IMF CONDITIONALITY AS INVESTMENT REGULATION –

A THEORETICAL ANALYSIS

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I. INTRODUCTION

The proper role for the International Monetary Fund ("IMF") is a controversial topic. Since at least the 1980s the IMF has attracted criticism for excessively interfering with the economic sovereignty of developing countries.[1] Following the Asian, Russian and Argentinean financial crises in the late 1990s, prominent U.S. economists have jumped on board, charging the IMF with pursuing policies which do not work.[2] This tension has led to a vigorous debate amongst commentators about whether reform of the "international financial architecture" is required, and if so, how.[3] Indeed, between 1997 and 2000, no less than five reports evaluating the IMF's record were generated.[4]

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[1] *See, e.g.*, Richard Gerster, *The IMF and Basic Needs Conditionality*, 16 JN'L INT'L TRADE LAW 497 (1982); JOHN WILLIAMSON, IMF CONDITIONALITY (1983); and THE POLITICAL MORALITY OF THE INTERNATIONAL MONETARY FUND (Robert J. Myers ed., 1987).

[2] *See, e.g.*, Dani Rodrik, *How Should Structural Adjustment Programs Be Designed?*, 18 WORLD DEVELP'T 933 (1990); Jeffrey Sachs, *The IMF is a Power Unto Itself*, speech delivered at Harvard University on December 11, 1997, *available at* <http://pages.stern.nyu.edu/~nroubini/asia/AsiaCrisisSachsViewFT1297.html> (last visited March 20, 2003); Tony Killick, *Principals, Agents and the Failings of Conditionality*, 9 J. INT'L DEVELOP'T 483 (1997); JOSEPH STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS (2002); and MICHAEL MUSSA, ARGENTINA AND THE FUND: FROM TRIUMPH TO TRAGEDY (2002).

[3] *See, e.g.*, BARRY EICHENGREEN, TOWARDS A NEW INTERNATIONAL FINANCIAL ARCHITECTURE (1999); and PETER B. KENEN, THE INTERNATIONAL FINANCIAL ARCHITECTURE (2001).

[4] (1) JOSE DE GREGORIO, BARRY EICHENGREEN, TAKATOSHI ITO & CHARLES WYPLOSZ, REPORT ON AN INDEPENDENT AND ACCOUNTABLE IMF (International Center for Monetary and Banking Studies, Geneva and Center for Economic Policy Research, London, 1999); (2) COUNCIL ON FOREIGN RELATIONS, INDEPENDENT TASK FORCE REPORT: SAFEGUARDING PROSPERITY IN A GLOBAL FINANCIAL SYSTEM: THE FUTURE OF THE INTERNATIONAL ECONOMIC ARCHITECTURE (Carla A. Hills and Peter G. Peterson, Co-Chairs; Morris Goldstein, Project Director, 1999); (3) Montek S. Ahluwalia, *The IMF and the World Bank in the New Financial Architecture* in INTERNATIONAL MONETARY AND FINANCIAL ISSUES FOR THE 1990S,

For its part, the IMF has responded to recent criticism and reformed its policies in some key areas, such as public relations and conditionality terms for gaining access to IMF credit. The IMF's tone has become considerably more diplomatic and conciliatory. One might argue that commentators should now suspend judgment and give these changes time to take effect.

I am not so sure. This paper argues that deeper changes still are required. To this extent, I am in the company of many of the recent IMF reports. But not necessarily for the same reasons. I hope to bring a different perspective to the debate. Most critics have assessed the IMF globally, from a primarily economic slant. Their main concern is whether what the IMF does actually works. This paper focuses on the specific (but often overlooked) intersection between the IMF and foreign investment, and takes a primarily legal approach.[5] My main concern is whether IMF conditionality is good investment regulation.

This topic is important for two reasons. First, foreign investment is the major driver of the world economy, already eclipsing trade in goods as a determinant of global economics.[6] But, compared to trade law, its rules are unclear.[7] Examining the IMF's

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Vol. XI, (United Nations, 1999) [unofficial report prepared for the G-24 countries]; (4) OVERSEAS DEVELOPMENT COUNCIL, THE FUTURE ROLE OF IMF IN DEVELOPMENT (2000); and (5) INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION, THE MELTZER COMMISSION FINAL REPORT: THE FUTURE OF THE IMF AND THE WORLD BANK (2000). As to (5), *see* U.S. Treasury, *Response to Report of the International Financial Institution Advisory Commission* (2000). *See generally*, John Williamson, *The Role of the IMF: A Guide to the Reports* (IIE Policy Brief, May 2000).

[5] That is not to say there is no work on the legal aspects of the IMF. The writing of Sir Joseph Gold, General Legal Counsel for the IMF from 1960 to 1979, is well known and is discussed *infra* in Part III.

[6] *See* WORLD BANK, GLOBAL DEVELOPMENT FINANCE: ANALYSIS AND SUMMARY TABLES 10 and Table 1.2 (2002), which states that the world economic slowdown in 2001 was "largely driven by investment cycles". Trade in services (which includes forms of investment) grew faster than trade in goods over the 1990s and has now overtaken trade in goods as factor of a country's GDP. WORLD BANK, GLOBAL ECONOMIC PROSPECTS AND THE DEVELOPING COUNTRIES 69 and 71 (2002). *See also* WORLD BANK, GLOBAL ECONOMIC PROSPECTS AND THE DEVELOPING COUNTRIES 128 (2003), which shows that FDI inflows are growing much faster than exports and output in developing countries.

impact helps clarify the *realpolitik* of investment regulation. Second, although investment is not one of the core functions of the IMF, it is an area in which the IMF is actively involved. This article uses investment as a prism to shed light on how the IMF works and how it should work.

This paper is best understood as part of a larger research project.[8] The empirical part of this project will examine the nature and degree of IMF foreign investment regulation through its conditionality policies. This paper *assumes* (but does not establish) that some regulatory effect does exist and seeks to explain why this is important.[9] Below, I argue that there are significant legal, practical and institutional implications of IMF regulation of foreign investment, which for the purposes of this paper (and as explained in Part III) includes foreign direct investment, portfolio investment and privatization.

II. REGULATION, CONDITIONALITY AND THE IMF

A. Regulation by Appropriation

It may be convenient to explain what I mean by "IMF regulation". To economists, regulation refers to "almost any external control of business"[10] and can take a variety of forms, ranging from non-binding codes of conduct (self-regulation),[11] to corrective tax incentives,[12] to domestic laws,[13] to international agreements.[14] Lawyers have

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[7] There is no multilateral treaty, such as the General Agreement on Tariffs and Trade ("GATT"), prescribing international investment rules. *See infra*, Part III, for a short discussion of the failed Multilateral Agreement on Investment ("MAI").
[8] To be undertaken as part of a J.S.D. degree at Columbia Law School.
[9] Some basis for this assumption is referenced *infra*, note 21.
[10] ANTHONY OGUS, REGULATION, ECONOMICS AND THE LAW ix (2001).
[11] *See* Anthony Ogus, *Rethinking Self Regulation*, *in* REGULATION AND DEREGULATION: POLICY AND PRACTICE IN THE UTILITIES AND FINANCIAL SERVICES INDUSTRIES (C. McCrudden ed., 1999).
[12] *See* Robert Dunbar, *Tax as a Regulatory Tool: The Case of the Proposed Climate Change Levy*, *in* REGULATION AND MARKETS BEYOND 2000 (L. Macgregor, T. Prosser and C. Villiers eds. 2000); Anthony Ogus, *Corrective Taxation as a Regulatory Instrument*, *in* REGULATION AND DEREGULATION, *supra* note 11;

traditionally adopted a narrower view, tending to think of regulation as referring to technical rules of public law enforced by government, or semi-autonomous, agencies.[15]

This divergence underscores the point that different legal tools may sometimes achieve similar economic effects. A form of regulation well-known to economists, but perhaps less so to lawyers, is regulation by appropriation – or regulation through conditionality on credit disbursement. This "soft" regulation is a way of influencing indirectly what an entity may not wish, or be able, to control directly.[16] Regulation by appropriation can be seen at all levels of society. Every business which has negotiated finance realizes the power that the bank's loan conditions place on operations. The same is true for individuals or organizations who receive government grants tied to specific conduct criteria.[17]

Regulation by appropriation also exists on a municipal and national level, whenever one political entity is dependent upon funding from another political entity. In the United States, the terms of federal grants have led to much jurisprudence and commentary on the scope of the "spending clause" in Article I, section 8, clause 1 of the U.S. Constitution. Under this provision, the Federal Government may tax and

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and *Corrective Taxes and Financial Impositions as Regulatory Instruments*, *in* REGULATION, ECONOMICS AND THE LAW, *supra* note 10. *See also* W. J. Baumol, *On Taxation and the Control of Externalities*, 62 U.S. ECON. REV. 307 (1972).

[13] Thomas J. Long, *Telecommunications Regulation in the USA: Seeking the Right Balance Between Regulation and Competition*, *in* REGULATION AND MARKETS, *supra* note 12.

[14] *See, e.g.*, JAN KLABBERS, AN INTRODUCTION TO INTERNATIONAL INSTITUTIONAL LAW (2002).

[15] Anthony Ogus, REGULATION, ECONOMICS AND THE LAW, *supra* note 10, ix.

[16] For example, Albert Rosenthal poses the question in the context of U.S. Federal grant disbursement as "…whether the federal government could constitutionally regulate matters otherwise beyond its power, through the device of attaching conditions to expenditures of money….As with most difficult, and therefore interesting, legal questions, the answer is not 'always' or 'never', but 'sometimes' or 'it depends'." *Conditional Federal Spending and the Constitution*, 38 STAN. L. REV. 1103, 1161 (1987).

