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The Bretton Woods Institutions and the Rule of Law: An Urgent Good Governance Issue

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ABSTRACT

At present proposals to reform the Bretton Woods Institutions (BWIs) abound, and good governance and the Rule of Law have been widely preached. It is all the more surprising that one urgent problem has practically eschewed attention: making the BWIs obey their own statutes and the principles they preach - applying good governance and the Rule of Law to those preaching it so keenly. This is foreseen by their statutes. But the BWIs honour their statutes in the breach rather than observance. Open violations of BWI-statutes have caused substantial damage to Southern countries, and increased BWI-income. BWI-flops create BWI-jobs. The BWIs are not preferred creditors as they know but nevertheless assert publicly. As a rule, BWI-claims are statutorily subordinated. Holding the BWIs financially accountable for damage done (tort) is enshrined in their statutes. Simply by observing rather than breaching their own statutes, good governance and the Rule of Law can be brought to the BWIs as their founders had intended. This would have enormously positive effects on development.

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The Bretton Woods Institutions and the Rule of Law: An Urgent Good Governance Issue

Kunibert Raffer

1 Introduction

At present proposals to reform the Bretton Woods Institutions (BWIs) abound. Especially reform proposals for the IMF have become some kind of cottage industry. Changes of its voting structure have been discussed, as well as reforms that would make the Fund more responsive to the needs of its members. The decision at the 2006 Annual Meetings in Singapore to make marginal adjustments in voting shares is one tangible though fairly irrelevant outcome. Early repayment by many clients, a corresponding shrinking of the Fund's outstanding claims from the 2002 peak of SDR (special Drawing Rights) 70 billion to some SDR 15.5 billion (end 2006) as well as income shortfalls projected to surpass 40% during 2008-10 (Torres, 2007, p.9) have no doubt contributed to this decision.

While these widely discussed proposals are useful, one urgent and basic institutional issue has received surprisingly little attention: the need to make the BWIs respect their own statutes. One may well argue that there is little reason for reform if and as long as the BWIs do not obey their Articles of Agreement anyway. This minimum of good governance is the basic precondition of any correct management. Considering the substantial damage inflicted on Southern members by the present practice of openly violating one's statutes while preaching the benefits of good governance and the Rule of Law to these very countries, this is surprising.

To the detriment of their members, both BWIs claim to be preferred creditors, making "debt management" much more difficult. It is patently unfair to debtors and private creditors. Fully in line with responsible and good governance, these institution's founders foresaw no preference and stipulated the necessary preconditions for applying tort law in their Articles of Agreement. Over decades, however, the BWIs have continuously laboured to undo this cornerstone of good governance, creating a perverted incentive system where they benefit financially and institutionally from tortiously done damage. This is the very opposite of sound economic and legal principles as well as at severest odds with the market mechanism. As long as this fundamental abnormality is allowed to continue, the BWIs' main governance problems will continue to exist. Unless they are made obey their own statutes and respect the Rule of Law, any reform is essentially meaningless. Discussing the issues of preferred creditor status and financial accountability, this paper shows how easily the Rule of Law and economic common sense can be re-installed. Without this change, the BWIs will never work properly.

2. Falsely Claiming Preference

Although the status of preferred creditor is alien to their statutes, the BWIs have over decades quite successfully created the impression that their claims would be entitled to preferential treatment. This perception is completely unfounded. In contrast to what they assert, the technical concept of preferred creditors does not apply to the BWIs. Neither legally nor pursuant to their own statutes do they have preferred creditor status. The International Monetary Fund (IMF) even published this fact on its homepage. Quite on the contrary, their founders wanted BWI-claims subordinated to other claims. Their function as international institutions safeguarding public interest explains this decision. The BWIs have undone their founders' intention, reversing it into its opposite, a move that is at the roots of present problems.

Since the very start of "debt management" by the BWIs, they have asserted that they would be preferred creditors and could therefore not be expected to "forgive" any debt. Once debt reduction had become unavoidable, International Financial Institutions (IFIs) claimed that others would have to grant it. Over the years, this wrong claim, fully supported by the Paris Club, gained more and more credibility. For poor countries with large shares of multilateral debts this means an important, additional difficulty. Even after James Wolfensohn had broken the taboo of reducing BWI-debts, pushing through the first Highly Indebted Poor Countries (HIPC) Initiative, IFIs have remained privileged. Under HIPC all other creditors were supposed to take haircuts first. Only if the BWIs would consider this haircut still insufficient, their own claims could be touched. Unsurprisingly, under the Multilateral Debt Reduction Initiative (MDRI), the BWIs were again able to shift the financial burden onto others. Most cleverly, they were able to organise their bail-out based on the wrong assertion that they would be preferred creditors and must be shielded from the consequences of their own lending.

