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# THE INTERNATIONAL MONETARY SYSTEM AND THE EROSION OF SOVEREIGNTY: ESSAY IN HONOR OF CYNTHIA LICHTENSTEIN

ANDREAS F. LOWENFELD\*

**Abstract:** When the major international organizations were established at the close of World War II, it was understood that they were concerned with international relations—political, economic, and social. As was made explicit in the U.N. Charter, but applicable in all the organizations, matters “essentially within the domestic jurisdiction of any state” were not the concern of the international organizations or the international community. In particular, the International Monetary Fund was to focus on member states’ balance of payments, exchange rates, and exchange controls, but not on their domestic policies or priorities. Gradually, it became clear that the wall between domestic and international policies could not be maintained. As the IMF moved to a regime of conditionality for the use of its resources, and thereafter to performance targets and deadlines, domestic policies of states became subjects of examination in ever increasing detail. Not only national budgets, taxes, and the money supply, but subsidies, wage policies, competition law, corporate governance, even accounting practices and regulatory reform became subject to scrutiny, negotiation and commitment. The Essay does not condemn this erosion of sovereignty, but points out that neither the member states nor the IMF have come up with a new theory to reflect the new reality, or reached agreement on where a new boundary may be set between national and international concerns.

## INTRODUCTION

I am very pleased to be able to participate in a tribute to Cynthia Lichtenstein. She is not only a friend of many years standing, but she was an intellectual bridge for me when I needed one.

When I became interested in the international monetary system as a young lawyer in the State Department, I did not receive a warm

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welcome. International monetary affairs were for Treasury, not State, and anyway not for lawyers, except for a few bank lawyers on Wall Street or at the Federal Reserve, who spoke only to one another. I thought that was wrong, but I have to say that in five and a half years in the Legal Adviser's office at the State Department, in which I participated in matters concerning trade, economic sanctions, shipping, aviation, foreign investment—virtually the complete range of international economic interests of the United States government, I never had the opportunity to become involved in issues of the international monetary system.

When I left government service and began on the project with Abram Chayes and Thomas Ehrlich to prepare a new kind of international law case book, I insisted on a chapter on the international monetary system, even though we had to learn as we went along.<sup>1</sup> And there was Professor Lichtenstein, with true credentials as a Wall Street lawyer, but also academic interests, and firm in her conviction that financial affairs are part of international affairs and that monetary law is a significant component of international law.

Later, when the chapter in the Chayes, Ehrlich, and Lowenfeld book grew into a volume of its own in my series on international economic law, I was very pleased that Professor Lichtenstein, by now a professor, gave it a nice review, both on substance and as a teaching tool.<sup>2</sup>

## I.

I was interested from the beginning in the concept of conditionality—that is what could be asked by the International Monetary Fund prior to making its resources available to a potential borrower. Some people, including Lord Keynes, thought no questions should be asked at all. If I go to Bloomingdale's and express an interest in an expensive carpet, I do not have to explain why I want the carpet, whether I can truly afford it, whether the money would not better be used to pay my children's tuition, or whether it will fit in my house. If I go to the perfume counter, I will not be asked whether I am looking for a gift for my wife, for a girlfriend, or for some actress whose eye I would

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<sup>1</sup> See ABRAM CHAYES, THOMAS EHRLICH, ANDREAS F. LOWENFELD, *INTERNATIONAL LEGAL PROCESS* ch. 10 (1968–69).

