages in growth matters through its various activities, and some facilities, such as the Poverty Reduction Strategy Papers, are concerned specifically with growth issues. One solution perhaps would be to classify facilities as either growth facilities or non-growth facilities limited to solving balance of payment issues and reducing vulnerability to crises. Countries would then choose for themselves which facilities they wish to apply for, and reasonableness review would be applied in accordance with the terms and aims of each facility.

reasonableness always be applied by reference to these aims.⁸² Otherwise, the process of explaining decisions and applying reasonableness will become arbitrary and unprincipled.

There may be some degree of skepticism with regard to the practicality of substantive review of economic decision-making. Two main concerns merit discussion. First, in domestic systems there is ample criticism of the opaqueness and uncertainty of the reasonableness test.⁸³ For example, it is often argued that reasonableness review conceals the level of judges' intervention in the substance of administrative decision-making and the grounds for such intervention. However, most of the criticisms of reasonableness review have to be understood against the function of judicial review, which is to review the legality rather than the wisdom of administrative actions. By contrast, the suggested reasonableness review is not amenable to such criticisms because it expressly allows the Fund to consider the substance of the proposed conditions and the weight countries give to each relevant consideration. Unlike the traditional administrative law standard, reasonableness, in this context, is largely identical with its common meaning rather than its 'legal' meaning.

Nonetheless, there would still be considerable scope for uncertainty because it cannot always be clear whether a proposal is reasonable to achieve its aims. In addition, the same jurisdictional uncertainty regarding the scope of the Fund's authority and the risk of 'mission creep' will persist as under the present system. The difficult questions concerning what is necessary to reduce vulnerability or foster growth, and what structural measures are critical, will remain.

But, although these difficult questions will no doubt persist, the proposal for self-imposed conditionality offers a more effective way of clarifying and elucidating the answers to them. The understandings – of what counts and what does not count as reasonable for restoring viability

⁸² In its website, the Fund defines the aims of conditionality somewhat more loosely than in the *Guidelines on Conditionality* to include laying the basis for sustainable growth by achieving broader economic stability. See <http://www.imf.org/external/np/exr/facts/conditio.htm> (last visited 24 January 2005).

⁸³ For a notable example on English law, see Jeffrey Jowell & Anthony Lester, 'Beyond Wednesbury: Substantive Principles of Administrative Law', *Public Law* (1987), 368.

and fostering growth in certain circumstances – are likely to emerge out of a growing body of case-studies and precedents. The Fund will not be bound by previous determinations, but it will have to use past cases and ex post reviews to justify its decisions when reviewing proposed conditions. These precedents will be constantly published and reviewed by laymen and professionals alike, and will thereby contribute to shared learning of economic issues as well as improve the consistency of Fund decisions. Similar to the way that case-law develops into a coherent body of rules, the Fund and member countries will learn by trial and error what constitutes a reasonable economic policy in circumstances of financial distress.

In addition, other means can be adopted to counteract potential uncertainties. The Fund can be required to take into account specified considerations in assessing the reasonableness of proposed conditions, such as the benefits and costs of the proposal, critical vulnerabilities of the domestic economy, the probability and political feasibility of implementation, risks and uncertainties, possible alternative measures, distributional effects, etc. Another possible consideration would be whether the proposed conditions themselves are consistent with various international standards.⁸⁴ It may also be helpful for the Fund to formulate some kind of guidelines as to what it is likely to consider reasonable, preferably by reference to specific precedents. These guidelines may add some certainty to the procedure, but it is important to keep them very flexible in order to leave space for member countries to make their own contribution to the process. Finally, the practical content of the reasonableness standard will be

⁸⁴ As Goldstein, above footnote 6, at 75, points out, a potential appeal of standards is that they represent the consensus on good practice by a group of international experts rather than the views of an individual mission chief or the Fund. In fact, the Fund is already using standards in designing loan conditions. See <http://imf.org/external/standards/index.htm> (last visited 22 December 2004). On the other hand, others have expressed concerns about the limited participation of developing countries in forming international standards and argue that such standards may not be conducive to the economies of developing countries. See Katharina Pistor, 'The Standardization of Law and its Effect on Developing Countries', *Am. J. Comp. L.*, Vol. 50 (2002), 97; Herbert V. Morais, 'The Quest for International Standards: Global Governance vs. Sovereignty', *U. Kan. L. Rev.*, Vol. 50 (2002), 779. The advantage of self-imposed conditionality is that developing countries have the opportunity to participate in the process of creating international standards by making reasoned submissions to the Fund. Developing countries would also be able to argue that the application of international standards in a specific situation is not desirable and explain their position.

complemented by the Fund's surveillance role, under which it already provides economic advice to countries.⁸⁵

The second concern is that the concept of 'reasonableness review' of economic policy-making is rather novel and arguably workable. Several examples may be helpful to demonstrate the viability and potential of policy review. First, there are domestic agencies that are involved in the review of policy-making, for example, the Office of Management and Budget (OMB), an agency of the President of the United States. The OMB's function is to review cost-benefit analyses of proposed regulation prepared by every regulatory agency in accordance with the Presidential Orders.⁸⁶ Its role is to discipline regulatory decision-making and eliminate unjustified regulation through cost-benefit analysis and centralized review, i.e., it essentially regulates other regulators.⁸⁷ As pointed out by Stewart, although the OMB regulatory analysis was initially controversial, it has become widely accepted by all administrations, Republican as well as Democrat, and has become an integral part of US administrative law.⁸⁸

The OMB is not a perfect analogy,⁸⁹ but it bears several similarities to my proposal. First, OMB review involves review of the substance of policy-making by economists and lawyers. In fact, it is more controversial than the idea of Fund review, because the OMB has to deal with regulation in various fields of which it has very little knowledge. The Fund's economists, on the other hand, have significant expertise in reviewing economic policy-making and making reasoned judgments on the relevant strengths and weaknesses of economic policies. In addition, like the Fund, OMB decisions are not subject to judicial review, and its function is designed to

⁸⁵ The IEO stresses the importance of high-quality surveillance to facilitate a better understanding of what would be expected of authorities if Fund assistance becomes necessary. It also says that surveillance reports should seek to actively present alternative policy options and to analyze the trade-offs between them. See IEO (2002), above footnote 28, at 84.