[17] In the U.S., conditions on federal grants to individuals or organizations may be struck down if these conditions require the individual or organization to relinquish a constitutional right. *See, e.g.*, Roberta J. Sharp, *Holding Abortion Speech Hostage: Conditions on Federal Funding of Private Population Planning Activities*, 59 GEO. WASH. L. REV. 1218 (1991).

appropriate funds to the several states for the "general Welfare" of the Union. But federal grants are usually conditioned on the states implementing certain policies. In this way, grants are used as tools for the Federal Government to seek through indirect pressure results which it cannot command through law.[18] In one notable example, after the Supreme Court struck down a federal law banning guns in school zones,[19] President Clinton announced that he would achieve the same result indirectly through the spending clause.[20] I will return to the U.S. analogy later in this paper.

And of course regulation by appropriation exists too on an international level, whenever funds given to a country – whether pledged by another country, a private donor or an international organization – are conditional on performance. Obviously there will be differences in the strength, coerciveness and effect of different donor conditions. So terming all conditional credit disbursement soft regulation is not to make a value judgment about its legitimacy. It is merely to use consistent taxonomy.

The IMF is a leading administrator of regulation by appropriation through its conditionality policies. Over time, its conditions have embraced broad aspects of a country's legal and economic development. Even through the IMF has no specific brief

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[18] *See. e.g.*, *South Dakota v. Dole*, 483 U.S. 203 (1987) (Grant required adoption of minimum drinking age of 21 years); *Nevada v. Skinner*, 884 F.2d 445 (9th Cir. 1989) (Grant required adoption of maximum speeding limit of 55 miles); and *New York v. U.S.*, 505 U.S. 144 (1992) (Grant required states to dispose of radioactive waste within their borders, or form "regional compacts" with other states to do so).
[19] *United States v. Lopez*, 514 U.S. 549 (1995).
[20] Clinton stated that he would seek to "encourage states to ban guns form school zones by linking Federal funds to enactment of school-zone gun bans". *See* "Clinton Seeks Way to Retain Gun Ban in School Zones", *N.Y. Times*, Apr. 30, 1995, A1; "Clinton Says Gun Ruling is a Threat; President Will Seek to Renew Bank on Schoolyard Firearms", *Wash. Post*, Apr. 30, 1995, A1.

to control foreign investment, its expansive view of its mission has led it to focus on investment as an important engine of economic growth.[21]

B. What is the IMF, and What Does it Do?

The IMF was the central achievement of the Bretton Woods conference in 1944.[22] The IMF's Articles of Agreement (the "Articles") created, for the first time, a codified international monetary system, designed to prevent the economic disintegration of the interwar years. The IMF's purposes are defined in Article I and require the IMF, among other things, "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation".[23]

Exchange stability was to be achieved in two ways. First, the IMF Articles mandated a fixed (but adjustable) "par value" system of exchange rates.[24] Once set, each member was required to maintain that par value, through intervention in the market if

[21] A recent IMF report states that: "[Capital account liberalization]…is often accompanied by a tightening of macroeconomic policy, sometimes in the context of an IMF-supported program. In Central and Eastern Europe, for example, almost all IMF-supported programs entailed measures to facilitate inflows of foreign capital, foreign direct investment in particular". Eichengreen, Mussa et al., *Capital Account Liberalization: Theoretical and Practical Aspects* 38, IMF Occasional Paper 172 (1998). Many authors have noted the IMF's interest in capital account liberalization. *See, e.g.,* Morris Goldstein, *IMF Structural Conditionality: How Much is Too Much?* 54 55 (2000), unpublished manuscript *available at* <http://www.ids.ac.uk/eldis/imfstruct.htm> (last visited January 28, 2003) (relating to Korea); STIGLITZ, *supra* note 2 (relating to capital market liberalization generally); and POLITICAL MORALITY, *supra* note 1, 34 (relating to liberalization, including of capital flows). *See generally* the IMF's *Annual Report on Exchange Arrangements and Exchange Restrictions* (IMF, various issues), which closely examines the liberalization of members' investment regimes.

[22] The conference was held in Bretton Woods, New Hampshire in July 1944.

[23] IMF Articles, I(iii).

[24] A par value system was a variation of the "gold standard" which had prevailed prior to World War I. Under the gold standard, each state fixed the price of their currency in terms of the price of gold. Under the par value system, each state fixed the price of their currency to the U.S. dollar or to gold. In practice, the U.S. fixed the price of the dollar to gold, and every other state fixed the price of their currency in terms of the U.S. dollar. *See generally,* ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 524-525 (2002); PAUL R. KRUGMAN & MAURICE OBSTFELD, INTERNATIONAL ECONOMICS: THEORY AND POLICY 549-551 (1997).

necessary.[25] Secondly, the IMF could lend money to members to help them deal with temporary balance of payments deficits in a manner which (unlike, for instance, a sharp tightening of monetary or fiscal policy) would not be "destructive of national and international prosperity".[26] In short, the IMF's role was to be something between an international credit union and an international reserve bank.

Over time, the functions of the IMF have evolved. The par value system collapsed in 1971.[27] Despite attempts at revival, the international monetary system now works on floating rates determined by market forces. The IMF has adapted by changing its role from a provider of short-term funds under fixed exchange rates to a manager of world financial crises and a long-term lender to developing countries.

The IMF has also developed its drawing rules. On joining the IMF, each member is assigned a quota which determines both its contribution to and ability to draw on the IMF General Reserve Account ("GRA"), as well as its voting rights.[28] From the outset, contributions have been paid in the proportions of one–quarter hard assets (gold, or the IMF's currency, Special Drawing Rights ("SDRs")), and the remainder in members' own currencies.[29] This first quarter, known as the "reserve tranche", may be automatically drawn on.[30] A member may also draw up to 200% of their quota through accessing so-

[25] IMF Articles, IV(3). The fixed value of a currency could, however, be altered in the event of a "fundamental disequilibrium". IMF Articles, IV(5).
[26] IMF Articles, I(v). Note that the legal form of the transactions is not a loan, but rather a purchase of a foreign freely-transferable currency (such as U.S. dollars) with a member's own currency, coupled with an obligation for the member to repurchase its own currency with the foreign currency within a specified timeframe. The economic effect is, however, equivalent to a loan. *See generally* LOWENFELD, *supra* note 24, 512.
[27] When the U.S. announced that it would no longer automatically convert foreign-held dollars into gold. *See* LOWENFELD, *supra* note 24, 526.
[28] Article III(1) and Article XII(5).
[29] Article III(3).
[30] *See* the 1946, 1948 and 1952 decisions on conditionality, summarized in LOWENFELD, *supra* note 24, 513-515.

called "credit tranches" (each tranche is equivalent to 25% of quota).[31] Requests to draw on credit tranches are subject to conditions, with a relatively basic test for the first credit tranche, but more rigorous conditions for the "upper" tranches. Over time, the IMF has developed increasingly sophisticated conditionality policies, which are discussed in more detail below.[32]

For present purposes, there are three important IMF lending mechanisms. Firstly, the *Stand-By Arrangement* ("SBA"), through which most applications for GRA credit tranches are made. This arrangement typicallylasts for 12-18 months and allows the IMF to undertake investigations necessary to approve a loan before an acute balance of payments difficulty arises.[33] Secondly, the *Extended Fund Facility* ("EFF"), which functions like a stand-by arrangement, but typically lasts for three years.[34] Thirdly, the *Poverty Reduction and Growth Facility* ("PRGF"), which is an independent credit line provided outside the GRA. For this reason, it is not subject to many of the rules contained in the IMF's Articles. The PRGF is a specific mechanism for "structural adjustment", which can include capital market and privatization reform.[35]

III. IMPLICATIONS OF IMF INVESTMENT REGULATION

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[31] Article V(3)(b). Although the 200% ceiling can be (and has been) waived. *See* Article V(4).

[32] *See* IMF, *Guidelines on Conditionality* (March 2, 1979). Recently, in response to international criticism, the IMF revised its conditionality guidelines to reduce the number of conditions and emphasize country-ownership of reform. IMF, *Guidelines on Conditionality* (September 25, 2002). The new guidelines are discussed in Part III.B, *infra*.

[33] An SBA involves: (1) a letter of intent from a member setting out the policies the member commits to implement; and (2) a cover note in which the IMF grants a limited term line of credit "to support [the] objectives and policies" set out in the letter. *See* LOWENFELD, *supra* note 24, 515. The legal status of SBAs is unclear, as they are explicitly not written as contracts. Repayment is required within 2.25 and 5 years. IMF, *Factsheet: How Does the IMF Lend?* (April 2003).

[34] Repayment is required within 4.5 and 10 years. IMF, *supra* note 33.

[35] Until 1999, this was known as the Enhanced Structural Adjustment Facility ("ESAF"). *See generally* IMF, FINANCIAL ORGANIZATION AND OPERATIONS OF THE IMF, Pamphlet Series No. 45 (6th ed., 2001).

This paper assumes that through the three lending mechanisms above the IMF influences international investment in some debtor countries. By this, I mean that some instances of these facilities have been or are conditional on the debtor country enacting policies aimed at liberalizing foreign investment.

