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Understanding IMF stand-by arrangements from the perspective of international and domestic law: the experience of Venezuela in the 1990s

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Abstract

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Keywords

stand, imf, experience, understanding, law, domestic, arrangements, 1990s, international, venezuela, perspective

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UNDERSTANDING IMF STAND-BY ARRANGEMENTS FROM THE PERSPECTIVE OF INTERNATIONAL AND DOMESTIC LAW: THE EXPERIENCE OF VENEZUELA IN THE 1990S

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Understanding IMF Stand-by Arrangements from the Perspective of International and Domestic Law: the Experience of Venezuela in the 1990s

Gabriel Garcia[1]

I. Introduction

During the 1990s, international financial institutions such as the World Bank and the International Monetary Fund (IMF) promoted the so-called 'Washington Consensus'. One of the premises of the Consensus was that developing countries needed to embrace a market economy and build a legal system supportive of the rule of law in order to promote progress and defeat poverty. The onset of financial crises across South America and the inability of governments to deal with problems derived from this financial meltdown provided the propitious conditions for the IMF to implement its agenda of promoting a market economy and the rule of law in this region. Disbursements of IMF financial assistance were conditioned on the fulfilment of a set of requirements by the assisted country. Conditions were listed in the letter of intent addressed to the Fund by the government of the distressed country and linked to an instrument known as 'stand-by arrangement' (SBA). The IMF Guidelines on Conditionality state that SBAs were not international agreements. Based on this assumption, SBAs were often agreed by governments without complying with the requirements stipulated by domestic law. The implementation of SBAs caused tension in countries where legal systems required congressional authorisation for the adoption of the type of commitments included in a standard SBA.[2]

Reviewing a SBA agreed by the IMF and the administration of President Rafael Caldera in 1996 under the so-called 'Agenda Venezuela' program, this paper explores the legal nature of SBAs as a form of international law, and the interaction between these arrangements and domestic law. The main argument develops in this paper is that SBAs are international agreements that govern rights and obligations between the IMF and its state members and therefore, governments must comply with the requirements prescribed by the domestic legal system in order to enter into this type of contracts.

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2 See Article 56 of the Peruvian Constitution; Section 75 of the Argentinean Constitution; Articles 49 and 52 of the Brazilian constitution; and article 150 and 154 of the Venezuelan Constitution.

II. Legal Nature of SBAs

When several countries agreed on the creation of the IMF at the United Nations Monetary and Financial Conference in 1945, they adopted the Articles of Agreement. Among the issues regulated by this treaty are the transactions between the IMF and its members for the purposes of providing financial assistance. According to Article V (2) (a) of the IMF Articles of Agreement

> Except as otherwise provided in this Agreement, transactions on the account of the Fund shall be limited to transactions for the purposes of supplying a member, on the initiative of such member, with special drawing rights or the currencies of other members from the general resources of the Fund, which shall be held in the General Resources Account, in exchange for the currency of the member desiring to make the purchase.

The first aspect that is worthy of notice is that the financial assistance provided by the IMF to its state members is not in the form of an ordinary loan. In the context of the IMF's financial assistance, a member in need agrees with the IMF to purchase special drawing rights (SDRs) or any other usable currency held by the institution in exchange for its own currency with the obligation to repurchase its official money later.[3] Acquiring SDRs or usable currencies, a country is able to resolve its balance of payments problems. This is contrary to the case of multilateral developing institutions such as the World Bank that agree to provide loans to their state members to undertake particular projects. The second issue that is important to underline from Article V is that a state member in need initiates any process that leads to IMF financial assistance. In this case, the government has to explain why it asks to enter into a transaction with the IMF. After that, the IMF reviews the member proposal and determines whether the assistance is required to address balance of payments problems in a manner consistent with the Articles of Agreement.

Article XXX (b) of the Articles of Agreement defines a SBA as 'a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specified period and up to a specified amount.'

Apart from these two general references to SBAs, the Articles of Agreement do not clearly explain what legal form IMF financial assistance should take or what type of instrument should be signed between the IMF and its members to set the terms and conditions that govern a

[3] SDR means Special Drawing Right, a reserve asset created by the IMF in 1979. 'A freely usable currency means a member's currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets.' (Article XXX (f)).

specific transaction; however, the Articles of Agreement state that the IMF shall adopt policies on SBAs which guarantee resources from the Institution are used in a manner consistent with the provisions of this Agreement (Article V (3) (c)). Based on this article, the IMF Executive Board has further developed the necessary policies for the implementation of SBAs and it has institutionalised the use of the term "arrangement" to refer to the IMF's decision to provide financial assistance to a state member. Decades ago, Joseph Gold, a former IMF general counsel, described SBAs as "a novel form of international understanding".[4] By that time, Gold asserted that these arrangements could not be classified as a loan and claimed that they were closer to an exchange transaction in which the organisation exchanges SDRs or hard currencies for a less strong one.

The first SBAs were written in terms that resembled a formal contract.[5] In those documents, it was common to find words such as 'rights' and 'obligations', and in general they were written in the classic style of contracts. In the 1950s, there was not any major problem which would have caused a need to address the issue of the legal nature of IMF arrangements. During the initial period, the IMF commonly included macro-economic performance clauses in SBAs. These provisions were often thought necessary for the success of the member's economic program and were considered objective and easily verifiable, without requiring any subjective judgement of the Fund.[6] Those conditions focused principally on requirements related to macro-economic variables closely associated with IMF core areas of responsibility and they were achievable in a short period of time. This was in agreement with the fact that SBAs were a tool to manage financial crises in the short term.

At the beginning of the 1960s, the IMF worked chiefly with quantitative conditions and the inclusion of structural conditionality in IMF programs was rare.[7] It was later that its programs began to have political ramifications when the IMF timidly began to include qualitative requirements associated with fiscal issues. This type of conditions caused discontent in developing countries that considered the institution was getting involved in political issues. A conflict associated with structural requirements erupted in 1967 when the IMF did not require the United Kingdom (UK) to adopt qualitative conditions when they negotiated a SBA. At that

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4 Joseph Gold, 'The Law and Practice of the International Monetary Fund with Respect to "Stand-By Arrangements"' (1963) 12 *International and Comparative Law Quarterly* 1, 1.

