Raymond Saner and Ricardo Guilherme***

IMF Conditionalities For The Least Developed Countries

This policy brief argues that, all too often, the Fund's use of "conditionalities" for lending has stepped beyond its core legal mandate, particularly causing harm to the least developed countries' economic development, for example by dictating their trade policies.

The controversial issue of the Fund's conditionality originates from Article V ("Operations and Transactions of the Fund"), Section 3 of the Fund's Articles of Agreement, which broadly presents the conditions governing use of the Fund's resources. Briefly, Section 3(a) states that the Fund: "shall adopt policies on the use of its general resources (…) and may adopt special policies for special balance of payments problems, that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund."

This means that, prior to the release of any financial resources to its members, the Fund requires that certain constraints, widely known as "conditionalities", are imposed in the form of compliance with both Fund rules and Fund-suggested (practically mandated, in the case of poor countries) policy guidelines and adjustments. These "monitoring techniques" provide the framework with which the Fund ensures solvency safeguards while targeting temporary balance of payments' problems.

However, in stark contrast with Fund conditions set until the early 1980s, there has been a significant increase in the number of conditionalities set for low-income countries eligible for its Poverty Reduction Growth Facility (PRGF)[1] programme. This increase in prescriptions has greatly expanded the IMF's remit to include public sector employment, privatization, public enterprise reforms, trade policy, pricing, social security systems and "systemic" reforms, among others.[2]

By acknowledging the existence of two broad types of structural reforms[3], the Fund tacitly admits the existence of double standards with regard to conditionalities. The first cluster, based on the Fund's core areas of expertise, tackles macroeconomic scenarios via policies that aim to ensure stabilization of exchange rate practices, as well as reduce balance of payments and financial or monetary problems. Such policies could also include measures such as tax reform, fiscal responsibility, banking and monetary reforms and exchange rate flexibility.[4]

The second cluster, involving a much enlarged scope of Fund conditionality, advocates "policies aiming more generally at improvements on the economy's underlying structure – its efficiency and flexibility – to foster growth, and facilitate adjustment to exogenous shocks."[5] This is where the Fund arrogates to itself the right to engage in much broader reforms including trade liberalization, pricing and marketing, labour market reorganization and generic institutional or regulatory changes.

This enlarged scope of Fund involvement, through its conditionalities, should be urgently reviewed and circumscribed by the Fund's existing legal provisions and guidelines. For instance, the mandate to establish "adequate" solvency safeguards should not be interpreted as giving the Fund an unlimited mandate to prescribe all-encompassing structural reforms on a Fund member.[6]

A restrictive interpretation of the Fund's mandate is supported by the IMF Guidelines on Conditionality[7], which emphasize that conditionality objectives must be strictly related to resolution of balance of payments problems, in conformity with the Fund's Articles and in a manner that establishes "adequate" safeguards for the use of Fund resources. In other words, "adequate solvency safeguards" to address balance of payments problems should not extend to trade, labour and regulatory policies.

Indeed, such guidelines spell out a number of precepts rarely applied in Fund-initiated trade conditionalities. Paragraph 3, for instance, emphasizes the need for national ownership of sound economic and financial policies and adequate administrative capacity, so that programmes may be implemented successfully.

Furthermore it states that "[i]n responding to members' requests to use Fund resources and in *setting* program[me]-related conditions, *the Fund will be guided* by the principle that the *member has primary responsibility for the selection, design, and implementation of its economic and financial policies*. The Fund will *encourage* members to *seek to broaden*

[1] The PRGF, established in 1999, is the IMF's low-interest lending facility for poor countries. The PRGF is supposed to integrate the objectives of poverty reduction and growth more fully into the operations of its poorest members.
[2] *See* IMF, Structural Conditionality in Fund-Supported Programs (Washington, D.C.: Policy Development and Review Department, IMF, 2001), p. 26.
[3] *Ibid.*, p. 28.
[4] *See* IMF and World Bank, "An Enhanced Partnership for Sustainable Growth and Poverty Reduction". Joint Statement by Horst Koehler and James Wolfensohn, 2000, affirming that the "Fund's core mandate is to promote international financial stability and the macroeconomic stability and growth of member countries…[T]he Fund must focus on its core responsibilities: *monetary, fiscal, and exchange rate policies*, and their associated institutional and structural aspects." (emphasis ours)
[5] *Ibid.*
[6] *See* D.E. Siegel, Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements, 96 *American Journal of International Law* 3, 2002, p. 573. According to Siegel, Fund conditionalities "must be limited to those [policy intentions] that are consistent with the Fund's Articles [of Agreement]." *See* also IMF and World Bank, "Strengthening IMF-World Bank Cooperation on Country Programs and Conditionality", 2001, p. 8; PRGF conditionality measures "should focus on policies within the Fund's *core areas of expertise: monetary, fiscal, and exchange rate policies*; the institutional arrangements underlying these policies; and structural aspects *closely related to them* (…)." (emphasis ours)
[7] *See* IMF, "Guidelines on Conditionality", Legal and Policy Development and Review Department, 2002, pp 1-2.

and deepen the base of support for sound policies in order to enhance the likelihood of successful implementation."[8] (emphasis ours)

This crucial distinction between Fund "demands" and "suggestions" is not resolved by other language regarding Fund conditionalities. While ownership of and capacity to implement a programme is acknowledged to be the *sole* responsibility of a member country, the Fund is supposed to only be *guided*, but *not bound* by the same principle of ownership.