First, some definitions. What sort of policies are directed at foreign investment? There are three relevant policy areas: foreign direct investment ("FDI") controls; portfolio investment controls; and policies relating to the ownership of national resources and infrastructure. The first two are evidently investment policies. The latter is also, but less evidently, related to investment. This is because a key aim of privatizing public assets is to increase the opportunity for FDI through acquisition. Even if this does not happen initially (for instance, when shares in newly privatized corporations are distributed to the domestic population) it is a very likely downstream consequence.

This defines investment. But what does investment "liberalization" mean? Liberalization is a slippery term to define,[36] but it essentially refers to the removal of barriers to entry and operation. In theory, a perfectly liberalized investment regime has three core features: (1) *right to establishment*: the regime would not ban, restrict, condition or subject to approval, investment transactions; (2) *national treatment*: the regime would not discriminate against foreign investors in favor of nationals;[37] and (3) *privatized infrastructure*: all commercially viable public assets would be transferred to private hands and would be available for purchase by foreigners. Throughout this paper I

[36] This difficulty is noted in Eichengreen, Mussa et al, *supra* note 21, 11.
[37] The Word Bank has written: "Promoting liberalization in international investment essentially boils down to securing nondiscriminatory terms of entry and operation": WORLD BANK, GLOBAL ECONOMIC PROSPECTS 124 (2003). Obviously, in practice, there are other important features of a liberalized investment regime. Two which come to mind are: (1) establishing strong investor protections; and (2) curbing investor-distorting policies, such as local content or performance requirements.

term the package of policies which tends towards these outcomes as the "investment liberalization formula".

Having assumed the IMF promotes the formula, one might ask "so what"? Does it really matter that the IMF has a finger controlling investment? One might argue that this is an unqualified good. After all, foreign investment is a major driver of economic growth. By encouraging investment liberalization, the IMF is prescribing policies which are theoretically good for debtor countries. Moreover, the IMF advocates reforms which many inside the country want to implement, and may provide the political leverage to permit reforms to take place. The IMF is entitled to a return on its investment and has an obligation to lend responsibly. There is no reason to expect any type of loan without repayment conditions.

My answer is two-fold. To start, even if IMF investment regulation is an unqualified good, it is important to acknowledge and study its effects – and its relationship to more traditional forms of regulation. The place of IMF conditionality in the international investment framework is therefore the first part of my discussion in section A below.

Second, it is far from clear that IMF investment regulation is an unqualified good. There are three main concerns, addressed respectively in sections B through D below. First, investment regulation is likely outside the IMF's mandate. Second, the legitimacy of such regulation is questionable, given its asymmetric application as between rich and poor countries and its tension with concepts such as democracy and political accountability. Third, for structural reasons, IMF investment regulation may simply be ineffective. After discussing these issues, I conclude that, even if the IMF is prescribing the right policies,[38] IMF conditionality is not the vehicle through which to implement them.

A. Coherence: theRelationship of IMF Conditionality to Traditional Forms of Investment Regulation

In 1998, negotiations for a Multilateral Agreement on Investment ("MAI"), conducted by the Organization for Economic Cooperation and Development ("OECD"), ended in failure. This failure was partly due to opposition from developing countries and non-governmental organizations.[39] If successful, the MAI would have been the investment equivalent of the GATT. As it is, the failure of the MAI underscores the lack of consensus, even amongst OECD members, as to appropriate rules for foreign investment and the proper balance between international investment regulation and domestic sovereignty.

Following the MAI's failure, there remain at least three traditional sources of international investment law. First, there is customary international law relating to foreign investment. In the main this is relatively rudimentary and focuses on expropriation and compensation issues.[40] Second, many states have now entered into bilateral investment treaties ("BITs") which govern aspects of investment relationships involving the two party states. While BITs have grown at a prolific rate,[41] they have

[38] There are some who would disagree with this proviso. *See, e.g.*, STIGLITZ, *supra* note 2.
[39] EDWARD M. GRAHAM, FIGHTING THE WRONG ENEMY: ANTIGLOBAL ACTIVISTS AND MULTINATIONAL ENTERPRISES 12 (2000); KENNETH W. DAM, THE RULES OF THE GLOBAL GAME 175 (2001).
[40] The key rule is that, although a state may expropriate property of a foreign investor (if it acts in a non-discriminatory manner and does not break binding contracts), the state must pay appropriate compensation. *See* LOWENFELD, *supra* note 24, 515. There is continuing debate over whether "appropriate" compensation incorporates the "Hull doctrine" of "prompt, adequate and effective" compensation. *Id.*, 414; Patrick M. Norton, *A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation*, 85 AM. J. INT'L L. 474, 476 (1991).
[41] As of 1998, more than 1300 BITs were in existence: *see* Kenneth J. Vandervelde, *Investment Liberalization and Economic Development: the Role of Bilateral Investment Treaties*, 36 COLUM. J.

largely focused on post-establishment FDI only, and have not usually prescribed substantive investment strategies.[42] Third, some regional trade agreements ("RTAs"), notably the North American Free Trade Agreement ("NAFTA"), include investment rules similar to those found in BITs (although NAFTA addresses entry as well as post-establishment issues).[43] The European Union, through its free trade area, has more expansive investment rules again.[44]

More recently, the World Trade Organization has intervened in the investment field. The General Agreement on Trade in Services ("GATS") and the Trade-Related Aspects of Investment Measures ("TRIMS") both restrict the investment policies open to WTO members.[45] There are also softer legal instruments, such as the OECD Code of Liberalization of Capital Movements, which encourage in a flexible and non-binding manner the easing of restrictions on capital transfers.[46] The chart below compares the scope and membership of the different regulatory tools.

Regulatory Tool	**Scope**	**Membership**

TRANSNAL'L LAW 501, 503 (1998). Today, there are almost 2000. WORLD BANK, GLOBAL ECONOMIC PROSPECTS 120 (2003).

[42] Such as privatization or capital market liberalization. *See id.* at 512. *See also* Georgio Sacredotti, *Bilateral Treaties and Multilateral Instruments of Investment Protection*, 269 RECUIL DES COURS, TOME 255 (1997). BITs generally contain post-establishment rights of national treatment, most favored nation ("MFN") treatment, fair and equitable treatment and compensation for expropriation. BITs also allow for direct investor-state arbitration. Note that the U.S. Model BIT (1984) does grant entry rights subject to sectors excluded by an Annex.

[43] *See* NAFTA, Chapter 11. NAFTA is modeled on a BIT and guarantees national treatment (Art. 1102), MFN treatment (Art. 1105), fair and equitable treatment (Art. 1107) and compensation for expropriation (Art. 1110). NAFTA also allows for direct investor-state arbitration.

[44] *See* Treaty establishing the European Community, Title III, Chapters 2 and 4, especially Article 43 (right to establishment), Article 49 (right to trade in services without restrictions) and Article 56 (right to transfer capital without restrictions).

[45] The GATS applies to all "trade in services" which phrase is defined to include four modes of supply. Mode 3, "supply of a service…by a service supplier of one Member, through commercial presence in the territory of any other Member" encompasses many forms of FDI: GATS, I(2)(c). The GATS has specific application to financial services. *See* GATS, Annex on Financial Services, Art. 5. The TRIMS essentially clarifies obligations existing in the GATT: *See* TRIMS, 2 and Annex.

[46] Another such instrument is the Asia Pacific Economic Cooperation ("APEC") Non-Binding Investment Principles.

Customary International Law	Addresses: Expropriation/compensation; and fair and equitable treatment (post establishment)	International community
BITs	Addresses: Expropriation/compensation; fair and equitable treatment; national/MFN treatment; and performance requirements (primarily post establishment)	Bilateral signatories
RTAs (NAFTA/EU)	Varied. NAFTA Chapter 11 resembles BIT protection but includes entry rights. EU guarantees right to establishment and allows free movement of people, services and capital.	Regional signatories / members
GATS	Requires liberalization of trade in services, including services provided through FDI. Particular concentration on financial sector.	WTO members
TRIMS	Requires elimination of trade balancing, domestic content and performance requirements.	WTO members
OECD Code	Encourages removal of restrictions on capital movements.	OECD members
IMF	Requires liberalization/deregulation of FDI and capital markets; and privatization of state assets.	IMF debtors

The chart shows that only the norms of international customary law and the WTO instruments have genuine range of application. Both require, however, only modest degrees of liberalization. Customary international law on investment is still stuck in a century-old debate as to the proper level of compensation for expropriation, and WTO coverage of investment is patchy – catching only investment incentives and FDI through provision of services – and is largely voluntary, depending on country decisions to schedule obligations.[47]

BITs are bilateral treaties, and so have necessarily limited coverage. They are usually signed between developed and developing countries and exist in such numbers that most countries are party to at least one BIT. They do not usually require broad-based liberalization, merely preferential investment treatment. They are, however, not always equal and do not always provide reciprocal obligations on both sides.[48] In many ways they are an asymmetrical instrument produced by heavily weighted bargaining power.[49]

The coverage of the remaining entries is demarcated on developmental lines. On the one hand there are the "rich" clubs, which include the OECD, NAFTA and the EU. Of these instruments, the OECD Code is not a binding treaty and does not require compliance – it is more of a "best efforts" prescription. NAFTA Chapter 11 resembles a more comprehensive BIT in terms of obligations. The EU investment regime is more comprehensive again. Indeed, the EU takes a general exception to the OECD Code so as to provide preferential treatment to its members. There are two important points. First, structural reforms, such as privatization, are not called for. Second, each instrument is exempt from the MFN discipline and benefits members only. Liberalization efforts are reciprocated by other attractive countries.