5 Gold's article included examples of typical provisions incorporated in SBAs in the early days.

6 Ibid 17.

7 Margaret Garritsen Vries, the International Monetary Fund 1966-1971 (IMF, 1976) Vol I, 344; Harold James, 'From Grandmotherliness to Governance/the Evolution of IMF Conditionality' (1998) 35 *Finance & Development* 44.

time, the UK requested a SBA in the amount of US$1.4 billion to deal with a balance of payments crisis that derived from a devaluation of the pound sterling.[8] An agreement was speedily worked out between the UK and the IMF. With this SBA, the Fund accepted selling to the UK the required amount in a single transaction rather than in various disbursements, as was the IMF's common practice. Meanwhile, the UK representatives agreed to periodically consult with the IMF and accepted the institution's monitoring.

The UK agreement represented a departure from similar arrangements previously agreed between the IMF and other state members, particularly developing nations, in which money was disbursed in several instalments depending on the achievement of performance criteria. For this reason, Board directors who represented developing countries argued that the institution was applying preferential standards to industrialised nations.

The UK stand-by agreement affair produced a revision of the policies related to this type of arrangement that culminated in the approval of a revised policy in 1968. During the debate of the new policy, a discussion arose about whether a consultation scheme or detailed performance criteria should be included in SBAs. One of the main criticisms argued by developing countries against performance provisions was the increasing inclusion of detailed conditions and other clauses in SBAs which made those documents very rigid.[9] The type of agreement accepted by the UK, which only included consultation obligations, was more suitable and convenient to the interests of such countries than performance criteria.

The agreed reform tried to conciliate demands of the state members and the result was a policy that harmonised the needs for flexibility with the demands for equal treatment for all IMF members. According to the 1968 policy, consultation clauses would be included in all SBAs. It also established that SBAs that exceeded the reserve tranche would incorporate performance criteria clauses that were 'necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives, but no others'.[10] Finally, to simplify the IMF agreements, the Executive Board decided that 'in view of the character of stand-by arrangements, language having a contractual flavour will be avoided in the stand-by documents'.[11] In this way, the Board tried to limit the practice of including complex contractual clauses in SBAs.

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8 Garritsen Vries, above n 7.
9 Ibid 346.
10 Executive Board Decision No. 2603-(68/132), 20 September 1968 in Garritsen, above n 7, Vol II, 197.
11 Ibid.

Because of the terms used in this policy, it is assumed that this provision was included to address the complaint of developing countries about the rigidity and complexity of performance clauses that were included in those documents at that time; but it did not answer the question about the legal nature of the IMF arrangement. This solution was acceptable since by then, and in spite of the criticism about the complexity of SBAs, they were still less complex than agreements completed in the 1990s and they virtually excluded structural conditionality, making them more of an emergency management tool rather than a mechanism to encourage structural reforms

Years later, in the 1979 Guidelines on Conditionality, the Executive Board established that SBAs 'are not international agreements and therefore language having a contractual connotation will be avoided in stand-by arrangements and letter of intent'. With the 1979 Guidelines, the Executive Board changed the terms "avoidance of any contractual flavour", included in the 1968 policy, to a more straightforward proposal that clearly states that arrangements were not contracts and, therefore should not be written using contractual language. The change arrived at a time when structural conditionality played a more determinant role in IMF programs. The Guidelines on Conditionality, approved in 2002, still maintain that IMF arrangements are not international agreements and state

> A Fund arrangement is a decision of the Executive Board by which a member is assured that it will be able to make purchases or receive disbursements from the Fund in accordance with the terms of the decision during a specified period and up to a specified amount. Fund arrangements are not international agreements and therefore language having a contractual connotation will be avoided in arrangements and in program documents. Appropriate consultation clauses will be incorporated in all arrangements.

The decision of the Executive Board to assure that a state member can make purchase of SDRs or usable currencies is linked to a compromise by the state to adopt a set of policies and conditions. A government includes these policies and conditions in a letter of intent, a memorandum of understanding and sometimes, a memorandum on economic and financial policies (thereafter the State Member Documents). The State Member Documents that are addressed to the IMF Executive Board underline the financial, economic and legal reforms that a country has agreed to implement. Although the Fund recognises that the State Member Documents and the Executive Board decision are two halves of the same whole, in terms of crisis management, the institution prefers to legally separate both components and refuses the existence of a legal contract. This dichotomy of having a 'non-legal' document that contains legal rights and obligations is evident in the IMF literature that reviews the legal nature of SBAs.

For example, Ross Leckow, IMF Deputy General Counsel, has stated that 'a stand-by arrangement, although not a contract, is a legal instrument which gives the member certain legal rights'.[12]

The IMF thus provides its financial assistance using 'arrangements', which the institution claims are not legal contracts; however the character of the matters governed by a standard IMF arrangement and the mechanisms used by the institution to implement these instruments belie this statement. As Joyner claims 'an international document does not have to be called a treaty to be a binding agreement under international law … different names for international agreements are of little consequences.'[13] To resolve this apparent contradiction, it is essential to determine whether or not the SBAs are legal contracts.

The scrutiny of the legal or non-legal nature of SBAs is important in two levels. First, the nature of SBAs may affect the authorisation level required by a government to enter into an IMF arrangement. It would not be expected that a non-legal document follow a very complex approval process because it does not contain legal obligations which would affect a country. In contrast, a legal contract seems to be more formal and derives legal consequences for the parties, hence it should involve a more complex approval procedure. In turn, the authorisation requirements may affect the suitability of the IMF arrangement as a crisis management tool. This point has been recognised by Leckow who has affirmed that the non-contractual approach to SBAs facilitates that a country requests a SBA without having to satisfy its domestic legal requirements for the conclusion of an international agreement.[14]

Second, the matters that would be embodied in a non-legal agreement should be different from the subjects included in a legal one. If it is not, then to establish differences between non-legal and legal agreements would be irrelevant. At the same time, the depth of reforms should affect how extensively they are discussed among different national authorities and therefore, it would be expected that a legal contract that requires a country to adopt extensive and numerous reforms should produce more discussions and involve the executive and the legislative branches. A non-legal document with no major obligations to reform may only produce negotiations limited to a few national governmental officials.