<sup>2</sup> Cynthia Lichtenstein, *Preparing Students for Practice in International Law: On Teaching the Law of International Transactions: International Economic Law*, 80 AM. J. INT'L L. 722, 727 (1986) (book review).

like to catch. At most, the credit card company—Visa, Master Card, or American Express—will check whether the purchase comes within my allowed credit, and whether I am current on my minimum monthly payment. Keynes thought that the same should apply to countries drawing on the Fund, i.e., purchasing dollars or other convertible currencies with their own currencies. He wrote, “if countries are to be given sufficient confidence, they must be able to rely in all normal circumstances on drawing a substantial part of their quota without policing or facing unforeseen obstacles.”<sup>3</sup> In contrast, the United States’ position was that, “discretion on the part of the Fund was essential if the Fund’s resources were to be conserved for the purposes for which the Fund was established and if the Fund were to be influential in promoting what it considers to be appropriate financial policies.”<sup>4</sup>

Both views could be supported by the text of the Articles of Agreement of the IMF as they emerged from the Bretton Woods conference.<sup>5</sup> Article V(3) provides: “A member shall be entitled to buy the currency of another member . . . [if it] *represents* that [the currency] is presently needed for making in that currency payments which are consistent with the provisions of this Agreement.” Such a statement seemed to support Keynes. But according to Article V(5), the Fund could limit or deny access to the Fund’s resources if it was “of the opinion that the member is using the resources . . . in a manner contrary to the purposes of the Fund . . . .”

What did that mean?

In their first interpretation in 1946, on request of the United States, the Executive Directors said authority to use the resources of the Fund is “limited to use in accordance with its purposes to give temporary assistance in financing balance of payments deficits on current account for monetary stabilization purposes.”<sup>6</sup> That was not very illuminating, but at least it suggested that requests for drawings were subject to some scrutiny. Then the question arose how to understand the phrase “the member . . . *represents* . . . .” in Article V(3). Did the Fund have to take the member’s word that it needed the Fund’s

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<sup>3</sup> Letter from Lord Keynes to Prof. Jacob Viner ( Oct. 1, 1943), *quoted in* HORSEFIELD & DE VRIES ET AL., 1 *THE INTERNATIONAL MONETARY FUND 1945–65*, at 72 (1969).

<sup>4</sup> RICHARD N. GARDNER, *STERLING-DOLLAR DIPLOMACY* 113 (3d ed. 1980).

<sup>5</sup> Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, 60 Stat. 1401, 2 U.N.T.S. 39.

<sup>6</sup> Ex. Bd. Decision No. 71–2 (Sept. 26, 1946), *in* SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND 128 (25th Issue 2000) [hereinafter SELECTED DECISIONS].

resources for a purpose consistent with the Agreement? Or could an independent examination be undertaken to see whether the representation was correct?

In 1948, the Executive Directors said that if the member applying to use the Fund's resources made the representation set out in Article V(3), it had fulfilled the requirement. But, the decision went on to provide that the Fund may, "for good reasons," challenge the correctness of the member's declaration on the grounds that the currency is not "presently needed," or because the currency is not needed for payment "in that currency," or because the payments will not be "consistent with the provisions of this Agreement."<sup>7</sup>

Again, what did this mean?

Four years later, the Managing Director stated, "a body of particular criteria will have to be built up," but even at the outset, "it must be clear that access to the Fund should not be denied because a member is in difficulty."<sup>8</sup> The Fund's attitude should turn on "whether the problem to be met is of a temporary nature and whether the policies the member will pursue will be adequate to overcome the problem within such a period."

I understood—perhaps misunderstood—this to mean that if the member's problem did not fit this standard, that is if the problem could not be met within a period of one to three years, then the issue was one of "fundamental disequilibrium" (an undefined term in the Articles of Agreement), and the member might be authorized—in the age of fixed exchange rates—to devalue its currency. Still, when the Managing Director said "[t]he policies, above all, should determine the Fund's attitude," the question remained—what policies?

My perception was that there was a kind of jurisdictional barrier between the international organization and sovereign states that could not be breached, even in the context of extending financial assistance. Thus, for instance, the Fund might say to a government, you must keep your budgetary deficit to within five percent of your Gross National Product (GNP); but the Fund could not decide or even advise on whether this prescription would be carried out through a reduction in veterans' benefits, farm subsidies, or road building. The Fund could not prescribe, much less condition aid upon, say, privatizing electric power production or opening telecommunications up to

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<sup>7</sup> Ex. Bd. Decision No. 284-4 (Mar. 10, 1948), in *SELECTED DECISIONS*, *supra* note 6, at 129.