[47] An important feature of the GATS is that it operates on a "positive list" approach, which means that a member is not bound in respect of any service sector unless it has listed this sector in a schedule. Even once a sector is listed, exceptions can also be taken against specific GATS requirements.
[48] WORLD BANK, GLOBAL ECONOMIC PROSPECTS 127 (2003).
[49] Andrew T. Guzman, *Why LDCs Sign Treaties Which Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, VA. J. INT'L L. 639 (1998).

On the other hand there is IMF conditionality which, since 1977,[50] has applied exclusively to developing countries. The degree of liberalization the IMF formula seeks goes beyond that required by any of the other regulatory instruments – especially with its focus on privatization – but without securing any reciprocal benefits for the IMF debtor.

This simple comparison illustrates that there is an asymmetry between how rich and poor countries are encouraged to liberalize their investment policies, and who benefits from the advances that have been made. Despite the rhetoric of global economic liberalization, the biggest cooperative advances have been made only within the smallest, and wealthiest, groups. This is the so-called bicycle approach,[51] which famously bypasses less attractive countries.

The IMF cannot correct this asymmetry, which is a harsh geo-political reality. But it should be careful not exacerbate it. Arguably IMF conditionality prevents IMF debtors from being able to join multilateral systems by bargaining their barriers down. The IMF would likely argue that it is only through capital account liberalization that a country can achieve the sort of growth which would make it an attractive treaty partner. But this argument does not hold up. BITs are clear examples that developed countries see benefits in open investment access to developing countries – and are keen to exploit that advantage through their superior bargaining power.

But the bargaining power of developing countries to press for further or better BITs, for regional agreements with developed countries (a US-African or US-Asian Free Trade Agreement), or a resurrected MAI on more balanced terms, dilutes even further if

[50] When Great Britain and Italy applied for funding.
[51] The idea is that, even if an expressway (multilateral agreement) would be ideal, riding a bicycle (RTA) is a quicker way of getting to one's destination than standing still. For a variation of the metaphor by a leading opponent *see* JAGDISH BHAGWATI, FREE TRADE TODAY 118 (2002).

they are required to liberalize using IMF conditionality. A wealthy country will not compromise to gain something it can already get for free. So, even if conditionality were an otherwise unobjectionable way of regulating investment, its inherent asymmetry is troubling.

Conditionality is also haphazard. Goldstein has recently undertaken a study into the amount and types of IMF structural conditionality terms, which found that a typical one-year SBA program would include between 9 and 15 structural conditions and a typical three-year EFF program over fifty.[52] Of all conditions imposed on transition economies, 17 percent related to restructuring and privatization and 15 percent to financial sector reform.[53] Other conditions concerned public sector management, trade, agriculture, social security and energy reform. Such regulation seems arbitrary in comparison to the carefully crafted obligations which apply in the developed world, courtesy of the OECD, NAFTA and the EU.

There are other options. Most countries appreciate the importance of foreign investment and are moving towards unilateral liberalization. The IMF can constructively provide countries with technical advice and assistance to undertake these reforms, quite apart from financial support.[54] Treaties are another avenue. The WTO illustrates that a multilateral system of economic concessions is possible, even with disparate country participation. The IMF could encourage countries to join existing international treaties – and perhaps pressure treaty bodies such as the OECD to accept wider membership for

[52] Goldstein, *supra* note 21, 34.
[53] Goldstein, *supra* note 21, Figure 3.
[54] Goldstein, *supra* note 21, 58.

specific Codes – rather than requiring unilateral reform. The IMF could also play a policy role in suggesting templates for possible treaties and advising drafters.

B. The Legality of IMF Investment Regulation through Conditionality

(1) New IMF Conditionality Guidelines

As a response to criticism such as that from Goldstein, the IMF's 2002 Conditionality Guidelines are intended to signal a new, back to basics, approach. To this end, they make reference to concepts such as "parsimony" in the choice and amount of conditions and the need for country "ownership" of reforms. The Guidelines provide that programs should be directed primarily towards the twin goals of solving a member's balance of payment problems, and "achieving medium-term external viability while fostering sustainable growth".[55] Conditions should be imposed only if they are of "critical importance" in achieving these goals, in monitoring progress, or in implementing the IMF Articles "or specific policies adopted under them". In general, "all variables and measures that meet these criteria will be established as conditions".[56]

Guideline 7(b) sets specific criteria. Conditions will "normally" consist of macroeconomic variables and structural measures that fall within the IMF's "core areas of responsibility" – defined as "macroeconomic stabilization; monetary, fiscal and exchange rate policies, including the underlying institutional arrangements and closely related structural measures; and financial system issues related to the functioning of both domestic and financial markets".[57] This last clause could possibly include investment

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[55] 2002 Guidelines, *supra* note 32, cl. 6
[56] 2002 Guidelines, *id.*, cl. 7(a).
[57] 2002 Guidelines, *id.*, cl. 7(b).

measures. At any rate, the IMF may impose conditions outside of its core areas; but this "may require more detailed explanation of their critical importance".

Taken as a whole, the Guidelines appear to impose an administrative rather than a jurisdictional fetter on the IMF. Moreover, they are not very dissimilar from the 1979 Conditionality Guidelines which provided that:[58]

> Performance criteria will be limited to those that are **necessary** to evaluate implementation of the program with a view to ensuring the achievement of its objectives. Performance criteria will normally be confined to (i) **macroeconomic variables**, and (ii) those necessary to implement specific provisions of the Articles or policies adopted under them. Performance criteria may relate to other variables only in **exceptional cases** when they are essential for the effectiveness of the member's program because of their macroeconomic impact [emphasis added].

Indeed, whereas in 1979 non-core conditions could only be imposed in "exceptional cases", non-core conditions today can be imposed after "more detailed explanation of their critical importance". So the exceptionality threshold has been dropped. The view that the Guidelines are largely an administrative statement of intent is strengthened by the fact that much of the rhetoric advocating parsimony and ownership appears not in the Guidelines proper, but in an annexed Staff Statement on the "Principles Underlying the Guidelines on Conditionality".

It is interesting that the Guidelines do not ringfence any specific type of condition as outside the IMF's mandate. The concession is one as to degree (less conditions, imposed only when necessary) rather than kind (conditions must be of types A and B but not of types C and D). Guideline 7(b) comes closest to a jurisdictional division but is

[58] 1979 Guidelines, *supra* note 32, 9.

worded very modestly: "[c]onditions will *normally* consist of…". Below I argue that, in relation to investment conditions, this analysis is inconsistent with the IMF's Articles.

(2) Who Cares What the Law Says, Anyway?

First, however, a short explanation of why such legalism is important. Some economists might argue that the new Guidelines show that the IMF is moving in the right direction. This is progress and there is little to be gained in additionally determining whether the IMF is acting within the strict text of its outdated Articles. Considering how the functions of the IMF have evolved as the world has changed, the important questions are not legal but practical – do its measures work?

I agree that it is important to keep analysis of the IMF grounded in an appreciation of the varied roles it plays today and to always consider, normatively, what it should be doing. But I disagree that a focus on the IMF's actual mandate is unimportant. An entity's legal structure reveals much about its purposes and role; both as conceived and as adapted over time. An informed debate about the powers of the IMF is one of the most powerful ways to frame a wider discussion about its role in global governance.

Indeed, I am surprised that there has been so little explicit legal focus in the literature on the powers of the IMF. There have been some recent articles from within the IMF – by Stanley Fischer, Deputy Managing Director,[59] Francois Gianviti, General Counsel[60] and William Holder, Deputy General Counsel.[61] But there has been very little

[59] S. Fisher, *Capital Account Liberalization, in* CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW (1999).
[60] Francois Gianviti, *The International Monetary Fund and the Liberalization of Capital Movements, in* CURRENT DEVELOPMENTS, *id.*. See also the contribution from the IMF's former General Counsel: Joseph

commentary from outside. A notable exception is the helpful paper by Professor Cynthia Lichtenstein.[62] Given the intense scrutiny the IMF has weathered recently, it is strange that the question of jurisdiction has not been more prominently examined. Partly, this has to do with the constituency of experts familiar with the IMF. To date, these experts have largely been economists and public policy theorists. Their mission has been to critique the operations of the IMF and suggest how they could work better.

Other comparable institutions, particularly the World Trade Organization and the United Nations, have a more heavily "legal" constituency and are careful to avoid charges of excessive jurisdiction. This is reflected not only in their day-to-day operations, but also in the sort of institutional conduct which is tolerated. In the WTO, members fight tightly pitched legal battles over the meaning of terms such as "like product" or "least restrictive means" to determine whether a regulatory measure is WTO-consistent or not.[63] The institutional balance between the members (as legislators) and the Appellate Body (as the judiciary) is also closely monitored.

The analogy between the IMF and the United Nations is even sharper. Both were intended to ensure a period of peace and cooperation: the one through international political cooperation and restrictions on the use of force; the other through international monetary cooperation and restrictions on the use of exchange controls. But the U.N. has always been subject to tighter legal scrutiny. Its powers to intervene in conflicts such as

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Gold, *International Capital Movements under the Law of the International Monetary Fund*, Pamphlet Series No. 21 (IMF, 1977).

[61] William Holder, *Fund Jurisdiction Over Capital Movements*, 5 ILSA J. OF INT'L COMP. L. 407 (1999).

[62] Cynthia Crawford Lichenstein, *International Jurisdiction Over Capital Flows and the Role of the IMF: Plus Ca Change* in INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM (Mario Giovanoli ed., 2000). Unfortunately, Lichenstein decided against going "into any detail concerning the IMF's power to impose conditions on its lending to members that have access to its resources" (71).