[12] Ross Leckow, 'The Stand-by Arrangement its Legal Nature and Principal Features' in IMF, *Current Developments in Monetary and Financial Law* (IMF, 2003) 33, 38.
[13] Christopher Joyner, *International Law in the 21st Century/Rules for Global Governance* (Rowman & Littlefield, 2005) 107.
[14] Leckow, above n 12, 38.

These two reasons compel us to scrutinise the legal nature of the IMF arrangement to determine whether they are really non-legal documents. In order to do this, it is useful to begin by defining the term 'arrangement'. The *Black's Law Dictionary*, for instance, defines arrangement as 'A plan of a debtor for the settlement, satisfaction, or extension of the time payment of his debt'.[15] The legal term means an agreement between a debtor and a creditor containing contractual obligations between both parties in order to repay a pre-existing obligation. In day-to-day banking transactions, an arrangement of this type, governing rights and obligations of lenders and borrowers, would definitely have a legal character and it would be legally binding. It could be argued that this definition is not completely applicable to SBAs because the IMF's operations are not, strictly speaking, banking transactions. However, the IMF, as a financial institution, conducts its operations in the global financial arena where it is highly influenced by other financial players. This influence can be clearly seen in the vocabulary used in its documents where IMF technical terms are often linked to commercial banking language.[16]

The legal definition quoted above was written for a domestic context, however, and for it to be applicable to the functions of the IMF, it may be necessary to study the concept of arrangement from a more international perspective, using the notion of international agreements involving sovereign states. Christopher Joyner provides an understanding of this concept and states

> International treaties and conventions are contract-like agreements between two or more states, usually negotiated for the purpose of creating, modifying, or extinguishing mutual rights and reciprocal obligations. An international agreement establishes a formal relationship between states or international organizations that is intended to be legally binding and governed by international legal rules.[17]

The existence and enforceability of international agreements has been recognised by law; however, experts concur that not all international understandings are legal and they agree that international understandings could only achieve a legal status if they meet certain criteria.[18] In an international context, the execution of a legal contract means that failure to comply with its terms can make liable the non-compliant party. At the same time, the other party can legitimately enforce the contract and invoke the remedies accepted by international law. A non-legal contract, on the other hand, contains a moral commitment, the breaching of which would

[15] Black's Law Dictionary, 6th ed., s.v. 'arrangement.'
[16] See IMF, *IMF Lending, Factsheet*. IMF, < http://www.imf.org/external/np/exr/facts/howlend.htm>
[17] Joyner, above n 13, 106.
[18] See, eg, Abbot, Kenneth W. et al, 'The Concept of Legalization' (2000) 54 *International Organization* 401.

not have major consequences. The problem is how to differentiate between these two types of international instruments and to determine to which class SBAs belong.

In the international arena '"Legalisation" refers to a particular set of characteristics that institutions may (or may not) possess. These characteristic are defined according to three aspects: obligations, precision, and delegation'.[19] According to Abbot et al., 'obligations' are legal rules and commitments which are binding on states and other subjects (such as international organisations).[20] These legal norms call into play rules, procedures and the tools of the international legal system.

'Precision' means that a rule must clearly specify the type of action that is expected from a state. Precision is not present if the obligation is designed in general terms and makes it difficult for a country to identify the action expected by the other party. In addition, 'For a set of rules, precision implies not just that each rule in the set is unambiguous, but that the rules are related to one another in a non-contradictory way, creating a framework within which case-by-case interpretation can be coherently carried out'.[21]

Under the Abbot model, the last of these terms, 'delegation', is understood as the agreement of states and other international actors to transfer authority to third parties (i.e. courts, arbitrators and administrative bodies) to implement and enforce agreements.[22] Under the delegated authority, third party entities can interpret norms and settle disputes. According to this design, a higher degree of legalisation exists if the interpretation and dispute resolution mechanisms are organised on the basis of clear and generally applicable rules, instead of procedures that involve political negotiations between the parties.[23]

Interestingly, applying this model, the authors studied the IMF Articles of Agreement and concluded that the obligations contained in the treaty (for example, the obligation to make available foreign currency to pay imports and external debt) are not legally binding.[24] These authors did not apply the same analysis to SBAs however.

Like Abbot, Raustiala also develops a conceptual framework for analysing the architecture of international agreements.[25] This author accepts that international agreements can be legal or

[19] Ibid 401.
[20] Ibid 408.
[21] Ibid 413.
[22] Ibid 415.
[23] Ibid.
[24] Ibid 407.
[25] Kal Raustiala, 'Form and Substance in International Agreements' (2005) 99 *American Journal of International Law* 581.

non-legal (he uses the terms contracts and pledges). He constructs his model using three elements: legality, substance and structure. Although Raustiala's model was intended to explain why a country might select a non-legal contract over a legal one and vice versa, it provides some insights into the different components embodied in a legal international contract.

Raustiala begins by explaining that the selection between pledges and contracts is a choice between 'the use of law and the avoidance of law'.[26] For this author, contracts contain legally binding obligations for states, while pledges are limited to political or moral commitments. Raustiala argues that although it could, theoretically, be difficult to differentiate these categories, in practice, governments generally know very well the distinctions between them and they rarely confuse the two. Raustiala claims that when a government wants to agree to a pledge without assuming a legal compromise, it expressly declares this.

Another characteristic of legal contracts, according to Raustiala, is that they often have implications for domestic law and therefore, their ratification will require legislative approval.[27] A parliamentary authorisation involves discussions and more time, which are reasons why a government could decide to issue a pledge if it wants to assume a commitment in a more timely fashion. In addition, a pledge may not require disclosing information to the public.