<sup>8</sup> Ex. Bd. Decision No. 102-(52/11) (Feb. 13, 1952), in *SELECTED DECISIONS*, *supra* note 6, at 130.

foreign investment. All of these matters were “essentially within the domestic jurisdiction of the member state”—to borrow from the text of the U.N. Charter—and were not appropriate for inquiry, advice, or command by the IMF.

## II.

Gradually, the understanding—a truism today—hit home that a state’s domestic economic policies could not be separated from its international economic policies, including the balance of payments and the value of its currency. A striking example came in connection with the devaluation of the British pound in 1967. Britain, which had been “living off tick,” in the language of the London streets; that is, by financing its deficits rather than undertaking fundamental reforms, found that its credit was exhausted, and that only a substantial devaluation of the pound would open up the opportunity for new borrowing, including for the first time, drawing under the General Arrangements to Borrow. The conditions for the drawing, as had become standard practice, would be contained in a Letter of Intent, nominally a letter from the Finance Minister or comparable official to the Managing Director of the Fund, but in fact a negotiated document. In those days, the Fund was more committed to confidentiality than it is today, and it did not make the conditions public. However, political pressure forced the British government to publish its Letter of Intent, for Parliament, and all the world, to see what commitments the government had had to make to obtain its loan.<sup>9</sup>

“My Dear Mr. Schweitzer,” Jim Callaghan, the Chancellor of the Exchequer wrote to the IMF’s Managing Director, “it will be the Government’s intention to maintain the policy under which there is no entitlement to a ‘norm’ or standard increase in pay . . . and there is no criterion for pay increases related to changes in the cost of living.”<sup>10</sup> The government pledged not to borrow, i.e., from domestic sources, more than £1 billion; it would abolish all remaining exchange controls on current transactions as soon as possible; and it would be “happy to consult” with the Managing Director on the results of its devaluation and accompanying measures within three months and twice more in the coming year, as well as whenever the

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<sup>9</sup> Letter of Intent of November 23, 1967, 755 Parl. Deb., H.C. (5th ser.) (1967) 648–65, reprinted in ANDREAS LOWENFELD, *THE INTERNATIONAL MONETARY SYSTEM* 65–67 (2d ed. 1984).

<sup>10</sup> *Id.*

Managing Director thought it was appropriate, as long as Britain remained a substantial debtor to the Fund.<sup>11</sup>

One could not quite say the jurisdictional barrier had crumbled—at least not without knowing what went on in the consultations to which Britain had committed itself. For instance, would the Fund tell, or urge, the British government to rescind the policy under which prescriptions under the National Health Service were free? Or how many troops Britain should maintain in Germany? But at least there was a breach in the barrier—an acknowledgment, if not an articulation, that countries were subject not only to the forces of nature, the laws of economics, but to a considerable extent to the judgments of the international community, represented not by the gnomes of Zurich but by the International Monetary Fund.

### III.

By the mid-1970s, the IMF had survived the collapse of the fixed exchange rate system, and though the code of conduct for member states was now much weaker,<sup>12</sup> certainly for states that did not draw on its resources, the Fund retained its role as the one institution that could tell countries what to do without provoking major political, bilateral storms. It would not be appropriate, for instance, for the United States to tell Brazil, Mexico, or the Philippines to reduce their domestic subsidies or collect taxes more effectively. But the IMF could do so.

When the Articles of Agreement were amended at Jamaica in 1976, essentially to recognize the demise of the par value system and to banish the no-longer stabilizing role of gold, Article V(3) was amended to at least confirm that the Fund could, and indeed should, place conditions on requests for drawings. Only requests for “reserve tranche purposes,” i.e., for the member states’ own gold or hard currency contributions, were not to be subject to challenge.<sup>13</sup> Even as the conditions for drawings or stand-by arrangements became more refined, with phased drawings and performance criteria, the implied jurisdictional barrier was maintained. In 1979, the Executive Directors

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<sup>11</sup> *Id.* To be precise, as long as Fund holdings of sterling exceeded 125% of Britain’s quota. *Id.*

<sup>12</sup> See Amended Articles of Agreement of the International Monetary Fund, Apr. 30, 1976, art. IV, 29 U.S.T. 2203, T.I.A.S. No. 8927 [hereinafter Amended Articles of Agreement] (concerning Obligations Regarding Exchange Arrangements).