⁸⁶ Stephen G. Breyer, Richard B. Stewart, Cass R. Sunstein & Matthew L. Spitzer, *Administrative Law and Regulatory Policy*, 5th ed. (Aspen Law & Business, 2002), at 120-144 (hereinafter referred to as Breyer & Stewart).

⁸⁷ Stewart, above footnote 1.

⁸⁸ *Ibid.*

⁸⁹ The OMB deals with cost-benefit analyses of regulation as opposed to economic policy-making in circumstances of financial crisis.

improve decision-making rather than create rights and benefits enforceable by any person.⁹⁰ Accordingly, the integration and centrality of OMB review in the US regulatory process suggests that the Fund's review of proposed policies may be a successful mechanism that will help improve economic policy-making in developing countries.

Second, the allocation of power over policy-making under my proposal is analogous to the manner in which the European Community (EC) formulates and administers the implementation of directives. Directives are legislative measures binding on member states as to the result to be achieved.⁹¹ They determine certain targets, usually relating to various economic and regulatory matters. National authorities reserve, however, the right to choose the form and method of implementing these targets. Both the EC Commission and the European Court of Justice (ECJ) perform actions, which are similar to the Fund's review under my proposal. Both effectively consider whether countries' policies are reasonable for achieving a target specified in the directives. The EC Commission has to make a determination as to whether a member state has satisfied the requirements of the directives when it considers whether to bring proceedings against a member state.⁹² The ECJ has to make the same determination in cases of alleged infringements of a directive.⁹³ Although EC directives are not a perfect analogy to the Fund's review because they serve different purposes,⁹⁴ they do support the argument that reviewing economic and regulatory policies can be an effective procedure.

Finally, it is necessary to consider the extent to which the Fund should take into account interests and considerations that do not directly concern the economy of the applying country. Possibly, the Fund should consider the interests of other member countries and international

⁹⁰ Breyer & Stewart, above footnote 86.

⁹¹ Article 249 EC.

⁹² Paul Craig & Grainne De Burca, *EU Law: Text, Cases, and Materials* (Oxford University Press, 3rd ed. 2002), at 407-412. It is also noteworthy that, pursuant to Article 226 EC, the Commission has to deliver a reasoned opinion to a member state which it considers to have failed to implement a directive.

⁹³ See generally, Craig & De Burca, *Ibid.*, at 202-229.

⁹⁴ The purpose of the directives is to harmonize legislation within the EC. The purpose of the grounds of review is to make sure that member countries commit to sound economic policies.

financial markets. An important consideration is whether the proposed policy is likely to endanger or injure another economy. For example, a major devaluation of the currency in one country may affect other economies. Another issue may be the consistency of proposed policies with the countries' international obligations pursuant to other international systems. For example, a policy is unreasonable if it includes an increase in tariffs contrary to binding WTO rules. Also, the Fund should possibly be able to take into account the environmental effects of economic policy-making or even the human-rights record of member countries where relevant.

D. The Procedure for Applying to the Fund

The procedure for applying to the Fund is significant for the efficiency of the application mechanism. There is no need to describe it in detail for the purposes of this paper, but some critical issues that the application procedure must address should be highlighted.

First, the procedure for application by written submissions and review by the Fund has to be expeditious, especially in emergency situations where the need for money is acute. Emphasis must be placed on a swift, organized procedure with a focus on a speedy review mechanism and strict deadlines. Parts of the submissions probably should be communicated to the Fund as they are formulated, and the Fund should be able to give some informal indications as to the reasonableness of proposed measures. Maintaining informal channels between countries and the Fund can facilitate agreement and prevent clashes. The Fund will also have a duty to provide technical assistance to countries and access to its information data-base.

Second, a decision need be taken in regard to what exactly member countries will have to submit. Several items or preparatory work need be considered, for example: does a country have to submit alternatives for its proposed conditions, explaining why they are less beneficial? Does it have to submit a full cost-benefit analysis? Would it have to point out potential difficulties of its proposal? Does it have to verify each of the figures that it supplies to the Fund, and in what

way? As said above, account has to be taken of the need for expediency. It may be better to leave these issues to the discretion of the Fund. They can be considered by the Fund when exercising its review powers. By applying the standard of reasonableness, the Fund could develop these procedural requirements incrementally on the basis of precedents. In some instances limited information may be sufficient, and in others when time is less pressing the Fund can demand more explanations.

Third, the question arises as to who bears the burden of satisfying the grounds of review: the Fund or the country applying to the Fund? The countries will have to bear this burden for all practical purposes, as the Fund cannot be compelled to give away money unless it is persuaded that the proposed conditions are reasonable. The main sanction against the Fund, if it uses reasonableness too strictly or fails to give adequate reasons for its decisions, is public censure and public pressure to change its conduct. It may be possible to initiate an independent review mechanism by an advisory committee that will adjudicate disputes between the Fund and member countries. But such a procedure may lead to over-formalization, increase administrative costs, and create excessive delays in the Fund's operation.