The second element incorporated into Raustiala's framework is 'substance'**,** which is defined in terms of 'the depth or shallowness of the commitments. Deep agreements require significant changes from the *status quo*; shallow agreements require little or no change'.[28] For this author, pledges generally contain shallow commitments that do not demand radical reforms. In contrast, legal contracts usually contain provisions involving profound changes in order to achieve the obligations assumed. A clear example mentioned by Raustiala is trade agreements which are normally designed to be very deep and oblige countries upgrade their legal systems and procedures to international standards.

The third element in the Raustiala model is 'structure', which refers 'to rules, procedures, and institutional bodies for the collective monitoring and enforcement of parties' performance'.[29] This author discriminates between strong and weak structures. The former is characterised by systems that are able to deliver decisions related to a state performance and may be associated with a sanction.[30] The latter, on the other hand, does not include a system of revision, or if it

26 Ibid 586.
27 Ibid 589.
28 Ibid 601.
29 Ibid 605.
30 Ibid.

does, then the scheme is expressed in very general terms, without sanctions. Raustiala claims that pledges often lack a determined structure which includes clear reviews and sanctions.[31]

Through an examination of the above-mentioned frameworks, it is clear that there are international agreements that can be regarded as legal contracts and not mere moral commitments. Legal international contracts are legally binding agreements that govern rights and obligations among states, or between states and international institutions. These documents are governed by international law and, therefore they are enforceable through the application of a specific set of norms. From the above, three elements of international legal contracts can be identified: (i) international parties; (ii) a legal component that refers to the regulation of rights and obligations; and (iii) an institutional enforcement system formed by international norms administered by designated bodies.

SBAs can be examined according to this three-component approach. It is necessary to note that this study is focussed on the SBAs. Obligations directly derived from the Articles of the Agreement, which some authors consider are enforced in a more flexible way, are beyond the scope of this study.[32] It is also to be noted that this section limits itself to a discussion of SBAs agreed under the IMF's general resources account, excluding other facilities such as the Poverty Reduction Growth Facility, which is regulated by a different set of norms because it operates through a trust administered by the Fund**.**

a. International Parties

First of all, it can be seen that SBAs involve two international actors: sovereign states and the IMF. In regard to states, there is no doubt that they can be the subject of rights and obligations in international relations. When a nation signs a treaty, for example, it is assuming rights and obligations that are enforceable according to international law.

Conversely, the IMF is an international organisation formed by several sovereign states and governed by the Articles of Agreement. Conforming to this treaty, the institution is a legal separate entity capable of contracting and assuming legal rights and obligations (Article IX).

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31 Ibid 607. However, there are few cases in which it is possible to find a pledge that contains a strong structure. Raustiala mentions the Recommendations on Money Laundering of the OECD's Financial Action Task Force (FATF) that includes a review system according to which a state legislation is evaluated by other members. Compliance with recommendations is enforced under the grounds of reputation concerns and the threat of expulsion.

32 See, eg, Raustiala, above n 25; Abbot et al. above n 18.

b. Rights and Obligations

The second element that needs to be present in order for a legal agreement to exist is a set of rights and obligations for the international parties involved. As Joyner states, international agreements create, modify or extinguish rights and obligations between the contractual parties. Rights and obligations of an international agreement are what Abbot et al. refers to as 'obligations' and 'precision', while Raustiala includes into his model what he calls 'legality' and 'substance'.

The SBA definition claims that such facilities are only a resolution of the Executive Board, however this decision contains a declaration that gives a state member certainty and the right to request a specific amount of financial assistance if as long as it complies with the terms set by the Board.[33] Generally, IMF decisions on arrangements contain details about the amount to be made available to a state member, the disbursement schedule and the conditions attached to each allotment. Hence, if a country fulfils the requirements set by the State Member Documents, it has the right to receive the money agreed by the Executive Board and the IMF has the obligation to disburse the negotiated amount.

From the state's perspective, there are also obligations. A country that has purchased SDRs or usable currencies through the implementation of an IMF arrangement must repurchase the amount disbursed by the IMF and pay interests and fees. Additionally, the state must implement reforms and comply with the other conditions negotiated with the IMF. If it does not, the IMF can suspend the implementation of the arrangement, including the postponement of additional disbursements. Contrary to this view, Leckow argues that members are not under legal obligation to meet the conditions agreed with the IMF.[34] He states that 'The only legal consequence which arises from the failure of a member to meet a condition for purchase is that the member will be deprived of the right to purchase under the arrangement. The member will not be in breach of an obligation. Rather the member is free to "walk away" from its program and the arrangement at any time'[35]

This paper disagrees with Leckow and considers that SBAs contain legally binding rights and obligations and not mere political commitments. Besides the provision included into the Guidelines on Conditionality which declares IMF arrangements to be non-legal contracts, there are no additional statements attempting to confirm that they are. Even the Articles of

[33] Leckow, above n 12, 39.
[34] Ibid
[35] Ibid.

Agreement, the treaty approved for all the IMF's members and ratified by their legislative bodies, do not expressly exclude the legal nature of arrangements.

As mentioned above, according to Raustiala, international actors know very well the limits between moral commitments and legal obligations and this is the reason why they tend to publicly ratify this character when they undertake a pledge. Reviewing both State Member Documents as well as IMF press releases, it is not possible to find a single declaration confirming the non-legal character of SBAs.[36] This state of affairs tends to confirm that the SBAs are legal, rather than non-legal in nature. Indeed, the IMF's use of such terms as 'credit' or 'agreement', words which tend to be associated with legal contracts, in addition to their setting out of the agreed conditions upon which the Executive Board decision was based, all tend to support the legal character of arrangements.[37]

Because the State Member Documents and the IMF decision attach conditions, terms and schedules to financial assistance, it cannot be argued at the same time that the IMF sees its SBAs as non-legal. That would mean that the terms of assistance are not really binding and that a country can decide whether or not it is bound by such terms. This constitutes a real contradiction between the formal declaration of the Guidelines, indicating that SBAs are not legal contracts, and the actual content, which includes specific obligations and clear instructions of how they must be carried out. In fact, arrangement obligations cannot be considered good will commitments because they compel governments to implement policies and take actions to fulfil IMF conditions. The conditions are written in a precise form, specifying what they mean and when they must be achieved. Likewise, countries are obliged to pay administrative charges, and the arrangements include other terms and conditions which are all well defined. These are all characteristics of legal, as opposed to non-legal agreements.