[63] *See, e.g.*, the Appellate Body Report in *Korea – Measures Affecting Imports of Fresh Chilled or Frozen Beef* (adopted January 10, 2001).

Rwanda, Kosovo and Iraq are carefully vetted against the provisions of the Charter and its operations require a large degree of legal maneuvering. Just as the United Nations is scrupulous to avoid condemning, let alone regulating, conduct which is not prohibited by its Charter, the IMF must be careful not to overstep the grant of power given it by member nations in 1944.

(3) Looking Closely at the IMF's Articles of Agreement

My particular focus is whether the IMF has the power to prescribe investment terms as conditions for receipt of IMF funds.[64] There is some writing on the IMF's lack of jurisdiction over capital flows.[65] It is evident that the IMF has sought, but does not yet have, such power.[66] The real issue is whether conditionality policies illegitimately circumvent this rule. I argue that they do.

The IMF has six core purposes, set out in Article I. These are:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of

[64] As far back as 1977, Joseph Gold, the IMF's former General Counsel, wrote:
"The negotiators of the Fund's Articles decided that members would retain substantial authority over capital movements. Marginal authority was conceded to the Fund in the form of certain discretions. There has been no disposition to extend this authority by amendment. The Fund has not exercised the discretions expressly conferred on it, but its influence in practice, although far short of managerial, has probably exceeded the role foreseen for it by the founding fathers. This influence, as it true of other activities of the Fund, has been exercised by means of surveillance, consultation and persuasion, and, not least, by the creation of a body of principles for the use of its resources." Gold, *supra* note 60, 50-51.

[65] *See*, *supra*, notes 59 through 62.

[66] *See*, Fischer, *supra* note 59, 2; and Holder, *supra* note 61. Note that the IMF Interim Committee's proposed, in a Communiqué of 8 April, 1998, to amend the Articles to make capital account liberalization a specific purpose of the IMF. This amendment was never effected. The Fund can, however, request a member to impose exchange controls if the member appears to be using Fund resources to meet a "large or sustained outflow of capital", which is forbidden: Article VI(1).

unemployment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

Purposes (i), (iii), (iv) and (vi) focus on core monetary policy: monetary cooperation, exchange stability, unrestricted current transactions and balance of payments equilibrium. Purpose (ii) is wider and gives the IMF a mandate to encourage international trade, employment and economic growth. Purpose (v) deals with lending IMF general resources and is one of the textual pillars of IMF conditionality. The restriction to general resources should be noted. As explained below, the Articles provide a framework for lending under the General Resources Account ("GRA") only – that is SBA and EFF facilities. Lending outside the GRA, which includes the PGRF facility, is dealt with by the solitary Article V(2)(b):

> If requested, the Fund may decide to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund….

This means that the conditionality (and all other) rules for the PGRF are entirely administrative in nature and are subject only to the limitation that they be consistent with the IMF's purposes.

Lending under the GRA is further clarified by Article V(3) which elaborates on purpose (v). Article V(3)(a) provides that the Fund shall adopt policies on the use of its general resources, including policies on stand-by or similar arrangements "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".

Article V(3)(b) sets the conditions for members' access to the GRA. It provides that a member is "entitled" to make a purchase (drawing) from the Fund under the following conditions, of which (iii) and (iv) can be waived:

> (i) the member's use of the general resources of the Fund would be in accordance with the provisions of this Agreement and the policies adopted under them;
>
> (ii) the member represents that it has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves;
>
> (iii) the proposed purchase would be a reserve tranche purchase, or would not cause the Fund's holdings of the purchasing member's currency to exceed two hundred percent of its quota;
>
> (iv) the Fund has not previously declared under Section 5 of this Article, Article IV, Section 1, of Article XXVI, Section 2(a) that the member desiring to purchase is ineligible to use the general resources of the Fund.

Reading section 3(b) one might conclude that, provided the four conditions are satisfied, a member is "entitled" draw on the GRA. This is not how the IMF has interpreted the Articles.[67] Through extensive use of conditionality policies, the IMF has effectively removed any sense of entitlement to draw beyond the reserve tranche.[68] As might be expected, most debate now centers on the meaning of "adequate safeguards" in Article I(v)/Article V(3)(a). This phrase clearly gives the IMF the right to require some conditions for the use of IMF credit. The usual view is that the IMF's power to determine the detail of the conditions is extremely broad. Sir Joseph Gold has written:[69]

> The concept of conditionality has never been defined by the Articles or codified, beyond a few broad principles, by decisions of the Fund. The absence of a detailed code has enabled the Fund to develop and modify conditionality, as well as the form and content of stand-by and extended arrangements, to accord with changes in the world economy and with the special circumstances of individual members or classes of members.

There must be some limits however. For starters, the phrase "adequate safeguards" implies that conditions should be directed at ensuring repayment, not at an exogenous reform agenda. This is so even if "adequate safeguards" is read in the context of Article I(v)'s reference to preventing resort to destructive measures. Secondly, the concept that a member is entitled to purchase cannot be entirely undermined by restrictive conditions. Such an interpretation would be mischievous. Further, implicit in the proviso to Article I, in Article V(3)(b)(i) – and in the very notion of the rule of law – is the concept that the IMF's own policies must be in accordance with the Articles.[70]

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[67] Note the Executive Committee decisions of 1946, 1948 and 1952, referenced *supra* note 30.
[68] This was first made clear in the 1952 decision. *See, generally*, LOWENFELD, *supra* note 24, 513.
[69] JOSEPH GOLD, LEGAL AND INSTITUTIONAL ASPECTS OF THE INTERNATIONAL MONETARY SYSTEM: SELECTED ESSAYS 439 (1984). For other, not necessarily consistent, comment, *see e.g.*, LOWENFELD, *supra* note 24, 545 *et seq.*
[70] The proviso to Article I provides that "The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article". Holder appears to recognize this, stating: "This use of Fund resources [to address balance of payments difficulties] entails the imposition of conditionality, but the Fund's power in this respect is not unlimited; conditionality needs to be consistent with the Fund's Articles…". Holder, *supra* note 61, 7. Gianviti appears to agree. *Supra* note 60, 14.

This conclusion is spelled out in relation to non-GRA lending, which must be "consistent with the purposes of the Fund".

My thesis drives off this last point, and is that IMF investment regulation is inconsistent with the IMF Articles. This is because the IMF Articles remand capital transfers to *member* control. Article VI(3) provides that "[m]embers may exercise such controls as are necessary to regulate international capital movements…". This is in direct contrast to the rule in Article VIII(2)(a) that "…no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions". The combination of these two rules is at the heart of the IMF's jurisdiction: the IMF has authority to regulate current transactions,[71] but not capital account movements.[72]

(4) The Two Key Questions

There are then two questions to answer. First, what types of policies concern capital account movements? Secondly, does it follow that an IMF conditionality policy concerning capital account movements, whether under the GRA or not, is illegal?

As to the first question, Article XXX provides that:

> (d) Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:
>
> (1) all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;
>
> (2) payments due as interest on loans and as net income from other investments;

[71] In relation to current transactions, members must avoid both restrictions and discriminatory practices with respect to current transactions. Articles VIII(2) and (4).
[72] Though, again, note the IMF's ability to request capital controls to prevent member misuse of IMF Funds. *Supra*, note 65.

(3) payments of moderate amount for amortization of loans or for depreciation of direct investments;

(4) moderate remittances for family living expenses.

In essence, this provides that a payment is on current account if the underlying transaction for which the foreign currency is bought or sold involves good or services for which the prompt payment is made between a resident of the country concerned and a non-resident.[73] Paragraphs (2) and (3) give the IMF some limited jurisdiction over the proceeds of an investment, and also connected payments for interest and amortization purposes. But, these aside, payments on capital account are outside the bound of the IMF. Reasoning both from commonsense and by exclusion from Article XXX(d), capital payments include: (a) direct payments to establish or acquire a foreign business (FDI); and (b) payments to acquire foreign securities, including shares, bonds, stocks and other chattel paper (portfolio investment).

To see, then, what policies might fall within Article VI(3), we need to examine the relationship between the underlying transaction and the payments made in support of that transaction. In actual fact, the line between the transaction and the transfer payment is wafer thin.[74] A paper written by IMF economists helpfully divides capital controls into two categories: direct and indirect.[75] *Direct controls regulate the underlying transaction* and include prohibition of the investment; approval criteria for the payment; or conditions restricting types of investment (such as minimum stay requirements). *Indirect controls*

[73] Gold, *supra* note 60, 19; Lichtenstein, *supra* note 62, 66.
[74] *See generally* the OECD Code of Liberalization of Capital Movements, which was intended to fill the gap left open by the IMF's Articles and applies equally to controls which regulate the underlying transaction, and those which regulate the transfer payment.
[75] Akira Ariyoshi, Karl Habermeier, Bernard Laurens, Inci Otker-Robe, Jorge-Ivan Canales-Kriljenko and Andrei Kirilenko, *Capital Controls: Country Experiences with Their Use and Liberalization*, IMF Occasional Paper No. 190, (2000).

regulate the transfer and include taxes (such as a Tobin Tax) on foreign exchange transactions; reserve requirements for foreign exchange transactions; or dual exchange rates with a higher rate applying to foreign exchange transactions.