Fourth, some solution will have to be provided for cases in which countries propose too many conditions when making submissions – perhaps in order to signal to the market an exaggerated willingness to launch reform. The IEO has warned against programs ‘over-promising’ on a range of structural reforms and the time frame for their implementation, especially when such reforms have no serious political backing. Such over-promising has weakened the credibility of Fund programs because it inevitably leads to an impression of poor implementation and poor program design.⁹⁵ As recognized in the *Guidelines on Conditionality*, conditions should be limited to those critical to achieving the aims of Fund programs. A plausible solution is that the Fund will indicate which conditions, out of those proposed by the

⁹⁵ See IEO (2002), above footnote 28.

country, will be regarded as critical and binding and which policies are not to be part of the program. The Fund will monitor only the former.

Fifth, a country whose submission has been rejected by the Fund will not be able to make a revised submission immediately following the Fund's decision. Otherwise, knowing they can always re-submit an application, countries will have an incentive to commit to minimal conditions in the hope that the Fund might accept them. A time-frame will have to be determined, following which re-submission would be possible. On the other hand, if the program requires only minor modifications, it may be returned to the country with comments for re-submission within a short period.

Finally, as pointed out by Bhagwati, economic programs almost always suffer from uncertainty or face unanticipated problems.⁹⁶ Accordingly, even when the Fund approves a country's submission, the Fund – with the country's cooperation – should formulate contingency plans in accordance with risks identified prior to program implementation.⁹⁷ Such contingency plans will be kept confidential, but will be used once the initial policies fail or require modification.

IV. Potential Problems with the Proposal, Replies and Suggested Solutions:

The proposal for self-imposed conditionality is admittedly imperfect. In the following discussions I deal with potential problems with the proposal. Each sub-section raises a potential problem, followed by a discussion of the problem. Some of these problems are relevant exclusively to this proposal, whereas others may be equally relevant to the current practice of conditionality.

A. Those Who Created the Problem Should Not Be the Ones Entrusted with Solving it

⁹⁶ Bhagwati, above footnote 34, at 260-261.

⁹⁷ The IEO has stressed the importance of contingency planning to the success of Fund programs.

A legitimate criticism of the proposal may be that the government that put a country in a difficult financial position should not be in charge of designing the policies for economic recovery. On this view, member countries should be subjected to the Fund's conditions partly because they have manifested irresponsible economic policy-making. Such a view is misguided for several reasons.

First, it may be that the government whose actions contributed to the creation of large debts has been replaced, or that the current government has made only little contribution to enlarging the national debt. Second, the government itself may not bear the prime responsibility for the difficult economic situation. In a global world, countries, especially small ones, may be affected by various changes in financial markets with very limited means of mitigating the effects of these changes. Contagions, the spread of market dislocation from one country to the next, were frequently the main cause of crises in the 1990s.

Third, the idea of a defaulter that is given the latitude to recover from distress or from failure to perform its legal obligations has been recognized in other legal frameworks, such as Chapter 11 and Chapter 9 of the US Bankruptcy Code. The main feature of Chapter 11 is that the debtor remains in control of its assets. In the case of corporations-debtors, the old directors and officers, known collectively as the 'debtor in possession,' normally remain in their positions.⁹⁸ They continue to run the business and enjoy almost all the rights of the trustee, including the right to sell and lease property and the right to borrow money.⁹⁹ Chapter 9, which deals with bankruptcies of municipalities, is even more deferential to debtors. The debtor-municipality remains in charge of the city's affairs, including its financial matters, and the bankruptcy court cannot interfere with any of the debtor's political or governmental powers, any of the debtor's

⁹⁸ 11 United States Code Annotated (U.S.C.A.) § 1104.

⁹⁹ 11 United States Code Annotated (U.S.C.A.) §§ 1106-1108.

property or revenues, or the debtor's use or enjoyment of any income-producing property, unless the debtor consents or the plan so provides.¹⁰⁰

Fourth, the Fund expressly acknowledges the importance of member countries retaining ownership of the substance of conditions. This is most prominently reflected in the *Guidelines on Conditionality*. As discussed above, the *Guidelines* expressly state that the domestic government should be in charge of selecting and designing the conditions, as well as drafting the letter of intent.¹⁰¹ Given that the Fund itself assumes a leading role for the defaulting government, the proposal effectively assures that the Fund will follow what it currently claims to be its own policy.¹⁰²

Fifth, the Fund and the World Bank have already initiated a formal program for inducing member countries to improve their own policy-making, namely the Poverty Reduction and Growth Facility (PRGF). Under PRGF, Poverty Reduction Strategy Papers (PRSPs) are prepared by member countries through a participatory process involving domestic stakeholders as well as external development partners, such as the Fund and the World Bank. PRSPs describe the country's macroeconomic, structural and social policies and programs over a three-year or longer horizon to promote growth and reduce poverty. The country's documents, accompanied by assessments made by the joint staff of the Fund and the World Bank, are published on a website.¹⁰³ These nationally-owned PRSPs provide the basis of all World Bank and Fund concessional lending and for debt relief under the enhanced Heavily Indebted Poor Countries

¹⁰⁰ 11 United States Code (U.S.C.) § 904. See also Kevin A. Kordana, 'Tax Increases in Municipal Bankruptcies', Va. L. Rev., Vol. 83 (1997), 1035.