In addition, IMF conditionality often implies profound changes. The magnitude of changes can be measured by the number of laws which the average IMF package requires a country to enact.[38] As the IMF-sponsored reforms usually contain implications for the entire legal system

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[36] The IMF generally informs the reaching of an arrangement through a press release.

[37] See, eg, IMF, 'IMF Approves Stand-By Credit for Indonesia' (Press Release 97/50, IMF, 1997); IMF, 'IMF Approves Augmentation of Argentina's Stand-By Credit to US$14 Billion and Completes Second Review' (Press Release 01/3, IMF, 2001); IMF, 'IMF Reaches Staff-level Agreement with Ireland on €22.5 Billion Extended Fund Facility Arrangement' (Press Release 10/462, IMF, 2010).

[38] For Instance, in 1994, the Costa Rican Legislative Assembly rejected an IMF agreement on the grounds that the program required the passing of 17 new laws in a way acceptable to the Fund but it did not specify how the laws must have be drafted in order to be accepted by the IMF. See, Diana Moller, 'Intervention, Coercion, or Justifiable Need? A Legal Analysis of Structural Adjustment Lending in Costa Rica' (1995) 2 *Southwestern Journal of Law and Trade in the Americas* 483, 514.

in developing countries, it would be only prudent to choose a legal form in order to involve the legislative body in the negotiations of such agreements. Countries such as Costa Rica have taken this approach and consider IMF arrangements as legal contracts which must be approved by the Congress.[39]

c. Institutional Enforcement System

The last component of a legal international contract is Raustiala's 'structure' or Abbot's 'delegation', upon which is based the enforceability of international legal contracts. As mentioned earlier, IMF powers are governed by the Articles of Agreement, an international treaty which must be understood and executed in good faith.[40] According to the IMF's constitutive charter, the Board of Governors and the Executive Board are the two bodies created to carry out the organisation's objectives through the interpretation, implementation and enforcement of the institution's norms. The Articles of Agreement provide for the mechanisms to enforce obligations assumed by the state members. In addition, the Executive Board has enacted a body of policies and regulations which further develop the principles contained in the treaty and the way in which arrangements must be enforced.

The IMF structure contains mechanisms to oversee compliance with the conditions accepted by state members when they agree to implement an IMF-sponsored program. Moreover, the Articles of Agreements and the various policies put in place by the Executive Board include sanctions in case of non-compliance with the obligations embodied in the IMF's arrangements. State members accept these enforcement norms when they ratify the Articles of Agreement and when they enter into an arrangement with the IMF. These features of the IMF scheme constitute a strong enforcement structure.

The IMF regulations provide a number of different tools to enforce arrangements. The primary safeguards are surveillance and conditionality because the IMF argues that such preventive measures are the first line of defence against overdue financial obligations.[41] There is a second line of defence, however, which guarantees enforcement of the financial obligations contained in IMF arrangements and these are even stronger than the preventive actions. These measures are contained in the IMF Articles of Agreement and the Executive Board Decision No. 12545-

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[39] Ibid. See also Article 56 of the Constitution of Peru that requires congressional approval for the ratification of any treaty that demands legislative measures for its implementation.

[40] Vienna Convention on the Law of Treaties *opened by signature* 23 May 1969, 1155, UNTS 331, Articles 3, 5 and 26.

[41] See IMF, *Review of the Fund's Strategy on Overdue Financial Obligations* (IMF, 2001).

(01/84) on the Fund's Strategy's on Overdue Financial Obligations adopted on 22 August 2001 (hereafter referred to as the Strategy).

The Strategy establishes various options and procedures in case of non-compliance with financial obligations. While the Guidelines on Conditionality expressly state that SBAs are not legal contracts, the Strategy assumes a different approach and converts a non-legal contract into a full legal international one by listing the 'Legal Sanctions or Remedies' that the IMF can invoke in case of overdue financial obligations. This change in wording in the Strategy document, in which the IMF expresses itself in terms of rights and obligations, remedies and sanctions, is decidedly an approach more appropriate to a legal, rather than a non-legal contract.

The Strategy begins by recognising the high financial limits imposed by overdue obligations on other IMF members, stating that, 'failure to meet scheduled obligations to the Fund is a serious breach of the principles that underpin the Fund.'[42] Then, the Strategy explains how overdue financial obligations will be dealt with. A leading principle therein is that staff should be flexible and propose an agreement based on the payment capacity of the country concerned.[43] In cases in which a member fails to fulfil any financial obligations and a consensual solution is not possible, the Strategy includes the legal sanctions that the IMF could use against a country. The document basically repeats the remedies provided by the Articles of Agreement.[44] These corrective actions are organised using an escalating timetable. This means that remedies must be applied beginning with the one that is less severe and given a prudential time for voluntary payments.

The first measure that the Fund can invoke to enforce an obligation is to declare a member ineligible to use the Fund's General Resource Account (Article XXVI, Section 2 (a)). If the IMF imposes this remedy, a member cannot request to enter into any new arrangement with the IMF. In the case where a state persists in its breach of financial obligations, the second alternative, after the declaration of ineligibility, is to suspend its voting rights (Articles XXVI, Section 2 (b)). The application of this sanction requires the support of 70% of the total voting powers of the IMF. The third and most radical remedy is a compulsory withdrawal of a member state in cases of continuing failure to fulfil member obligation (Article XXVI, Section 2 (c)). The

[42] Ibid., [23]. See also, IMF, *Review of the Fund's Strategy on Overdue Financial Obligations* (IMF, 2005).

[43] IMF, above n 41, [30].

[44] All remedies included in the Fund's Strategy on Overdue Financial Obligations are covered by Article XXVI of the Articles of Agreement and can be invoked not only for non-compliance with financial obligation derived from a SBA but for failures to fulfil any obligations under the constituting charter.

initiation of a compulsory withdrawal procedure needs a decision of the Board of Governors carried by a majority of the Governors having 85% of the total voting powers.