<sup>13</sup> *Id.* arts. V(3) (a), (c).

issued Guidelines on Conditionality<sup>14</sup> calling for phasing and performance clauses beyond the first credit tranche, but stated, “[p]erformance criteria will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the [Articles of Agreement] or policies adopted under them. Performance criteria may relate to other variables only in exceptional cases . . . .”<sup>15</sup>

By the end of the 1970s, two things had become clear—at least to those who paid careful attention. First, the clients of the Fund, that is the countries that sought to draw on the Fund’s resources, were now entirely developing countries, so that the issue of focus essentially became a North-South issue, until the 1990s, when Russia and some of the other states that once made up the Second World, became members of the Fund and then clients.<sup>16</sup>

Second, a number of countries, particularly in Latin America, had figured out how to get around the intrusiveness of the IMF, which was threatening even if the new performance criteria were limited to macroeconomic variables. The major money-center banks (and some not so major banks as well) were flush with the deposits from the newly rich oil producers for which they had agreed to pay high interest rates, and they were only too glad to re-lend these funds to developing countries, with no questions (or at least not many questions) asked—certainly not questions about internal policies.

Shortly after the beginning of the next decade, the first crisis of a developing country debt broke out, set off by Mexico’s announcement in August, 1982 that it could not make the payments due on its external debt, followed not very long thereafter by Brazil, Venezuela, Argentina, and others. The causes of the defaults—carelessness by the lender banks, recklessness by the borrowing states, shifts in interest rates to the detriment of the borrowers, inadequacy of the surveillance supposed to be undertaken by the IMF—are outside the topic of this essay. What brings me back to my topic is that at this point private lenders were no longer available as an alternative to the IMF and those who relied on the IMF to set the conditions. A massive rescue effort was arranged by the United States, the Group of Ten countries,

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<sup>14</sup> Ex. Bd. Decision No. 6056-(79/38) (Mar. 2, 1979), in *SELECTED DECISIONS*, *supra* note 6, at 228.

<sup>15</sup> *Id.* ¶ 8.

<sup>16</sup> See MARGARET GARRETSON DE VRIES, 1 *THE INTERNATIONAL MONETARY FUND 1972–1978*, at 23–24 (1985). Italy was the last “First World” country to draw on the Fund, in 1977.



the commercial banks, and the Fund. Each participant depended on the others before a deal could be struck, and all counted on the Fund to ask the necessary questions and secure the necessary commitments from the countries in distress. Among the many documents, the critical one was an IMF stand-by granted on the basis of a Letter of Intent. Though, technically the commitment was only to the IMF, and the Fund always maintained that stand-by arrangements are not international agreements,<sup>17</sup> in fact, the commitment extended to the entire international financial community. Funds were to be made available periodically, and if the IMF turned off its tap, it was very likely that the other participants would do so as well, as indeed happened more than once.

Amid various rumors of a sell-out, the Government of Mexico made its Letter of Intent public promptly, as the British government had done fifteen years earlier, but it did not attach a Technical Memorandum of Understanding, which also became public, and of course contributed to the perception, as Mexico's newspapers claimed, that the IMF ran Mexico even according to the calendar.