¹⁰¹ See also IEO (2002), above footnote 28, at 14,83. It is also noteworthy that, at least formally, countries have always drafted their own conditions in the Letter of Intent submitted to the Fund. The Letter of Intent was traditionally written by the country seeking the Fund's assistance, but, as discussed above, the Fund's intervention has gradually increased.

¹⁰² The Fund has already started to move toward a procedure in which the country seeking assistance makes the initial reform proposal. For example, the recent letter of intent by Peru, dated 25 May 2004, was originally drafted and submitted to the Fund by the Peruvian government. But, as discussed above, such a procedure has not been formalized in the sense that countries have a right to make a recorded submission to which the Fund must respond in a reasoned and transparent manner.

¹⁰³ See <http://www.imf.org/external/np/prsp/prsp.asp> (last visited 8 December 2004)

(HIPC) Initiative. Countries are expected to commit to reducing poverty in accordance with their own economic policies as a condition for receiving debt relief.

Experience with the SPRPs has been mixed, with some success. With regard to ownership, concerns have been raised that countries are forced to propose the same policies that the Fund would otherwise impose.¹⁰⁴ The IEO's recent report suggests that there has been considerable widening of the policy space afforded to member countries, although the Fund continues to be overtly prescriptive in several areas and the level of ownership varies across countries.¹⁰⁵ In addition, some of the IEO's recommendations support the key elements of self-imposed conditionality. Apart from the need to further enhance ownership and afford more policy space to countries, the IEO recommends, *inter alia*, that both countries' and Fund policies should be subject to more public scrutiny, that the Fund joint assessments with the World Bank of countries' PRSPs should be more principled and refer to specific criteria, and that the rationale and reasons for IMF policies should be more clearly stated in program documents.

Finally, even under my proposal the Fund retains the power to invoke its intrusive powers. The exercise of such powers may be necessary in certain circumstances, especially when a country consistently fails to implement conditions in loan agreements or insists on pursuing policies that are likely to lead to financial crisis. In such cases, giving a sovereign country an opportunity to rectify the situation itself before the Fund actively intervenes will legitimize the Fund's involvement in that country's internal affairs.

B. Countries May Not Have the Power and Resources to Make Submissions to the IMF

Some countries have very limited means and resources, to the extent that they would be unable to make their own detailed submissions to the Fund. In some countries there is a scarcity of the

¹⁰⁴ See Stiglitz, above footnote 8, at 50-51; Eurodad, above footnote 31; Wood, above footnote 31. These concerns are also relevant to my proposal. I deal below with the possibility that the Fund will use reasonableness review to impose its views on member countries.

¹⁰⁵ Independent Evaluation Office, IMF, 'Evaluation of the IMF's Role in Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility' (2004).

most basic resources. However, several arguments should be raised in this context. First, the proposal provides for countries to waive their right to make submissions and accept the Fund's jurisdiction. Following a waiver, the Fund would act on a footing similar to the current system. Second, the Fund is able to grant technical assistance to member countries. Moreover, the possibility of maintaining a pool of economists that advise member countries can also mitigate this problem. Finally, a good argument can also be made that Fund conditionality is not the appropriate mechanism to deal with truly impoverished countries that require overall restructuring of their economies rather than temporary loans. World Bank conditionality or the PRGF discussed above are more suitable mechanisms for this purpose. Thus the proposal is more relevant to countries that generally have sufficient resources to run their own affairs.

It may be noted that the more detailed and complex the submissions that countries have to make when applying to the Fund, the more difficult it will be for countries to comply with the requirements. Again, the interest in both countries' ownership and responsible policy-making should be considered. The objective is to design procedural requirements, which are not too burdensome to prevent governments from making submissions to the Fund, but yet require of them a reasonable measure of commitment and seriousness in making these submissions.

C. The Fund Can Still Impose its Own Views on Developing Countries

It may be argued that the Fund might take an overtly restrictive view of the range of reasonableness and strike down too easily conditions proposed by member countries. The standard of reasonableness is very flexible, and domestic jurisprudence shows that it may be applied with varying degrees of intensity.

There are several replies to this argument. First, there is no better alternative. A standard of reasonableness creates a better balance between sovereignty and responsible lending than the current practice, under which the actual level of ownership is somewhat arbitrary and affected by extraneous considerations. The reasonableness standard recognizes the right of countries to

continue making their policies, but also the fact that strongly owned policies may be misguided, in which case the Fund should insist on internal reform while explaining the reasons for its position.¹⁰⁶

Second, the risk of unduly restrictive application of the reasonableness standard is mitigated by several factors. The country has a right of first proposal in designing the content of Fund programs. The Fund will have to refer to the terms proposed by the country, and if it decides not to accept the proposal, it must provide the reasons for its decision.¹⁰⁷ These reasons will be published and presumably scrutinized by reference to this standard. The emergence and growth of precedents and standards will add certainty to the application of reasonableness. Accordingly, it will be difficult for the Fund – or at least, more difficult than under the present system – to use reasonableness in order to supplant the judgment of domestic authorities.¹⁰⁸

Third, the Fund does care about its public image. Recent criticisms of its policies have led the Fund to consider various changes concerning its relationship with developing countries.¹⁰⁹ If the Fund is to have a legal obligation to explain its decisions publicly, this may well be a sufficient incentive for the Fund to exercise its judgment fairly and consistently. The costs of being regarded as ‘unjust’ toward developing countries are high and borne not only by the Fund but