If any dispute arises between the IMF and a member which has been withdrawn, the controversy shall be submitted to arbitration by a tribunal of three arbitrators, one appointed by the IMF, another by the withdrawn member, and an umpire to serve in the event of disagreement, elected by both parties or by the President of the International Court of Justice (Article XXIX (c)). Any other dispute associated with the interpretation of the Articles of Agreement shall be decided by the Executive Board and its decision can be referred to the Board of Governors for a final decision (Article XXIX (a) and (b)).

While the IMF has used declarations of ineligibility against countries with overdue financial obligations, suspensions of rights and compulsory withdrawal are rare. For example, during the 1990s the IMF refused to arrange new facilities for countries such as Peru, Sierra Leona, Zambia, Cambodia, Honduras, Panama and Vietnam due to failure to fulfil their financial obligations.[45] In order to repay the arrears, for example, the first three mentioned nations accepted the implementation of a solution called 'the right approach'. Under this scheme, countries agreed on a Rights Accumulation Program that allowed them to implement an adjustment package to re-establish a good credit record and accumulate rights for future IMF disbursements through the achievement of targets mutually accepted by the IMF and the country considered.

In the event of members with long outstanding arrears obligations, instead of invoking the suspension of rights or compulsory withdrawal, the IMF has first followed a process of negotiation. In some circumstance, discussions have finished with an agreement acceptable to both parties (for example, Sudan and Liberia). Other non-performing countries have not been able to achieve satisfactory results (for example, Zimbabwe). As a result, the IMF implemented the suspension of votes and initiated compulsory withdrawal procedures.[46]

45 IMF, above n 41, [9].

46 See IMF, 'IMF Initiates Compulsory Withdrawal Procedures for Zimbabwe' (Press Release 03/210, IMF, 2003); IMF, 'Zimbabwe Pays its Overdue Financial Obligations to the IMF under the General Resources Account' (Press Release 06/33, IMF, 2006). On September 2001 the Fund declared Zimbabwe ineligible to use the general resources account due to overdue financial obligations and lack of cooperation with the IMF. Later in June 2003, the Executive Board suspended the voting rights of Zimbabwe. Finally, because the country had not fulfilled its obligation, the IMF decided to initiate the compulsory withdrawal process in December 2003. However, Zimbabwe made a partial payment in February 2006 and the Executive Board decided to suspend the withdrawal process.

Despite the limited application of IMF sanctions, such remedies do exist and make obligations derived from SBAs enforceable. As Raustiala claims, the notion of structure must not be confused with the enforcement effectiveness of an international agreement.[47]

In addition to these legal remedies against a non-compliant state, there are other consequences derived from the failure to fulfil financial obligations. For example, the IMF can include special charges and additional interest on overdue obligations to compensate for the lack of due payment.[48] Moreover, in order to maintain the value of its currency holdings, the IMF may adjust the value of a member's currency and compel a state to pay back additional usable currencies or SDRs to cover any depreciation of value.[49]

Another IMF policy document that tackles potential defaults on the part of an IMF member state is the 'Misreporting and Noncompliance Purchase in the General Resources Account Guidelines on Corrective Action', originally enacted in November 1984 and amended by Decision No. 12249-(00/77) in July 2000 and Decision No. 13849-(06/108) in December *2006*.[50] These Guidelines are applicable in cases where a member state makes a purchase of SDRs or usable currencies from the IMF General Resources Account which does not comply with the terms of an arrangement or regulations applicable to the purchase. In such a case, where the state has completed a purchase of usable currency or SDRs from the IMF because it had submitted information which was subsequently proven to be incorrect (for example, the state did not complete prior actions required by the IMF),[51] it is expected that the state complete a repurchase of the outstanding amount within a period of 30 days. This is the equivalent of a technical default and full mandatory prepayment under a commercial loan. The lack of mandatory repurchase may produce the invocation of Article V, Section 5 of the Articles of Agreement; that is, the declaration of ineligibility to use the Fund's General Resources Account.

Finally the information about overdue financial obligations is made available to the public, a situation which could have legal, financial and moral repercussions. It may have legal consequences because most bonds issued by sovereign states, as well as loan agreements in which they are party as a borrower, include a cross-default clause which considers the lack of

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[47] Raustiala, above n 25, 605.

[48] IMF, above n 41, 13.

[49] Ibid [21].

[50] IMF, Misreporting and Noncompliance Purchase in the General Resources Account-Guidelines on Corrective Action (IMF, 1984). Amended by Decision No. 12249-(00/77) July 2000 and Decision No. 13849-(06/108) in December *2006.*

[51] Prior actions are measures that a country is expected to adopt before the approval of an IMF arrangement or completion of a review.

payment to the IMF as an event of default.[52] The breach of IMF arrangements brings financial consequences because other fund providers would refuse to facilitate fresh resources to a non-performing country, and even if the country were able to find another source of financing, it would be more expensive because of higher interest rates. Finally, the public becoming aware of a country's default would expose a country to the censure of the international community.

In summary, the existence of two international parties, legal obligations and an institutional enforcement system in the context of SBAs, allow us to conclude that these instruments can be considered legal contracts. Such arrangements are agreed between state members and the IMF; they govern rights and obligations between them and they are regulated and enforced by a clear set of international norms administered by the IMF. Obligations embodied in the State Member Documents and the IMF decisions are far from being a mere moral or political undertaking. Breaches of these obligations trigger specific legal sanctions, from the payment of penalties to the compulsory withdrawal from the institution in the most serious infractions.

III. Venezuelan Experience: Agenda Venezuela

Since the 1920s, oil has played a decisive factor in the policy-making process in Venezuela. Oil production represents about 70% of Venezuelan GDP. Oil has even affected the relationship between the country and the IMF. The government's interest in the IMF's orthodox policies has fluctuated following the trends of the international oil markets. When the market is depressed, the government has tented to convert to neo-liberalism and other policies sponsored by the IMF and when prices are high, it has resisted any intent to convert to a market economy.