I do not share the accusation of "sell-out" or surrender. And indeed a good case can be made that what the international community demanded, with the IMF out front, came within "macroeconomic variables," and thus within the jurisdiction barrier that we started with. But it was at least a way station, recall my title *Erosion . . .*, not sudden collapse. The Fund had sought to reduce Mexico's budget deficit from 17% of GDP to 6.7%; the government sought to hold out for 10%; the final target figures in the Letter of Intent were 8.5% for 1983, 5.5% for 1984, and 3.5% for 1985. Public sector external debt was to rise by no more than \$5 billion in 1983, compared to \$19 billion in 1981 and some \$6 billion in the first half of 1982. The Letter of Intent contained a murky paragraph about "protecting the standard of living of the popular classes"; the IMF's own press release spoke of a reduction in inflation from 90–100% in 1982 to about 55% in succeeding years, and said "incomes policy," i.e., the opposite of wages keeping pace with rise in prices, was "of central importance in the adjustment program."<sup>18</sup>

The issue of incomes policy became even more critical with Brazil, which was just emerging from two decades of military rule, and

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<sup>17</sup> See JOSEPH GOLD, STAND BY ARRANGEMENTS OF THE INTERNATIONAL MONETARY FUND 44–45 (1970).

<sup>18</sup> IMF Press Release No. 82/72 (Dec. 23, 1982), reprinted in 12 IMF SURVEY, Jan. 1983, at 1.

had held its first election since 1964—for the Chamber of Deputies and state governors, not yet for the presidency—in November, 1982, just before its cash ran out. Brazil first received a rescue package to prevent default, then a massive credit and postponement of maturities of existing credits built around a Letter of Intent to the Fund, including quarterly performance targets linked, at least by implication, to phased disbursements from the Fund and the other lenders.

Was the IMF really prepared to enforce the link, that is to cut off disbursements if Brazil did not comply with the performance targets? The key was inflation, which the government had promised to reduce from 100% in 1982 to 80% in 1983, 40% in 1984 and so on—to be accomplished by interrupting the cycle of wage increases reflected in, and at least partly caused by the practice of indexing practically everything, that is, making wages, interest rates, tax rates, and currency values move in parallel. The government was reluctant to force visible give backs by the population, and in fact did not meet its targets for the first quarter of 1983. What to do? Should the Fund actually turn off the tap, with the other lenders likely to fall in line?

The Fund was reluctant. It sought—properly—for a solution that could both maintain the credibility of conditionality and keep Brazil in compliance, rather than in default. Not incidentally, if Brazil actually defaulted, that would have a devastating effect on the balance sheet of the major money-center banks. The Fund decided to send another mission, with a view to renegotiating the Letter of Intent.

The negotiations—I am compressing a little—involved a decree-law to be issued by the President limiting wage increases to 80% of price increases, with some relaxation by the Fund of the targets for reduction of the public sector deficit. But under the newly revived Brazilian Constitution, a decree-law could remain in effect only for sixty days without approval of the Congress, and when Congress voted, the decree-law lost. With the revised financial package not yet signed in Washington, President Figueredo issued another decree-law, still designed to meet the IMF's demand to reduce the inflation rate to 80%, but with the lowest paid workers, roughly two-thirds of the work force, retaining their right to increases equal to 100% of the inflation rate. Subsequently the President issued still another decree, and after an all-night session including a seven-hour filibuster, the Chamber of Deputies approved by 245 to 3, with 231 members abstaining. Eventually a \$6.5 billion credit package that had been tenta-

tively announced in September was signed in January, 1984, with 550 banks participating.<sup>19</sup>

I tell this story not to bring up details almost twenty years old, but to point out that when democracy itself hangs in the balance, the focus on “macroeconomic variables” cannot be the whole story, for the IMF or for the international financial community as a whole.