This wording ensures that the Fund is shielded from external criticism on legal grounds, since sole responsibility is borne by the borrowing government. The same guidelines provide unlimited scope for the Fund to apply conditionalities even though a borrowing least developed country might have different policy preferences and priorities, e.g. with regard to trade and poverty reduction policies. Hence, "adequate safeguards" allows the Fund to demand reforms even though they are not supported by the Fund's own core mandate.[9]

Such conclusion is further buttressed by Paragraph 8 of the same Guidelines, asserting that the Fund "is fully responsible for the establishment and monitoring of all conditions attached to the use of its resources" and, even more candidly under the "Principles Underlying the Guidelines on Conditionality", which state that the "need for ownership implies selectivity: approval of the use of Fund resources depends *in particular on the Fund's assessment that the member is sufficiently committed* to successful implementation"[10] (emphasis ours).

With regard to Fund trade policy conditionalities in low-income countries, proper regard to social and political goals as well as the specific circumstances of members has not been given, contrary to the spirit of Paragraph 4 of the Guidelines. This is especially relevant for the one size fits all approach or policy reform homogeneity characteristic of Highly Indebted Poor Countries (HIPC)[11] and PRGF programmes, including trade policy reforms; such policy conditionalities also seem insensitive to the challenges of correct policy sequencing, particularly for low-income borrowing countries.

The ambiguity of Article I principles contributes to such a state of affairs whenever trade policy are included in Fund programmes. In fact, this has been one of the major justifications for trade policy conditionalities in Fund arrangements, particularly since the Fund regards more selective or restrictive trade regimes as "destructive of national or international prosperity" or against the "balanced growth of international trade". But one cannot forget that, in line with the Articles of Agreement and the Guidelines on Conditionality, the scope of conditions for reform must be strictly interpreted and applied. This implies that, from a legal perspective, when setting programme goals and applying Fund provisions, the focus should be on what is critically important or necessary, and not on matters of high principle.

As correctly acknowledged by key Fund documents, trade policy conditionalities have little to do with the Fund's traditional mission or areas of expertise, and represent an obvious deviation from the Fund's "core" legal mandate to provide assistance to countries with balance of payments problems. Instead of focusing on exchange rate issues, balance of payments concerns or financial and monetary analysis, the Fund has turned to trade policy reforms, streamlining trade policy administration, government revenue, governance and customs administration reforms, all pushed through on the basis of dubious efficiency improvement claims.[12]

Finally, it should be emphasized that imposition of cross-conditionalities by the Fund is prohibited; nevertheless, in the recent past, the Fund has made specific requests for the least developed countries to undertake unilateral commitments towards further trade liberalization within the WTO or via regional trade agreements,[13] drastically restricting a least developed country's sovereign right to pursue its own interests. As the Fund demands that its conditionalities not be subject to decisions taken by countries in other multilateral frameworks, it seeks to be "primus inter pares", relegating other international organizations and commitments to "secondary status".

Notwithstanding the ongoing debate on coherence, it appears doubtful that lending arrangements with IMF member countries have complied with existing Fund rules. Such deviation from the core mandate of the Fund also raises the likelihood of resource misallocation and failure to provide proper oversight of the international economy.

**Raymond Saner, Director, Diplomacy Dialogue, Geneva and Professor at Basle University and Sciences Po, Paris.*

***Ricardo Guilherme, LL.M., M.A., former Associate Trade Researcher at CSEND and currently lawyer at the Universal Postal Union.*

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[8] *Ibid.*

[9] In fairness, the ambiguity of the distinction between Fund-supported programmes (along with a member's intended reforms) and Fund-driven conditionalities might also be convenient to certain governments that may prefer to transfer responsibility for unpopular reform measures to the Fund, by blaming "Fund requirements". *See* Siegel, *op. cit.*, p. 573.

[10] *See* IMF, Guidelines on Conditionality, *op. cit.*, p. 8.

[11] The Heavily Indebted Poor Countries Initiative, the current debt relief scheme created in 1996 by the World Bank and IMF to provide limited debt relief for the poorest countries, with the goal of achieving "debt sustainability".

[12] See IMF, Trade Conditionality Under Fund-Supported Programs, 1990-2004 (Washington, D.C.: Policy Development and Review Department, 2005), pp 4-6.

[13] This was, for instance, the case of Uganda. *See* P. Walkenhorst, HIPC and Trade Policy Reform: Some Early Observations, OECD Trade Directorate, TD/TC/WP (2003)4/FINAL (Paris: OECD, 2003), p. 8, and DENIVA, Uganda: Trade Liberalization and its Impact on Poverty, Country Background Paper, Final Report (DENIVA, 2005), p. 7.