Both direct and indirect controls are discriminatory in that they treat foreign payments differently from national payments, even if the underlying transaction is the same. Direct controls, in addition, restrict the circumstances of the underlying transaction. Accordingly, both direct and indirect capital controls are inconsistent with the investment liberalization formula.[76] Because the formula would promote free entry rights and prohibit discriminatory treatment, a country which followed the formula would relinquish the unfettered right to control capital movements.

What about privatization? This is not obviously outside the scope of the IMF's powers. Merely requiring that certain assets are transferred to the private sector does not, of itself, interfere with members' rights to regulate capital transactions. However, much of the framework for a privatization scheme might do. A debtor country which privatized using non-discriminatory open auctions could not simultaneously maintain restrictions that would bar a foreigner's success.[77] The same applies to schemes which either require the participation of foreigners, or require that shares or vouchers initially distributed to nationals be transferable to foreigners.

Turning to question two, does it follow that the IMF cannot make the formula a condition of funding? Gold would argue it does not follow because IMF conditionality does not impose a legal obligation. The very concept of an SBA (or EFF and PGRF

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[76] As defined in Part III *supra*.

[77] This proposal was incorporated in the draft of the MAI. See MAI Negotiating Text (as of April 24, 1998), 32.

arrangements) is that it is not a contract and there is no legal consequence of breach.[78] IMF conditionality is simply a mechanism of influence. Gold writes:[79]

> The practice of the IMF must be taken to have affirmed the interpretation that as performance criteria [imposed through conditionality policies] are not obligations under the Articles or under a treaty or contract, they can include matters over which the IMF has no regulatory jurisdiction if they have a bearing on the balance of payments and on the purposes of the IMF.

Gold would further argue that capital flows do bear on the balance of payments and are now within the purposes of the IMF, even though Article I does not refer to them. Gold notes that when the Articles were amended for the second time, Article IV(1), which is entitled "Obligations Regarding Exchange Arrangements", was redrafted to begin:[80]

> Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services **and capital** among countries, and that sustains sound economic growth…[emphasis added]

On the basis of this argument, Lichtenstein has tentatively concluded that:[81]

> It would seem to be appropriate for the IMF in setting a programme for a country utilizing its resources to include a requirement of removal of capital controls if in the circumstances of the country such liberalization will lead, in the IMF's view, to a return to external balance and an ability to repay the resources borrowed.

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[78] JOSEPH GOLD, INTERPRETATION: THE IMF AND INTERNATIONAL LAW 348 (1996). This was a major premise of the 1979 Conditionality Guidelines and is reflected in the 2002 Guideline 9: "Fund arrangements are not international agreements and therefore language having a contractual connotation will be avoided in arrangements and in program documents".

[79] GOLD, INTERPRETATION, *id.*, 355 (1996). *Also see* GOLD, ASPECTS, *supra* note 69, 21.

[80] See Gold's statement that: "It may be assumed that on this occasion [the second amendment] the United States succeeded in incorporating among the purposes of the Fund language that implies support for the free movement of capital." Gold, *Pamphlet, supra* note 60, 44.

[81] *See supra* note 62, 72.

Following the Asian financial crisis, it is certainly arguable that capital movements are sufficiently related to the international monetary system to give the IMF a legitimate interest in their operation. But a legitimate interest does not equate to a power to regulate. I disagree with Gold and Lichtenstein's argument, which seeks to use a declaratory phrase in Article IV(1) to eviscerate the clear operational division between capital and current transactions.

(a) A domestic law analogy – the U.S. spending clause

The United States case law on the spending clause – noted earlier – may be helpful for sharpening analysis of essentially the same issue under the IMF Articles. Relatively early case law resolved an ancient debate between two framers of the U.S. Constitution, Madison and Hamilton, over whether the spending clause, which permitted Congress to tax (and, implicitly, apportion) for the "general Welfare" of the Union,[82] was wider in scope than Congress' specifically enumerated powers.[83] The Court decided Hamilton was correct in arguing that the spending power was indeed wider.[84] A key reason was thatth e words "general Welfare" would otherwise be redundant.[85] This view has been stoutly affirmed. Relevantly, the leading case, *South Dakota v. Dole,* held that the spending power could prescribe conditions relating to liquor licensing, a matter which is explicitly remanded to states by the Twenty-first Amendment.[86]

[82] Article I, section 1, clause 1.
[83] Article I, section 1, clause 2.
[84] *U.S. v. Butler*, 297 U.S. 1 (1936).
[85] *U.S. v. Butler*, 297 U.S. at 65 ("In [Madison's] view the phrase is a mere tautology, for taxation and appropriation are or may be necessary incidents of the exercise of any of the enumerated legislative powers").
[86] *South Dakota v. Dole*, 483 U.S. at 206.

Of course, there are some limitations to the use of the spending power.[87] Conditions must be: (a) imposed in pursuit of general welfare; (b) unambiguously expressed; (c) related to the federal program; (d) otherwise consistent with the Constitution; and (e) not so coercive so as to compel, rather than influence, the result sought. Many commentators have, however, criticized these conditions as being ineffective. Each condition is routinely satisfied and the Courts are especially wary of condition (e).[88] It is widely understood that, through generous interpretation of the spending clause, the Courts have permitted Congress to indirectly control that which it cannot regulate directly.[89]

(5) Why IMF Conditionality Cannot Include Investment Measures

If the U.S. approach were applied to the IMF Articles – especially the reasoning in *Dole* – it is arguable that the IMF would have the power to include investment liberalization measures through fund conditions. I argue that this would be the wrong result for two reasons.

First, the IMF Articles are worded differently from the U.S. Constitution. The implication that the general spending power exceeded the enumerated powers was based on the argument that, otherwise, the phrase "general Welfare" would add nothing to the Constitution. This argument cannot be made vis-à-vis the IMF. The Articles provide that

[87] *South Dakota v. Dole*, 483 U.S. at 209-210.
[88] In *Nevada v. Skinner*, 884 F.2d at 448, the Ninth Circuit Court of Appeals upheld a condition which penalized non-compliance by withholding 95% of available highway funds, stating that conceptual and practical difficulties render, "the coercion theory highly suspect as a method for resolving disputes between federal and state governments".
[89] See Lynn A. Baker, *The Spending Power and the Federalist Revival*, 4 CHAP. L. REV. 195 (2001); and *Conditional Spending After Lopez*, 95 COLUM. L. REV. 1911 (1995); Celestine R. McConville, *Federal Funding Conditions: Bursting Through the Dole Loopholes*, 4 CHAP. L. REV. 163 (2001); and Albert J. Rosenthal, *Conditional Federal Spending and the Constitution*, *supra* note 16.

a member seeking to draw on general funds must provide "adequate safeguards". [90] The pertinent concern is not that "adequate safeguards" would be rendered redundant if this phrase excluded capital movements. The real concern is the contrary: that this phrase could be inflated so as to include the only matter which is expressly withdrawn from the jurisdiction of the IMF. Unlike the case of the spending clause, there is no reason to adopt this perverse interpretation. If it is adopted, the IMF is simply enforcing through the backdoor what it cannot require directly.[91]

The only lever for such an overbroad interpretation of "adequate safeguards" is the reference to capital in Article IV(1). However, Article 31 of the Vienna Convention on the Law of Treaties[92] supports the view that Article IV(1) does not dilute Article VI(3). As Gold has himself acknowledged, Article IV(1) is not written as a firm obligation, but only as a desirable goal of the international monetary system.[93] Whatever the purpose of the reference to capital in Article IV(1), it was surely not to override the express power over capital movements given to members by Article VI(3).[94]

Second, U.S. jurisprudence is informed by a naïve view that conditionality is not necessarily regulation. The premise is that, if the state can refuse the grant, the result is a free bargain.[95] Gold's argument is nearly identical: that conditionality does not

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[90] Articles I(v) and V(3)(a).
[91] The present Deputy General Counsel for the IMF has some sympathy for this view: *see* Holder, *supra* note 61.
[92] Article 31(1) provides: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."
[93] *See* Gold, ASPECTS, *supra* note 69, 121. Gianviti appears to agree, describing Article IV(1) as a "soft law" obligation only. *Supra* note 60, 12.
[94] Moreover, such an argument does not sit well with the IMF's 1997 proposal to amend the Articles to make capital account liberalization a purpose of the IMF. *See supra* note 66. Neither Holder nor Gianviti express conviction that, absent an amendment, the IMF can legally require liberalization of capital inflows through conditionality policies. *See supra* notes 60 and 61.
[95] *See, e.g.*, *Kansas v. U.S.*, 24 F. Supp. 2d 1192, 1199 (D. Kan. 1998) ("Plaintiff is required only to choose between receiving federal funds and complying with certain statutory mandates, or not receiving such

"regulate" anything because it is the result of agreement. However, as Epstein has shown, real world bargains often involve coercion; especially when there is unequal bargaining power.[96] It does not help to try to discern precisely when persuasion becomes compulsion (it is this chimerical search which has led to an incoherent U.S. coercion test). The flaw is the diametric opposition between bargain and coercion. Formally, there is always a choice, even if practically there is none. A more realistic approach is to abandon this false dichotomy. Many bargains *are* coerced. The essence of regulation is not the subject's lack of choice but the official's aim – to alter the subject's behavior. Regulation by appropriation – while involving agreement, and therefore an instrument of soft and not hard law – is regulation nonetheless.

The better view, then, is that IMF conditionality is an indirect form of regulation, in that it requires certain conduct in exchange for funding needed to finance acute payments deficits.[97] Once this is appreciated, the clear opposition with Article VI(3) is apparent. Members have the sole right to regulate capital transactions. Yet conditionality policies prescribing investment liberalization also regulate capital transactions. Therefore such IMF policies interfere with members' autonomy. This conclusion applies equally to GRA and non-GRA lending. In relation to both, the IMF is regulating capital transactions – something it has no mandate to do – and thereby acting inconsistently with the Fund's purposes.