I want to move on to the Southeast Asia Financial Crisis, but I think a brief stop is justified for the second Mexican peso crisis in the winter of 1994–95. Within a few days of the collapse of the peso, the Clinton Administration came forward with a big rescue plan, with loan guarantees up to \$40 billion, on the strength of which—plus the usual commitments—the IMF agreed to the then largest credit in its history, about \$7.8 billion or 300% of Mexico’s quota in the Fund. But then the U.S. Congress balked, and the Clinton Administration improvised a second package, drawing on the Exchange Stabilization Fund which, assuming it was legal, did not require the approval of Congress.<sup>20</sup> To justify its action, the U.S. government insisted, and Mexico agreed, to a comprehensive detailed financial plan, in part restating the commitments made to the IMF, but with default and acceleration clauses straight out of the form book for commercial bank loans, complete with forum selection clauses—the Southern District of New York—New York choice of law, waiver of immunity, and so on. More than that, Mexico agreed, not in 1895 but in 1995, that all receipts from the sale of oil by PEMEX, the state-owned oil company, would be deposited in a special account maintained by the Banco de Mexico at the Federal Reserve Bank of New York. As such deposits were received by the New York Fed, Banco de Mexico was to credit a corresponding amount on its books to PEMEX, but the funds remained in New York, and the New York Fed was authorized and instructed by the Banco de Mexico to use the funds to repay the U.S.

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<sup>19</sup> See Kenneth N. Gilpin, *Brazil Gets \$6.5 Billion in New Loans*, N.Y. TIMES, Jan. 28, 1984, at 39.

<sup>20</sup> The Exchange Stabilization Fund (ESF) was established pursuant to section 10 of the Gold Reserve Act of 1934, codified and amended as 31 U.S.C. § 5302. Though the purpose of the ESF had no relation to crises in foreign countries, the General Counsel of the Department of the Treasury pointed out in a formal opinion that Congress had, at several times, rejected proposals to limit the President’s authority under the Act, and argued that, “[t]he highly technical and complex area of foreign exchange and exchange market stability blends important considerations of monetary and foreign policy . . . an area that is properly left to the discretion of the President.” Letter from Edward S. Knight, General Counsel, to Robert E. Rubin, Secretary of the Treasury (Feb. 21, 1995) (on file with author).

Treasury all amounts due and payable under the Financing Agreements.

In any event, those security arrangements did not have to be used, as Mexico drew less than was authorized under the U.S. plan and repaid the full amount by the end of 1996. President Zedillo stated in a speech in Mexico City:

Some predicted that our country would collapse, that the foreign aid would be unpayable and infringe our sovereignty, and that in the short term we'd be in a worse crisis. But the early retirement of the debt to the United States Treasury demonstrates the coherence and responsibility the Mexican people and Government have shown in these tough times.<sup>21</sup>

#### IV.

Hardly had Mexico calmed down when the Southeast Asia crisis flared up in the summer of 1997. It is still not clear, and may never be, what combination of factors caused the crisis, which started in Thailand and spread with surprising speed to the Philippines, South Korea, Indonesia, and elsewhere in the region. What seemed to be different this time, however, was the absence of macroeconomic imbalance. In contrast to Mexico, Brazil, and other states of Latin America, the countries of Southeast Asia had experienced low budget deficits, relatively low public debt, inflation in single digits, rapid economic growth, and high savings and investment rates. If these indicators looked healthy, what could have caused the sudden capital flight, sharp drop in currency values, bankruptcy, and massive layoffs? The answer, as it seemed to the IMF and other outsiders, must have been in internal management.

For the first time in the IMF dialogues, one hears of nepotism, corruption, and the need on the one hand for more regulation of weak banking systems, and on the other hand for deregulation of economic sectors with sheltered inefficient monopolies. "Crony Capitalism" entered the vocabulary. The chaebols in Korea—that is large conglomerates with cross-holdings linking banking, steel, automobiles, and electronics—which had once been looked up to as propelling Korea almost into the first world (it had become the eleventh

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<sup>21</sup> See David E. Sanger, *Mexico Repays Bailout by U.S. Ahead of Time*, N.Y. TIMES, Jan. 16, 1997, at A1.

largest economy in the world) were now seen as a major cause of collapse.