When Rafael Caldera assumed a second presidential mandate in February 1994, Venezuela was affected by a banking crisis that was trigged by the collapse of *Banco Latino* in December 1993. The management of the banking crisis by Caldera can be divided in two stages which coincide with the economic programs launched during his government. The first program was known as "My Letter of Intent to the Venezuelan People". The program's name was a criticism against the letter of intent and the SBA agreed by President Carlos Andres Pérez, with the IMF in 1989. Different from Pérez's IMF sponsored program, Caldera decided to implement a heterodox approach and reverted some of the neo-liberal measures implemented by Pérez (i.e.

[52] See, eg, the Listing Memorandum prepared by the Bolivarian Republic of Venezuela for the offer of the US$1,500,057,000 5.75% Bonds due 2016 which includes as an event of default 'if (i) the Republic ceases to be a member of the IMF or ceases to be eligible to use the general resources of the IMF'. Bolivarian Republic of Venezuela, 'Listing Memorandum US$1,500,057,000 5.75% Bonds due 2016' (2005), 22. Available at https://www.bancobest.pt/ptg/BESTSite/best_docs/VENZ_USP97475AG56.pdf

abandonment of the privatisation program, postponement of petrol price increases and suppression of the value-added tax).

After the failure of the Letter of Intent to the Venezuelan People, Caldera's administration launched a second program known as 'Agenda Venezuela'. This program was supported by a SBA. Agenda Venezuela did not really differ from other IMF sponsored programs. The government argued, however, that it was a social program and the Venezuelan negotiators' focused on people first caused the IMF to make 'a 180 degree turn to benefit Venezuela.' [53] Negotiations with the IMF were complex and lasted more than one year, a period that was used by the government to adopt various prior actions required by the IMF.[54] Finally, in July 1996, Venezuela entered into a twelve-month SBA with the IMF for a total of US$1.4 billion. The State Member Documents were signed by the minister of finance, the minister of planning and the president of the BCV with little or none participation by the members of the Congress.

Agenda Venezuela and the SBA included more than macro-economic performance clauses and called for the adoption of structural reforms. Underneath Agenda Venezuela was the idea of dismantling the interventionist-state model used by the country and the implementation of a new market-oriented model where the state liberalised the economy and promoted foreign investment, including in sectors that were traditionally reserved to the state (i.e. oil industry). The goal required restructuring the government apparatus, adopting sound fiscal and monetary policies and the implementation of legal reforms.

Although compliance with some of the IMF conditions required congressional actions, this body was not directly engaged in the negotiations and congressmen had limited access to information about the agreement with the IMF. The government only provided certain access to the information to the members of the Congress at the time this body was compelled to pass the legal reforms required under the IMF program and approve the *1996 National Budget Act* which included debt payments to the IMF.[55]

While the position of the IMF of considering SBAs as non-international agreements may facilitate a country requests a SBA without having to satisfy the legal domestic requirements for

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[53] BBC Monitoring Services: Latin America, 'Finance Minister Discusses Economic Plan, Negotiations with IMF', 30 April 1996.

[54] In the documents prepared by the government and agreed by the IMF these actions were called 'interim measures', a term that differs from the official 'prior actions'. See, IMF, 'Venezuela-Staff Report for the 1996 Article IV Consultation and Request for Stand-By Arrangement' (ERS/96/108, IMF, 1996) 50.

[55] Reuters News, 'Venezuelan Tax Reforms Needed for IMF Deal', Reuter News, 14 December 1995; Dow Jones Newswires, "Debt Servicing and the 1996 Budget,' Dow Jones, 16 December 1995.

the conclusion of an international agreement, it is doubtful whether this approach is effective to achieve this goal, especially the requirement related to congressional approval. This is particularly valid in countries where in order to determine whether or not an international undertaking requires congressional approval, the legal system contains norms that not only consider the name used to identify the document but also substantial criteria that focus on the type of obligations assumed by the government. This seems to be the case of Venezuela.

According to Article 128 of the 1961 Constitution,[56] treaties and international agreements had to be approved by a special law enacted by the Congress unless they referred to pre-existing obligations; or they were associated with ordinary actions common in international relations; or they were signed by the president exercising powers that were granted by the Constitution. In addition to the existence of Article 128, there was another provision in the 1961 Constitution that required congressional authorisation for the subscription of contract that affected the national public interest and were entered by the government with a foreign state or entity (Article 126).[57]

The 1961 Constitution did not provide a definition of ‘’national public interest’, a term highly disputed among Venezuelan experts. For example, Brewer-Carías claims that contracts of national public interest refer to contracts that involve the federal government and its agents, as opposed to those agreed upon by states and municipalities. [58] Second, Brewer-Carías states that contracts that affect the national public interest and require congressional approval are those that are beyond the normal conduct of governmental affairs and are not regulated by law. This position has been criticised for its formalistic approach and for not considering other substantial factors in determining whether a contract affects the national public interest.

Rafael Badell believes that contracts of national public interest is a category of contract that has been historically subjected to congressional approval to avoid that the government can enter into agreements from which foreign states or international entities may derive claims against the country.[59] Following this argument, Badell refers to other Venezuelan commentators who concur that defining contracts that affect national public interest requires more that a formalistic approach. For example, Perez Luciani states that contracts of public national interest are those

56 The 1961 Venezuelan Constitution was in force until December 1999 when a new Constitution was approved by referendum. Article 154 of the 1999 Constitution is equivalent to Article 128 of the 1961 Constitution.

57 Article 126 of the 1961 Constitution is equivalent to Article 150 of the 1999 Constitution.

58 Allan Brewer-Carías, 'Los Contratos de Interés Nacional y su Aprobación Legislativa' (1982) 11 *Revista de Derecho Público* 49.