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funds"). This view has been applied to the IMF by at least one U.S. commentator: *see* Anthony Galano III, *International Monetary Fund Response to the Brazilian Debt Crisis*, 6 PACE INT'L L. REV. 323 (1994).

[96] RICHARD EPSTEIN, BARGAINING WITH THE STATE (1993). Epstein gives the following example of such a bargain. A robber tells a victim "your money or your life" (40). The victim is "free to reject the threat and to face the use of force" (41). Epstein notes earlier that most taxation and other regulation is in the form of a bargain: "…*if* you choose to earn or sell, then we will take so much from you" (11, emphasis in original).

[97] The word "needed" should be emphasized. IMF funding is much more crucial to debtor countries than federal funding is to U.S. states. States can tax their citizens to make-up budget shortfalls. Not so indigent debtor countries – this is precisely why they need IMF assistance.

Putting everything together, I argue for the following propositions:

(a) Members have the sole right to regulate international capital movements through capital controls.

(b) Some controls on international capital movements prohibit, condition or restrict the underlying transaction. All such controls discriminate against foreign investors.

(c) The investment liberalization formula restricts a government's right to control international capital movements by guaranteeing entry rights and prohibiting discriminatory treatment (including with respect to privatization).

(d) IMF conditionality is a form of indirect regulation. Where it exists in an area, the government does not have the sole right to regulate for that area.

(e) Therefore, the IMF cannot legally condition access funds on implementation of the investment liberalization formula.

C. The Legitimacy of IMF Investment Regulation

Concerns about the legitimacy of IMF conditionality have been widely voiced and the arguments are well-known. Mostly, the arguments arise out of the tension between a state's right to economic sovereignty[98] and the IMF's right to demand adequate safeguards for repayment. In this section I examine some general arguments and explain how they specifically relate to the IMF's intervention in investment.

[98] The *United Nations Charter of Economic Rights and Duties of States* (1974) provides that "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".

It is hard to deny the IMF's "mission creep" since its inception. The original intent of the IMF to temporarily lend money to all nations to support a fixed exchange system does not sit comfortably with the IMF's modern role of policing the adjustment of developing countries to market economies. On one view, this mission creep is simply a fact that must be accepted: a host of developing countries requiring balance of payments support came into existence during the 1950s due to the retreat of the French and British colonial powers, and during the 1990s with the fall of communism. The IMF had little choice but to adapt to its new task.[99]

(1) The IMF's Governance Structure

Perhaps this is so, but it remains that the IMF's new role as an apostle of globalization lacks the neutrality of its origins. It is strange to consider it today, but the IMF was designed to be compatible with a range of different political and economic systems. Keynes' idea in 1944 was not that all countries would turn into free-market democracies, but that each country could abide by certain rules relating to current transactions and exchange rates. The IMF was to police those rules. By becoming an architect of reform the IMF necessarily aligns with Western developed countries and seeks to impose their political and economic values on debtor countries.

The most serious problem caused by the IMF's ideological bent concerns the IMF's governance design. The fact that the IMF was a technical body meant it was not unacceptable that, unlike at the UN for instance, all representation was determined by

[99] Some have, however, argued that the structural adjustment programs the IMF requires are more properly the province of the World Bank. *See, e.g.*, Williamson, *supra* note 4, 17.

economic strength.[100] The IMF has a weighted voting system in which member states' votes are held in proportion to their quota, which in turn is based on each member's wealth.[101] For instance, the U.S. holds 17.10 percent of the total votes. In contrast, India, Bangladesh, Bhutan and Sri Lanka collectively hold 2.41 percent. Even more tellingly, Angola, Botswana, Burundi, Eritria, Ethiopia, Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, South Africa, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe, collectively hold 3.22 percent.[102] As 15 percent is enough to veto many critical decisions, the U.S. is the only country with a unilateral veto. The European Union, collectively, also has a veto.

The day to day affairs of the IMF are managed by its Executive Board.[103] The Managing Director who heads this Board is, by convention, a European (the head of the World Bank is, by convention, an American). The Board presently has twenty-four permanent directors, all of whom are elected for two year terms save the directors for the U.S., Japan, France, Germany and the U.K.. Most countries without permanent directors are represented collectively by proxy directors.

At present, there is a serious risk of institutional capture. By advocating Washington Consensus policies, the IMF's agenda comfortably aligns with neo-liberal Western governments and with the profit motives of Western multinational companies.

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[100] The vision of the IMF as a technical body also arguably explains why the IMF's requirement to pay due regard to members domestic politics (see Articles IV(3)(b) and XII(8)) is weaker than the equivalent provision found in the UN Charter (2(7)) or in the World Bank's Articles (V(10)). Unlike the latter two bodies, the Fund had a specific and non-political task – regulating exchange rates. It was not envisaged the IMF would become deeply mired in designing domestic policies. The alternative explanation – that the IMF could interfere with domestic politics but the UN and the World Bank were prohibited from such interference – is unconvincing.

[101] Article XII(5).

[102] Figures based on the 2002 voting round and *available at* <http://www.imf.org/external/np/sec/memdir/eds.htm> (last visited March 19, 2003).

[103] Article XII(3)(a).

There is some evidence IMF conditionality has, in specific cases, been driven by the wishes of G-7 countries.[104] This is not surprising. Capital flows today connect the world: both developed and developing. Forty five percent of global output comes from developing countries, which also attract more than one third of foreign investment inflows.[105] Integrated capital markets mean that developed countries have a genuine economic interest in influencing the investment regimes of the developing world. The IMF's governance structure makes this only too possible.

This leads back to the problem of asymmetry.[106] The IMF's shift in focus has effectively transferred regulatory power from the developing to the developed world, thereby exacerbating an already unequal situation. Whereas rich countries control their own economies, poor countries are gradually ceding such control to international financial institutions, especially the IMF. As stated, since 1977 no developed country has applied for an IMF loan and therefore been subject to IMF conditionality.[107] In contrast, the need of developing countries for long-term balance of payments support has grown considerably.

This asymmetry contributes to the growing inequality in global finance. Countries at the centre of the global economic system are able to lend and receive loans in their own currency (e.g., the U.S., Europe, Japan). Countries at the periphery have to borrow in the currencies of the major players and are subject to the increased financial

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[104] *See* Goldstein, *supra* note 21, 69; and Williamson, *supra* note 4, 12.

[105] *See* COUNCIL ON FOREIGN RELATIONS, INDEPENDENT TASK FORCE REPORT, *supra* note 4, 35. Flows have, however, recently declined, though mainly in developed and not developing countries. *See* WORLD BANK, GLOBAL ECONOMIC PROSPECTS 9 (2003) and UNCTAD, WORLD INVESTMENT REPORT, xvii (2002).

[106] Note that Gold defined symmetry ("in the sense that countries want to ensure that all enjoy equivalent rights and observe equivalent obligations") as a key legal objective of the international monetary system. GOLD, INTERPRETATION, *supra* note 79, 255 (1996)

[107] *See supra* note 50.

pressures this entails. IMF conditionality is intricately involved in this process because the IMF is a credit flagship for the private sector. If the IMF won't lend, nobody else (including the World Bank) will lend not invest.[108] Should the IMF suddenly call in a loan or refuse to release the next tranche, private lenders and foreign investors presently operating in the country will likely pull out also, triggering a financial collapse. So a poor country needing credit often has no realistic choice but to accept IMF conditionality. The IMF is not just one lender amongst others. It is the leader.

(2) Conceptual Problems of Conditionality

As described above, conditionality is a difficult regulatory concept. To understand it, one must understand the complex relationship between the IMF and a debtor country. The two do not stand in definite opposition. Often the country wishes to reform and the IMF provides the technical guidance to help the reform to succeed. Nevertheless, there is something about regulation through conditionality which poisons the outcome.

One way to try to understand the concept of conditionality is using Max Weber's theory about the effect of power on behavior.[109] Weber argued that power exists in an infinite variety of forms – legal, economic, social. Economic power typically involves domination through a "constellation of interests" (i.e., two parties act to further their own self-interests, but these intersect in such a way that party A gains some control over party B's conduct: e.g., a standard bank loan). This can, however, gradually transform to

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[108] *See* Lance Taylor, *IMF Conditionality: Incomplete Theory, Policy Malpractice* in POLITICAL MORALITY, *supra* note 1, 33.

[109] MAX WEBER, ECONOMY AND SOCIETY, 946 (Uni. Cal. Press 1968). Interestingly, Weber argued that "domination which originates in the market or other interest constellations may be felt to be much more oppressive than an authority in which the terms of obedience are set out clearly and expressly".

domination through "authority" (i.e., B comes to obey A's commands as if the command was intrinsically binding). It is interesting to consider the relationship of Weber's "obedience" and the IMF's concept of "ownership".

There is already literature on the latter term. Some tends to suggest that country ownership can be attained simply by the IMF focusing more strongly on this goal.[110] Other commentators recognize the complexity of the concept – "ownership" must be defined, even then it is not observable, and there are multiple dynamic actors – but conclude that it is achievable in practice through the right conditionality policies.[111] It may be the case, however, thatconditionality inherently precludes country ownership. If the country does not become obedient (accepts IMF policies as inherently wise), its reforms may be little more than paper laws. Real reform requires commitment and grassroots institutional change. But if the country does become obedient, then there is a problem of political power transfer to the IMF. The IMF's continued contact and surveillance over the country then assumes greater influence. Who "owns" the policy in this scenario? The risk is that the IMF's role comes to subvert the political process.