There were, of course, other factors of the kind the IMF and the G-10 countries lining up with it were more familiar with. For instance, as the Japanese economy stagnated and the yen lost value in relation to the dollar, economies whose currencies were tied to the dollar found it harder to compete with Japan in export markets. Certainly the IMF did not forget all that it had learned over half a century, or totally discard its form books. But there was a new approach, as commitments of a different kind were now required from the applicant countries. I focus here on Korea—which is interesting also because there was an election in the middle of the negotiations with the Fund—but the same point could be made with respect to Thailand, Indonesia, or the Philippines. The Fund, prodded by the United States, was looking closely at the private sector, and securing commitments related specifically to private activity. For instance, the deal with Korea was held up for ten hours in its final stages before the Korean government agreed to require GAAP—generally accepted accounting practices, American style.<sup>22</sup> Korea also agreed for the first time to acquisitions by foreign companies of Korean companies, not hostile take-overs but friendly mergers, and it agreed to permit companies to lay off workers, which had previously been close to impossible.

A few excerpts from Korea's ten-page Letter of Intent to the IMF of February 7, 1998, will serve to illustrate the new limits, or rather lack of limits, of international concern.<sup>23</sup> In addition to commitment to targets concerning such macroeconomic indicators as growth in Gross Domestic Product and increase in usable foreign exchange reserves, the government now undertook to issue regulations on:

- mark to market accounting for all financial institutions;
- loan classification criteria; and

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<sup>22</sup> See Richard W. Stevenson & Jeff Gerth, *I.M.F.'s New Look: A Far Deeper Role in Lands in Crisis*, N.Y. TIMES, Dec. 8, 1997, at A1.

<sup>23</sup> In accordance with the IMF's new policy of encouraging member states to make their Letters of Intent and associated documents public, Korea's Letter of Intent and six accompanying Memoranda on Economic Program, 1998 appear on the IMF Web Site. Letter of Intent from the Government of the Republic of Korea to Michel Camdessus, Managing Director of IMF (Feb. 7, 1998), at <http://www.imf.org/external/np/loi/020798.htm>. A footnote to the Memorandum on Macroeconomic Policies states, "[I]t is the government's intention to seek approval of the National Assembly for the measures that require the enactment or amendment of laws." *Id.* Footnotes to two other Memoranda state the details of the measures there outlined will be included in the World Bank Structural Adjustment Loan negotiated at the same time. *Id.*

- external audits of specialized and development banks by internationally recognized accounting firms.

And about a dozen similar subjects related to management of the internal financial market. Further, the government undertook (where necessary by legislative amendment) to:

- clarify the circumstances and procedures for layoffs;
- relax restrictive legal provisions relating to private job placement and manpower leasing services;
- triple budgetary resources for an employment insurance fund, including more training support and employment stabilization; and
- expand unemployment benefits to cover firms with more than ten employees (in contrast to the previous minimum of thirty employees), and to increase the minimum benefit level to seventy percent (from the prior level of fifty percent) of the minimum wage;

and so on.

Corporate governance became a major subject of discussion, and commitment. Korea also committed to requiring:

- financial statements of listed companies to be prepared and audited in accordance with international standards;
- publication of combined financial statements for associated companies;
- reduction in use of mutual guarantees by corporate affiliates and subsidiaries;
- at least one outside director for companies listed on the Korea Stock Exchange;
- strengthened rights of minority shareholders; and
- believe it or not, reviewing the possibility of allowing for class action suits against corporate executives and auditors.

One would expect the Fund to call for trade liberalization, and phasing out trade-related subsidies, linked to commitments under the rules of the World Trade Organization. But Korea now undertook as well a series of commitments on foreign direct and portfolio investment:

- foreign banks and brokerage houses were to be permitted to establish subsidiaries in Korea;
- ceilings on foreign investment in Korean equities were to be eliminated; and

—transparent guidelines would govern foreign investment in domestic financial institutions.

Each of these commitments carried a target date in calendar year 1998. In March, 1999 Korea and the IMF negotiated a further Letter of Intent covering many of the same subjects plus details on privatization of specified state-owned enterprises, regulation of insurance companies, and restructuring of chaebols.<sup>24</sup>

Most of the reforms appear sound to an outside observer. I don't even want to make the point that they seem to impose (if that is the right word) Western and largely American practices. My point here is only that the boundary between international and internal concern seems to have largely disappeared.