¹⁰⁶ IEO (2004), above footnote 27, at 6: ‘Emphasis on country ownership in IMF-supported programs can lead to an undesirable outcome, if ownership means misguided or excessively weak policies. The IMF should be prepared not to support strongly owned policies if it judges they are inadequate to generate a desired outcome, *while providing the rationale and evidence behind such decisions.*’ [my emphasis]

¹⁰⁷ Recent literature on negotiations suggests that the right to make the first proposal gives a substantial advantage in negotiations to the party making the first proposal and affects the outcome in favor of that party, especially in situations of ambiguity and uncertainty. The reason for this is that a first offer has a strong anchoring effect on the other party, which influences the ensuing negotiation between the parties. See Adam D. Galinsky, ‘Should You Make the First Offer?’, *Negotiation* (July 2004). The anchoring here would probably be of lesser effect than in straightforward negotiations because of the Fund’s review powers, and because the Fund possesses significant knowledge of members’ economic affairs.

¹⁰⁸ It is also noteworthy that the experience of the OMB in reviewing regulation suggests that the reviewing body can operate effectively by complementing the regulatory process rather than supplanting the discretion of the regulator.

¹⁰⁹ For example, the inclusion of the concept of ownership in the *Guidelines on Conditionality* and the establishment of the PRGF. See Woods, above footnote 56.

also by its major shareholders. Without good reasons, it will be very difficult for the Fund to disapprove reasonable submissions.

Alternatively, as suggested above, it is possible to consider having a review mechanism of the Fund's decision by an advisory committee. This may be necessary if public censure is not a sufficient incentive for the Fund to exercise its power fairly and consistently. But again, the major downside is that the procedure may become too legalized and cumbersome.

D. The IMF Has to Work Fast – the Costs of a Prolonged Procedure

In many instances, the Fund has to make decisions in no more than several weeks, or even days. For example, in the case of the economic crisis in Argentina that erupted in 2001, the country was in need of immediate funds. Countries may have no time to make detailed submissions to the Fund.

There are several replies to this argument. First, in most circumstances member countries do have sufficient time to make submissions to the Fund. The average time in which countries negotiate with the Fund over the terms of loans is approximately one month, and in many instances negotiations may take even longer. By contrast to the previous example, in other instances Argentina negotiated loans with the Fund over a period of several months without any major new crisis emerging during that time.¹¹⁰

Second, the procedure can be carried out relatively promptly. Well-crafted policies can be prepared quickly, especially if the application procedure is regularized, studied and practiced for some time.¹¹¹ It is also likely that countries that are frequently in need of Fund assistance will assign specific officers with the responsibility of making applications to the Fund when necessary; presumably, these will be officers that already work vis-à-vis the Fund regarding

¹¹⁰ Similarly, in the case of Russia in 1992-1993 negotiations took many months, indeed over a year. See Lowenfeld, above footnote 47, at 597-603.

¹¹¹ The formalization of the procedure and the emergence of case-studies and standards may also expedite the process. The IEO has said in connection with the crisis in Argentina in 2001: 'A more rule-based decision-making process could likely result in a *faster* resolution of a crisis when a solution is uncertain.' (See IEO (2004), above footnote 27, at 73 [my emphasis]).

other issues, such as surveillance.¹¹² The review procedure, with the help of guidelines, precedents and organized coordination with member countries, can be conducted relatively quickly. Although it does not normally operate in emergency circumstances, the experience of the OMB shows that review of complex regulation can be conducted in a relatively short time.¹¹³

Third, certain solutions may be designed to deal with emergency cases. For example, if the procedure and formalities for applying to the Fund are not specified in advance, the Fund may relax them in emergency cases. As suggested above, the Fund may then take the sufficiency of the procedure followed (i.e., the reasons, facts and consultations on which the submission is based) into account when considering the reasonableness of the proposed conditions. On this view, a short, laconic submission may be reasonable in circumstances of extreme emergency. Alternatively, the procedure can provide for the applicant to ask for immediate financial assistance in return for a commitment to come up with a proposal for reform by some deadline. If necessary, the Fund could state its own conditionality immediately, as it does now, but with the understanding that this would be the default should the applicant's proposal be adjudged unreasonable.¹¹⁴ The applicant would still have the option of accepting the Fund's default conditions.¹¹⁵ Finally, countries may still waive their right of first proposal if they prefer the Fund to step in immediately.¹¹⁶

Fourth, a bad policy imposed quickly is worse than a good policy delayed for some time. This clearly holds true in cases where the conditions imposed by the Fund have aggravated the

¹¹² During the Clinton administration each agency appointed a Regulatory Policy Officer to work with the OMB. Similarly, countries may assign the responsibility of dealing with the Fund to specific officers.

¹¹³ OMB review normally takes 60 days or less. The Fund's review is likely to take less time given the emergency environment in which the Fund operates and given that, unlike in OMB review, member countries would not have to submit a detailed cost-benefit analysis.

¹¹⁴ The problem here would be that the Fund may require some irreversible conditions to be immediately implemented. However, this is not usually the case, and normally it takes some time until the required reform is expected to be implemented.

¹¹⁵ In such circumstances, the Fund's conditions may remain confidential until the applicant country makes its own proposal or accepts the Fund's conditions.

¹¹⁶ It should be noted that exercising a waiver may incur some costs to the countries nonetheless, because it may indicate to the market that the government is unable to formulate its own policies.

economic situation of the borrower country. It is also valid in cases where the member country is reluctant to implement conditions imposed by the Fund. In such cases, effective implementation is unlikely, the chances for economic recovery are low and the potential for strife between the country and Fund officials is high. Therefore, the costs of some delay, if any, are likely to be less than the benefits of creating a system that produces more effective policy-making in developing countries.