59 Rafael Badell Madrid, ‘Contratos de Interés Publico Nacional’ (2005) 19 *Revista de Derecho Público*. Available at www.badellgrau.com/

that, due to their economic or financial magnitude and importance, have significant consequences for the country, justifying legislative control.[60] Thus, using this criterion, a contract that has a high cost and may compromise the financial stability of the country can be considered a contract that affects the national public interest. This is also the view of Melich-Orsini who thinks that this notion is associated with the idea of large contracts that affect the financial stability of the country and may derive international claims that affect the sovereignty of Venezuela.[61] Fermín Toro Jiménez argues that contracts of national interest are those completed by the federal government with foreign entities and which could derive claims against the country.[62] The constitutional history of Venezuela suggests that the goal of establishing a congressional control for this type of contract is to avoid a practice that was common in Venezuela according to which government officials confidentially negotiated loans with foreign entities without adequate legislative controls and guidance.[63]

The use of a qualitative approach has been used by the Venezuelan Supreme Court that interpreting similar provisions in the 1999 Constitution, has stated that in order to qualify an agreement as a national public interest contract, it is necessary to fulfil the following conditions: (i) the contract has been executed by the Republic; (ii) the object of the contract is essential to achieve the goals of the federal government and satisfy the interest of the national community; and (iii) the contract contains a debt to be paid by the government over a period of several fiscal years.[64]

The Supreme Court has also indicated that the government did not need congressional approval when it carries out financial transactions associated with offers of government securities (i.e. treasury notes).[65] The Court, however, has considered that it is different in the case of loan contracts in which the country assumes a debt with a foreign entity. In this case, the National Assembly must exercise its control powers and authorise the government to enter into this type of contracts.[66]

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60 Gonzalo Perez Luciani cited by Badell, above n 59.
61 Tribunal Supremo de Justicia, Sala Constitucional, Decisión 2241 (Andrés Velásquez, Elías Mata y Enrique Márquez), 24 Septiembre 2002, 17.
62 Fermín Toro Jiménez cited by Badell, above n 59.
63 See, eg, Tomás Carrillo Batalla, *Cuentas Nacionales de Venezuela 1831-1873* (BCV, 2001); Tomás Carrillo Batalla, *Cuentas Nacionales de Venezuela 1874-1914* (BCV, 2002). Venezuela suffered a naval blockade in 1902 imposed by several European countries that were demanding the payment of loans by the Venezuelan government.
64 Tribunal Supremo de Justicia, Decisión 2241, 18.
65 Ibid 20.
66 Ibid 21.

In the first part of this paper, it was argued that a SBA was a legal international agreement. Based on this conclusion, it could be said that the Venezuelan government must have obtained the approval of the Congress to agree on the SBA associated with Agenda Venezuela unless the contract with the IMF could have been classified within one of the exemptions provided by Article 128 which was not the case.

If Caldera administration assumed that the SBA associated with Agenda Venezuela was not an international agreement as stated by the IMF, it should have considered that it was a contract that affected the national public interest as defined by Article 126 of the 1961 Constitution. This paper arrives to this conclusion considering the country entered into a SBA with the IMF to deal with a crisis that was beyond the normal conduct of governmental affairs and obtain financial resources to address balance of payments problems. Indeed, the Venezuelan government requested the IMF's financial assistance not to deal with a normal situation but with a banking crisis which had negative social, economic and financial consequences. The crisis was so complex that Caldera's administration issued Decree 208 on 27 June 1994, suspending several constitutional rights and declaring a "financial emergency' in July 1995 based on the *Regulation of the Financial Emergency Act*.[67] Thus, it was not doubt for the government that the situation was far from the normal conduct of government affairs.

The SBA was also of great importance considering that the government was obligated to implement several legal reforms within specific deadlines. Various of these reforms required for the Congress to pass various laws (for example, the *Labour Act*, the *Tax Code* and the *Value-Added Tax Act*), agreed between the Venezuelan government and the IMF. The terms of the reforms required by the Fund were specific. To illustrate, the Congress had to increase the VAT from 12.5% to 16.5% and amend the *Labour Act* to suppress the retroactivity of severance payments associated with the termination of an employment contract and limit this type of payment 'to reasonable levels'.[68]

Although the IMF conditions required congressional action, this body was not directly engaged in the negotiations and congressmen only had limited access to the terms negotiated because it was forced to pass the above-mentioned legal reforms. The pressure imposed by the executive on the Congress emerged in March 1996 before the government achieved a final agreement

[67] Decree 241 was later revoked by Congressional Agreement on the same day restating all the suspended rights but the economic rights. Later the same day, Caldera issued Decree 285 con-validating Decree 241.

[68] IMF, above n 54, 14.

with the IMF. That month, the legislative body refused to pass the required changes, forcing the government to defer the completion of the agreement with the IMF for a month.[69]

Finally, the SBA included several financial obligations that had to be complied by the government associated with repayment of the money withdrew from the IMF and the payment of interests and administrative fees that would be made in different fiscal years. As it was explained earlier, default on financial obligations to the IMF could legally trigger claims from the IMF and could risk other loans and bonds issued by the country.

All these factors suggest that the SBA was not only an international contract but also a contract that affected the national public interest; and therefore, it must have been approved by the Congress.

IV. Conclusions

The existence of two international parties, legal rights and obligations, and an institutional enforcement system in the context of SBAs, allow us to conclude that these instruments can be considered international contracts and a source of international law. Arguing that SBAs are not legal contracts, the IMF paves the way for governments to escape from constitutional systems of checks and balances, allowing governments to deal with SBAs as an ordinary administrative matter. Such a solution could have worked during the 1950s and 1960s when SBAs were limited to compliance with a few macro-economic performance clauses and were used as an emergency tool to manage financial crises in the short run. This situation changed in the 1990s when more and more structural conditions were attached to SBAs. Some of these conditions required legislative actions and deep reforms, transforming SBAs in a mechanism to achieve structural reforms that could be hardly implemented in a short time period.

The IMF’s categorisation of arrangements as non-legal instruments together with the existence of conflicting constitutional provisions create a legal grey zone in the implementation of IMF programs, a situation which is in conflict with the clarity and certainty required by the principles of the rule of law promoted by the Institution. This also ignores global demands for more transparency in IMF’s transactions.

[69] Reuters News, 'Matos sees Political Will for IMF talks', Reuter News 01 March 1996; Noti-Sur-Latin American Political Affairs, 'President Rafael Caldera Faces Mounting Protests against Economic Measures', Noti-Sur'Latin American Political Affairs 05 April 1996; Humberto Marquez, 'Government, IMF Seek Support for Tough Reforms', Inter Press Service 12 April 1996.