## V.

Some critics here and abroad thought the new IMF was overstepping its bounds. Professor Feldstein, for example, wrote that the legitimate political institutions of the country, not the Fund, should determine the nation's economic structure. "A nation's desperate need for short-term financial help does not give the IMF the moral right to substitute its technical judgments for the outcome of the nation's political process."<sup>25</sup>

Feldstein, being an economist, spoke of a "moral right." As lawyers, we see the question perhaps more in terms of jurisdiction and standing, and ultimately of sovereignty. Feldstein proposed three questions:

- (1) Is this reform really needed to restore the country's access to international capital markets?
- (2) Is this a technical matter that does not interfere unnecessarily with the proper jurisdiction of a sovereign government?
- (3) If the policies to be changed are also practiced in the major industrial economies of Europe, would the IMF think it appropriate to force similar changes in those countries if they were subject to a Fund program?

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<sup>24</sup> For more information, see Letter of Intent from the Government of the Republic of Korea to Michel Camdessus, Managing Director of IMF (Mar. 10, 1999), at <http://www.imf.org/external/np/loi/1999/031099>. Similar Letters of Intent were negotiated with Thailand and Indonesia, differing in detail but not in the scope of the subjects covered.

<sup>25</sup> Martin Feldstein, *Refocusing the IMF*, 78 FOREIGN AFF., Mar.-Apr. 1998, at 20, 27.

The Fund's management saw no reason to hide the change in approach.

Michel Camdessus, the Managing Director said, "[t]he centerpiece of each program is not a set of austerity measures to restore macroeconomic balance, but a set of forceful, far-reaching structural reforms, to strengthen financial systems, increase transparency, open markets, and in so doing, restore market confidence."<sup>26</sup>

Stanley Fischer, the Deputy Managing Director, answered Feldstein directly:

To question 1, *is this reform really necessary*, the answer in the Asian programs is yes.

To question 2, *is this a technical matter that does not interfere unnecessarily with the proper jurisdiction of a sovereign government*, the answer is complicated—yes, for instance, banking sector reform is a highly technical issue—far more than the size of the budget deficit. But why is this more of an intrusion into sovereign government than trade liberalization, which has long been a part of IMF and World Bank programs.

To question 3, *Would the IMF ask the European countries to make similar changes if they had a Fund program*—absolutely.<sup>27</sup>

Finally, Fischer said, Feldstein omitted the most important question: Does this program address the underlying causes of the crisis?

### CONCLUSION

Three years later, I think the justification for the Fund's "structural reforms" in terms of success can be found in Korea. The rather different outcome in Indonesia suggests that if success is the justification for breaching the jurisdictional barrier with which we started—more than fifty years ago—the answer is not so clear. One could look to other illustrations—at Russia, for instance, or at some of the African countries applying or refraining from applying for debt relief under the Heavily Indebted Poor Countries or the Poverty Reduction and Growth Initiatives.<sup>28</sup> Some have been successful, some not, and in some cases it is hard to tell.

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<sup>26</sup> Michel Camdessus, Address at the Council on Foreign Relations (Feb. 6, 1998), 27 IMF SURVEY, Feb., 1998, at 49, 50, available at <http://www.imf.org/external/np/speeches/1998/020698.htm>.

<sup>27</sup> Stanley Fischer, Address at U.C.L.A., *The IMF and the Asian Crisis* (Mar. 20, 1998), at <http://www.imf.org/external/np/speeches/1998/032098.htm>.

<sup>28</sup> See IMF ANN. REP. 2001, at 47–57.



I have not come to pass judgment. My purpose has been merely to point out that what Professor Lichtenstein and I learned in law school about the boundaries between states and the international community—part law, part history, part political theory—is in several respects obsolete, at least for those countries that need the IMF, the World Bank, and related agencies. It is also obsolete for those agencies themselves, though the replacement, that is a new combination of authorities and restraints, remains inarticulate. Once again, the facts on the ground have outrun the theoretical concepts.