Some undue delay, however, may occur when countries make proposals that are clearly inadequate. Moreover, governments may manipulate the process and make sham proposals to the Fund. This may occur either because the government wants to be perceived as resisting intervention by the Fund,¹¹⁷ or because it is simply acting recklessly. To provide for such situations, it may be useful for the Fund to have some limited power to deny a country the right to design self-imposed conditions. Such power, if adopted, should be used sparingly in extreme situations where reform must be carried out to bring about financial stability, and where the government is clearly incapable of initiating it.¹¹⁸

E. The Administrative Costs are too High

It may be argued that the administrative costs involved in this new procedure, especially the costs of making submissions and explaining decisions may be excessive.

As regards the costs to the Fund, it is submitted that they will not necessarily be higher than under the present system. The Fund will have to bear the additional costs of publishing its decisions and the reasons for them. But if member countries will do most of the work of designing and formulating loan conditions, the Fund can save the costs of preparing and fiercely

¹¹⁷ In some cases, the government may prefer outright external intervention to bring about internal reform, for example, because various interest groups within the country resist such reform.

¹¹⁸ Presumably, the Fund will have to justify and give reasons when exercising such extreme powers.

negotiating arrangements.¹¹⁹ Even in cases where the Fund disapproves a proposal, its costs in preparing the conditions may be reduced to the extent that it has already examined the economic situation of the relevant country and acquired relevant information.

As regards the applying country, it may be more costly to prepare an economic policy rather than have the Fund prepare it. Nonetheless, the benefits of being able to design the policy independently, whether they derive from non-interference with the country's sovereignty or from more effective policies, are likely to outweigh these administrative costs. Moreover, as noted above, it is plausible that countries will take the opportunity to establish mechanisms to deal with the Fund rapidly and efficiently, for example, by training officers to prepare the required submissions and specialize in matters of concern to the Fund. In any case, countries can always choose to waive their right to make submissions to the Fund; but if they choose to make the submissions, this would be the best indication that the benefits of designing conditions outweigh the costs of doing so.

F. Other Countries and Private Banks Will Not Assist the Fund in making Loans

Additional co-operation and the provision of further funds by other countries and private banks have in many cases been essential to complement the Fund's assistance. One notable example is the United States' \$20 billion aid package to Mexico in 1995.¹²⁰ It could be argued that countries and private banks may not be willing to cooperate with the Fund if country borrowers are given a right to impose conditions on themselves. However, if the quality of conditions increases and countries have a better chance of recovery, there is no reason why other parties should be reluctant to continue to play the same role and lend similar assistance, as they do under the current system. In fact, there are strong indications that private actors increasingly act

¹¹⁹ Note, however, that the costs of maintaining a pool of economists may be subsidized by the Fund.

¹²⁰ See Lowenfeld, above footnote 47, at 586-590.

independently of the Fund and tend to make their own judgments as to the merits and probability of success of countries' policies, even in the face of disapproval by the Fund.¹²¹

G. Confidentiality Versus Transparency

Enhanced transparency is a key element of the proposal set out in this paper. Some may argue that confidentiality and informality are essential to the Fund's operations. This argument may largely be divided into four claims. I will take each of these claims in turn.

Confidentiality and informality are sometimes seen as essential to enable governments to agree to accept conditions they would otherwise be incapable to adopt because of internal opposition. Several counter-arguments can be made. First, the fact that confidentiality has facilitated formal acceptance of certain conditions by governments does not necessarily mean that these conditions were desirable or complied with. As shown above, conditionality has often been ineffective, and without sufficient ownership, including sufficient political and social support, compliance with conditions is unlikely. Second, under the current system not only hasn't agreement been secured between the Fund and developing countries, but strife has actually reached new heights. In addition, in some instances, confidentiality enabled the Fund to put pressure on governments to accept policies that they were not willing to accept.¹²² Third, under this proposal, a decision to seek Fund assistance is likely to attract less internal political

¹²¹ Jamaica's experience, as depicted in IEO (2002), above footnote 28, strongly supports this point. In 1996 Jamaica decided not to seek further Fund assistance because of disagreements with the Fund over its economic policies. Nonetheless, Jamaica was able to maintain access to private markets on relatively good terms. It is also remarkable that Jamaican officials published IMF surveillance reports even when they did not fully share the Fund's views and explained the reasons for their different approach.

¹²² Under self-imposed conditionality, a potential strife between the Fund and a member country may occur if both sides cling to their views and the Fund formally disapproves a country's submission. Such a scenario is only expected to occur when both sides are truly persuaded of their position, and when the costs of entering into a direct dispute are lower than the costs of accepting the other side's position. Because a greater public debate will no doubt follow, a major cost of entering into dispute is the cost of losing in such a debate. These costs will be particularly high because each party's position is published and scrutinized. Accordingly, each party will normally challenge the other publicly only if it has good reasons for its position. It is submitted that in such cases, where there is a genuine disagreement between the Fund and a country, greater public debate will help achieve better results and more effective ex post study.

opposition because the Fund's power over governments is limited. The government continues to make its own policies subject to specified grounds of review, and the Fund's intervention has to be thoroughly explained.¹²³ Fourth, economic recovery has been more effective where countries pursued economic reform openly and publicly. For example, the recovery of the Korean economy in the late 1990s was partly due to the openness of the government commitment to economic reform and cooperation with the Fund.