Why, one might ask, can the relationship not be characterized as a debtor country properly relying on a body with genuine expertise in reform? In short, for the same reason why relationships between doctors and patients are inherently one-sided. The power imbalance prevents a true partnership, or the patient "owning" advice provided by the doctor.

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[110] *See* COUNCIL ON FOREIGN RELATIONS, INDEPENDENT TASK FORCE REPORT, *supra* note 4, 90.

[111] James M. Boughton & Alex Mourmouras, *Is Policy Ownership An Operational Concept?* 18 (IMF Working Paper 02/72, 2002). See also Wolfgang Mayer & Alex Mourmouras, *Vested Interests in a Positive Theory of IFI Conditionality* (IMF Working Paper 02/73, 2002).

One might argue that the obvious regulatory alternative – treaty obligation – is not much different as developing countries often have little choice but to sign on to a package deal of new international rules. The WTO might be a case in point. This perspective has some truth but should not be pushed too far. Developing countries do play roles in negotiating treaties, as the Doha Round attests. It is more conceivable that a struggling developing country would not sign a new investment treaty than it is that such a country would refuse IMF funding. Most importantly, however, treaties are reciprocal. Instead of being a debtor subject to the demands of the IMF, the developing country is a signatory, equal in status and bound to the same set of rules as all other signatories.

(3) Conditionality and Democracy

A core problem with conditionality, then, is that it is not conducive to healthy democracy. Issues that would usually be at the centre of democratic debate are simply removed from the table. A country reliant on the IMF is bound to follow certain paths in relation to many of the most pressing issues concerning its population: taxes, foreign investment, social welfare, land distribution, privatization. This means that, no matter which party is in power, the agenda on important points is fixed.

This leads to elections being trivialized through candidates campaigning not on serious policy differences but on minor or personality issues. The election of Lula in Brazil is a recent counterexample, but the Western outcry which greeted his election shows the pressure IMF conditionality can place on developing countries.[112] Many

[112] The full name of Brazil's president is Luis Inacio Lula da Silva, but he is commonly known as Lula. For relevant coverage, *see, e.g.*, "Brazil's Election Spooks Investors", *BBC News*, September 27, 2002 ("Whoever wins Brazil's presidential race on 6 October will find that many of the country's economic policies have already been set in motion by the International Monetary Fund (IMF)"), *available at* <http://news.bbc.co.uk/2/hi/business/2276538.stm> (last visited May 6, 2003); and "Brazil's Presidential

incipient democracies do not have serious choices of different candidates or the economic power to reject the IMF's preferred candidate.

Conditionality can also contribute to darker problems, such as corruption. Conditioned policies naturally dilute accountability on the part of both domestic politicians and IMF officials. This point has been recognized in the U.S. spending clause jurisprudence.[113] If policies do not work out, it is always possible for the domestic politicians to blame the IMF, and vice versa.[114] This attribution of blame is sometimes unfair and is usually unproductive. In some cases the lack of clear accountability lines permits corrupt or inefficient politicians to escape public scrutiny and censure.

Developing countries are developing in every sense of the word. Their economic institutions are developing, and their political structures are often fledgling democracies. A recent study has shown that new democracies are inherently fragile and often do not last long.[115] One might argue that, by requiring a range of fixed measures held in place by external mechanisms, the IMF is financing economic reforms with political capital. The result might be that the reforms fail, not because they were the wrong medicine, but because they fractured the incipient democracy and plunged the country into chaos.

This is especially a risk for foreign investment reforms. One unfortunate side effect of investment liberalization is that wealthy and influential foreigners may come to

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Election", *The Economist*, October 3, 2002 ("Good for Latin American Democracy. How Good for Brazil?"), *available at* <http://www.economist.com/research/articlesBySubject/displayStory.cfm?story_ID=1365282&subject=SAO> (last visited May 6, 2003).

[113] *See New York v. U.S.*, 505 U.S. at 168 ("…where the Federal Government compels States to regulate, the accountability of both state and federal officials is diminished").

[114] For a case in point, consider the on-going debate between the IMF and Domingo Cavallo, the Finance Minister of the Menem Government, over the reasons for Argentina's financial crisis. This is well outlined in MICHAEL MUSSA, ARGENTINA AND THE FUND: FROM TRIUMPH TO TRAGEDY (2002).

[115] Christopher Clague, Philip Keefer, Stephen Knack & Mancur Olson, *Property and Contract Rights in Autocracies and Democracies*, 1 J. ECON. GROWTH 243, 247 (1996).

have firm political views, which find influence outside the political process. This can be problematic in mature democracies. But, especially if associated with crony capitalism, it can be devastating for fragile democracies. As Amy Chua has argued, foreign investment can be uniquely destabilizing.[116] Chua's thesis concerning the cyclical nature of privatization and nationalization movements in Latin America and South East Asia is a provocative illustration of the political consequences of investment reform. Chua argues that:[117]

> Subverting or abolishing foreign ownership restrictions, although potentially lucrative in the near term, is a shortsighted strategy. These laws were enacted for a reason and should not be done away with casually.

Perhaps this thesis can be taken a step further. Chua argues that liberalization of investment markets and privatization of state assets can destabilize already fragile developing countries, leading to revolution and reversal of reforms. Arguably, the problem is exacerbated if the legitimacy of the reforms is questioned from the outset. Even if pursued unilaterally, the investment liberalization formula is risky. Conditionality simply raises the ante.

D. The Effectiveness of IMF Investment Regulation

For foreign investment reforms, as for many things, the devil is in the detail. Some reforms have worked very well; others have turned out very badly. Scholars are still learning about the transposability of legal rules between different cultures and environments. What is becoming clear is that formal rules do not work without the institutions and cultural knowledge to support them. While the IMF's focus is on

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[116] AMY CHUA, WORLD ON FIRE (2003).
[117] Amy L. Chua, *The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries*, 95 COLUM. L. REV. 223, 291 (1995).

macroeconomic policy, arguably the difference between success and failure lies in the intricate grassroots decisions which require local knowledge. There is unlikely to be any "off the rack" policy which will work for every nation. The IMF has been accused by many prominent economists of pursuing policies which lack the finesse and detail required.[118] If this is true, the IMF is not to blame. It is hard to design successful reform through macroeconomic variables alone. Nevertheless, if the design of foreign investment regimes is heavily influenced by the IMF, legitimate questions can be asked about likely success rates.

This is not an academic concern. There are huge risks in mismanagement. Investment flows are more volatile in developing than in developed countries.[119] Capital market liberalization had tragic consequences for the Asian Tigers. Privatization of water supply was not successful in Bolivia. Foreign direct investment in Nigeria's oil reserves has not greatly benefited its country's citizens. Foreign investment liberalization can hurt an emergent economy as well as help it.

Moreover, as Russian privatization has shown, the political will for extensive reforms is not inexhaustible. It is important to get reforms right the first time around. Getting an investment climate right is harder than simply deregulating capital inflows. Other factors, such as good governance, the rule of law, competition rules, clear property rights, are also required.[120] Arguably both unilateral reform (with proper advice), or a

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[118] *See, e.g.* STIGLITZ, *supra* note 2; Goldstein, *supra* note 21. See also the reports by the INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION and the COUNCIL ON FOREIGN RELATIONS, both *supra* note 4.
[119] WORLD BANK, GLOBAL ECONOMIC PROSPECTS 23-24 (2003).
[120] WORLD BANK, GLOBAL ECONOMIC PROSPECTS 77 (2003).

treaty model, are better than reforms urged through conditionality, because they are more likely to attract the necessary political will.

The most damning effectiveness problem, though, is that IMF conditionality programs are too short.[121] SBAs last for eighteen months and EFF facility loans for three years. The PGRF facility, which is directed to structural reform, is also only three years with a possible one year extension. Given the decades, and sometimes centuries, developed countries took to become open market economies, these timeframes seem extremely ambitious. A palpable risk is that, in order to complete the reform cycle – and be repaid the money it loaned – the IMF is tempted to roll-over loans and effectively lend money to a country to pay itself back with. This ties uncomfortably back into Weber's theory of power. The IMF's mandate for "temporary" assistance simply does not lend it to structural reforms.

IV. CONCLUSION

Few now debate the economic benefits of foreign investment. The important question is the framework, and the rules, under which this should take place. At present these rules are piecemeal. This article has argued that IMF conditionality is a flawed regulatory tool and should not be permitted to entrench itself as part of a new investment framework.

A number of long-term investment frameworks are possible but none are closely on the horizon. One proposal would be for the IMF to continue its sophisticated technical assistance programs to countries seeking to liberalize investment, but not make participation a condition of finance. Another would be the negotiation of a new MAI

[121] *See* KENEN *supra* note 3, 110.

balanced to address the many contested issues for both developed and developing countries. Until either event happens, however, the IMF should not further distort international investment regulation in the name of trying to simply achieve what it can. Sometimes the cure is worse than the disease.

As a final thought, the case of investment underscores how important it is that the role of the IMF be loudly and widely debated – and then reflected clearly in its Articles. More than anything, the Achilles heel of the IMF is the widening chasm between its legal and its actual roles. An important step forward for the IMF is to adopt a transparent set of responsibilities which are endorsed by its members. For this, it may be that a complete redraft, rather than an amendment, of the IMF's Articles might be in order.