A second possible claim is that publication of certain facts about the applying country may in some circumstances injure the economic outlook for that country. Although this may be true, especially in the short run, concealing information may be even more costly. The IEO, for example, recommends that the Fund should be able to disclose information, including unfavorable information, about misguided domestic policies and express its views regarding the need for critical reforms: '...relevant information should be disclosed *even if it may cause negative shifts in market sentiment* because, in the long run, the IMF cannot expect to be effective if it is perceived as willing to go along with hiding information from the markets.'¹²⁴ The Fund's endorsement of domestic policies does not by itself restore confidence without sufficient justification of the rationale of the program and disclosure of all relevant information.¹²⁵ As discussed above, transparency and communication of the rationale of program design are highly important for building the credibility of Fund programs.

The third and fourth claims also concern the publicity of the procedure. If the Fund publishes its disapproval of a state's proposal, various counter reactions may become disruptive to the

¹²³ An internal debate on the content of submissions will no doubt take place, but such a debate can be conducive to achieving broader domestic support for policies and strengthening ownership.

¹²⁴ IEO (2003a), above footnote 28, at 44 [my emphasis]; at 53, the IEO expressly recommends early publication of 'any unfavorable information'. Also see IEO (2004), above footnote 27, at 71: 'An important lesson of the Argentine experience is that *strong ownership should not deter the IMF from forcefully making its views known*. The IMF should be prepared not to support a strongly owned program, if it is judged inadequate in generating a desired outcome, but should be prepared to explain the rationale and evidence behind such decisions.' [My emphasis]

¹²⁵ See discussion above, especially footnote 121. Also see IEO (2004), above footnote 27. The latter report says that market actors were puzzled by the Fund's actions in the Argentinean crises and that the Fund's endorsement of bad domestic policies did not help restore the confidence of commercial banks, which were well aware that problems continued to persist.

continuance of the lending process and various groups may seek to challenge or influence the Fund's operation. In addition, publicity can discourage countries from revealing information to the Fund and making submissions.¹²⁶ These concerns over publicity can be resolved by modifying the publication requirement. Publication of submissions or of the Fund's reasons for its decisions need not occur in the midst of the process of application and negotiations. There are two main options. First, the Fund may publish the reasons for its decision, including all relevant documents, after a certain period of time following the conclusion of the loan agreement. Accordingly, the information will no longer have any effect on the lending process or on the economy of the country. Second, it may be possible to leave the publication to the discretion of the country. The Fund will deliver its reasons to the member country, and the country will consider whether it wishes to publish the information.

The second option has the advantage of being able to protect a country from disclosure of information that may be sensitive to its economy. But this is not a compelling advantage. Under the first option, the country hardly needs protection because the information published will have already become stale. More fundamentally, the first option is preferable because of the benefits of ex post review and mutual study. It ensures that countries can learn from the experience of other countries. Programs, policies and the Fund's review can be deliberated, criticized and improved – for the benefit of all countries.

It should be emphasized, however, that these two options have one significant drawback. Under both options there would be less scope for timely criticism of the Fund's decisions and discussion of alternative choices. The country which is directly affected by the Fund's decision may not be able to influence the Fund to agree to its position through public and academic pressure. Again, there is no need to make a conclusive determination for the present purposes as

¹²⁶ Although note that, as discussed above, countries will also have an incentive to disclose information to the extent that this will allow them to get financial assistance on the basis of owned policies. In addition, it should be added that published reasons should be limited to those necessary to explain a decision and must not extend to general and irrelevant information on a country's economic situation.

regards which option is preferable. The point is that there should be a balance between the benefits of timely criticism as against the potentially (and arguably) harmful effect of publicity on the lending procedure and the economy of the applying country.

V. Legalization, Formalization and the Role of the IMF

Legalization has been broadly defined by reference to three dimensions: obligation, precision and delegation.¹²⁷ At present the degree of legalization of the Fund's activities is regarded as relatively low,¹²⁸ although this may be less accurate when considering conditionality apart from other Fund activities.¹²⁹ In any case, if the proposal for self-imposed conditionality is adopted, the procedure for applying to the Fund and its operation will be substantially legalized and formalized. Instead of having a relatively informal procedure whereby the Fund negotiates arrangements with member countries, the Fund and member countries will have to follow a regularized procedure and act within specifically defined powers.

As pointed out by Kahler, it is impossible to specify in generalized terms the consequences of legalization and formalization.¹³⁰ Although legalization may lead to improved compliance of member countries and increased credibility and legitimacy of international institutions, it may also create various costs, such as administrative costs, sovereignty costs, etc. The consequences of legalization depend on its substance and on the institution in question.

¹²⁷ Kenneth O. W. Abbott, Robert Keohane, Andrew Moravcsik, Anne-Marie Slaughter & Duncan Snidal, 'The Concept of Legalization', *International Organization*, Vol. 54, Issue 3 (June 2000), 401. Obligation means that states or other actors are bound by a rule or commitment or a set of rules or commitments. Precision means that rules unambiguously define the conduct they require, authorize and prescribe. Delegation means that third parties have been granted authority to implement, interpret, and apply the rules.

¹²⁸ *Ibid.*. The Fund has a low level of obligation and precision, but a high to moderate level of delegation.

¹²⁹ The Fund has various tasks including surveillance and consultation. Conditionality probably has a higher degree of obligation and precision than the Fund's other activities. Once included in loan agreements, conditions are fairly precise and binding on member countries.

¹³⁰ Miles Kahler, 'Conclusion: The Causes and Consequences of Legalization', *International Organization*, Vol. 54, Issue 3 (June 2000), 661.

I argue above that in the context of the Fund's operation legalization will provide various benefits to the Fund and its client member countries. Legalization will grant legitimacy to the Fund's power to intervene in countries' internal affairs, increase transparency and accountability of the Fund's decision-making process, and enhance the participation of developing countries. In addition, legalization is likely to improve compliance with conditions, not only because of increased ownership, but also because it strengthens countries' commitment to abide by their obligations pursuant to these conditions.¹³¹ Within the developing countries, legalization can also lead to specialization because governments will have incentives to train people to engage with the Fund.

Legalization may also lead to a change in the Fund's function. Instead of trying to tell countries in financial distress what to do, it will assume a role as educator of developing countries. The manner in which the Fund will apply its review powers over conditions proposed by member countries will signal to member countries the Fund's understandings of the limits of reasonable economic policy-making.

The Fund can further assume the role of educator by continuing to make its information resources available to all member countries, especially those applying to it. The Fund will retain a record of all case-studies and precedents that the new procedure will generate. These cases may in fact lead to a convergence of economic ideas and economic thought. Likewise, they can increase our understanding of the effectiveness of alternative policies in similar situations. The Fund thus will keep information on potential economic solutions and regulatory structures.¹³²

Member countries, especially developing countries, will be able to use these resources to study

¹³¹ Beth A. Simmons, 'The Legalization of International Monetary Affairs', *International Organization*, Vol. 54, Issue 3 (June 2000), 573. Simmons argues that legalization of international monetary affairs has improved compliance with the Fund's monetary rules under Article VIII of the Articles of Agreement because it increases countries' commitment to these rules and the reputational costs of renegeing on them. On this view, with further legalization of conditionality, countries' commitment to implement conditions could be strengthened.

¹³² As Pistor, above footnote 84 at 128, says in relation to international standard-setting, there ought to be '...a market for information on the scope of legal solutions to solve comparable problems, including information about how these solutions are tied into the general legal framework and the enforcement institutions'. Pistor's argument is equally applicable to the Fund's role as educator of domestic economies.

the experiences of other countries and choose the economic and regulatory frameworks that fit their political and social needs.

Furthermore, there are reasons to believe that the costs of legalization and formalization will not be substantial. The main costs of legalization, as pointed out by Kahler, are sovereignty costs and the costs of inflexibility of policy-making.¹³³ As to the former, my proposal accords more respect to the sovereignty of member countries than the current system. As to the latter, the proposal is inherently flexible because it does not prescribe predetermined solutions or obligations. In fact, it is more flexible than the current system because it is designed to give effect to a wider range of ideas and policies. Finally, the potential costs of delay and administrative costs have been discussed above.

VI. Conclusion

The proposal for self-imposed conditionality has many benefits. It is likely to lead to increased participation, transparency and accountability, better compliance with loan conditions, more respect for sovereignty, and less strife between the Fund and developing countries. The Fund can assume a role as educator of developing countries, which in turn will have greater incentive to improve their economic policy-making. The procedure for self-imposition of conditions and the Fund's review of proposed conditions are likely to induce mutual study of the international financial system through a deliberative process. Most importantly, the procedure is likely to generate better economic programs for economic recovery, recognizing that in some instances domestic officials know best, whereas in other instances intervention by external professionals is required.

The main difficulty with the proposal may be its implementation. Developed countries and the Fund may be reluctant to cede control over the lending mechanism. This is unjustified, because the proposal contemplates that the Fund will retain the power to strike down

¹³³ Kahler, above footnote 130, at 664-665.

unreasonable conditions. Developing countries may resist legalization because of the transparency element and because it makes non-compliance with conditions more difficult. In addition, as I discuss above, concerns over issues, such as, the costs of resources, delay in program design and the publicity of the procedure need to be addressed. Perhaps the move towards self-imposition of conditions should be accomplished gradually and with some experimentation before changing the current system.

I also note that there are several issues that merit consideration but are not discussed in this paper. One example is the question of which instrument is best suited to accommodate the proposed procedure: an amendment to the Articles of Agreement, a Board resolution, or internal guidelines. Another important issue concerns the question of who within the Fund will be responsible for making decisions on the reasonableness of country's submissions and for providing the reasons for such decisions: the Fund's management, the Executive Board, or both.¹³⁴ Consultations with civil society should also be duly incorporated into the procedure, although not necessarily via formal arrangements.

Finally, it is also worth noting that this proposal is not incompatible with other reform proposals that concern financial crises of developing countries, the international bankruptcy procedure in particular. International bankruptcy assumes that the Fund will continue to lend to member countries.¹³⁵ Accordingly, reform of the lending procedure and conditionality is necessary irrespective of other reform initiatives.

¹³⁴ A plausible solution would be for the Fund's management to provide a full account of its view of the reasonableness of submissions. If the Board decides to depart from the views of the staff, it will have to provide its own explanation. Both the staff's account and the Board's decision will be published.

¹³⁵ See Hal S. Scott, 'A Bankruptcy Procedure for Sovereign Debtors?', *Int'l Law*, Vol. 37 (2003), 103; Anne Krueger, Address at Institute for International Economics Conference on Sovereign Debt Workouts: Hopes and Hazards, *New Approaches to Sovereign Debt Restructuring: An Update on our Thinking* (April, 2002), at <http://www.imf.org/external/np/speeches/2002/040102.htm> (last visited 10 September 2004).