Granting bilateral reductions, the Paris Club has demanded comparable losses from the private sector and other non-Paris Club official creditors, but not from multilaterals. However, such decisions by some creditors to extend preferential status *de facto* to IFIs differ fundamentally from a legal right of being exempt, even though the private sector has usually acquiesced. There exists no legal obligation to grant such treatment. Regarding debtors, it is obvious that they are not in a position to argue when, under severe duress, they have to approach IFIs. More nicely put, though equally clear:

> "Most debtor countries regarded staying current with the Fund as of primary importance, if only because it was a prerequisite for maintaining normal relations with other creditors and with donors. Nevertheless, as noted in several of the case studies above, some countries with protracted arrears had concluded that the national

> interest lay in repaying those creditors … that were willing to provide a positive net flow of resources."
>
> (Boughton, 2001, p.820)

2.1 The IMF

By 1988, the IMF could no longer ignore problems with Southern debtor countries unable to service their debts to the Fund in time. After more than a decade of "adjustment" some economies were still not economically viable again. Reacting to this failure, the IMF tried to find arguments in favour of preference. The obvious, namely that the IMF had no legal or contractual status as a preferred creditor, could not be denied (cf. *ibid*., p.820) Supporting their institution's drive for undue preference, its "Executive Directors stressed the . . . need . . . in practice . . . to treat the Fund as a preferred creditor." (*ibid*.) In September 1988 the Interim Committee endorsed this position and "urged all members, *within the limits of their laws*, to treat the Fund as a preferred creditor." (*ibid*., p.821; emphasis added)

In contrast to the impression the IMF has tried to create, there is no legal privilege. The qualification "within the limits of their laws" shows that even this IMF-organ could not bring itself to demand unconditional preferred creditor status for the Fund from its own members. The Committee accepted that national laws may forbid any such treatment. Its exhortation has no legal relevance. It simply is the opinion or wish of one IMF organ, to which it is, of course, entitled – as anyone is entitled to claim or wish to be the world's best poker player. This passage clarifies that there is no legal hindrance to treating the IMF like any other creditor, i.e. expecting it to take the same haircut as the private sector. It is easy to understand, why the Sovereign Debt Restructuring Mechanism (SDRM) advocated by the IMF attempted to obtain *de jure* preferred status for IFIs in an extremely self-serving way. (cf. Raffer 2006)

Rutsel Silvestre (1990) published a very thorough analysis of IFI-preference in international law. Her conclusion is that “general international law contains no compulsory standard of conduct requiring the preferential treatment of any external creditor, including the Fund.” (*ibid*., p.825) She goes on arguing that the IMF’s Articles of Agreement “contained a provision suggesting that others would have preference on the Fund” (*ibid*.) before the Second Amendment. The author refers to Schedule B, paragraph 3 on the calculation of monetary reserves on which repurchase obligations were based. It seems logical to argue that the exclusion of holdings “transferred or set aside for repayments of loans during the subsequent year” was done "to give preference in repayment to lenders other than the Fund." She argues that the intention of deleting this calculation and with it Schedule B, paragraph 3 from the statutes by the Second Amendment “was not to repudiate the underlying thought that it was beneficial to encourage bank lending by giving banks and others a preference in repayment” (*ibid*. p.814) Unfortunately, rather than making the IMF clearly financially accountable when conditionality was introduced, as economic reason would demand, initial intentions were blurred. Still, the IMF’s statute contains “a presumption against a preferred creditor status” (*ibid*.) Her conclusion is corroborated by the statutes of Multilateral Development Banks (MDBs), and by the IMF’s attempt to gain legal preferred creditor status via the SDRM.

However, even if one chose not to agree with her, two facts cannot be denied:

a) the IMF’s founders subordinated its claims to others, no doubt because of the Fund’s public policy tasks

b) even nowadays, its Articles of Agreement contain no wording whatsoever that could be stretched to construe preferred creditor status. While IMF-friendly argumentation may possibly challenge Rutsel-Sylvestre on subordination, it cannot claim any preference.

Some clarifying facts must be made in the case of the IMF. When it was established, conditionality did not exist. Loan loss provisions were considered unnecessary. Acting as an emergency source of finance providing short-term liquidity on a comparatively small scale without any strings attached justified unconditional repayment. Nevertheless, no preferred creditor status was enshrined in its statutes but the possibility to waive its immunity. This is all the more interesting as it is difficult to think of reasons for lawsuits under these circumstances of unconditional emergency lending. Payments such as "criminal debts" (i.e. drawings disbursed fully knowing that substantial percentages would disappear in private pockets, *v*. Winters, 2004) might be one logically possible case for which the IMF's founders wanted to allow legal relief. Violating one's own statutes, for instance by forcing members "to meet a large and sustained outflow of capital" (prohibited pursuant to Art.VI.1.a) as done in Asia 1997-8 or by denying them their membership right to "exercise such controls as are necessary to regulate international capital movements" (Art.VI.3), as usual over decades, may be another. However, the IMF has no explicit statutory obligation to grant debt reduction, which can again be explained by its initial role as a helper without conditionality. Had its founders wanted it to do more, they would doubtlessly have mirrored the statutes of the International Bank for Reconstruction and Development (IBRD).

2.2 The IBRD and IDA

As in the case of the IMF, the information that neither the IBRD nor its window for the poorest countries, the International Development Association (IDA), is a preferred creditor is published at their respective homepages, more precisely in their Articles of Agreement. In contrast to the IMF, their own statutes clearly subordinate their claims.

The IBRD's Articles of Agreement recognise default as a fact of life, requesting it to prepare or this eventuality. Article IV.6 demands a special reserve to cover what Article IV.7 calls

“Methods of Meeting Liabilities of the Bank in Case of Defaults.” Detailed rules on how to proceed follow. As the Bank is only allowed to lend either to members or to other borrowers if member states fully guarantee repayment (Article III.4), the logical conclusion is that default of member states was definitely considered a possible, maybe even an occasionally necessary, solution. The IBRD’s founders understandably wanted lending to be subject to some market discipline, and designed mechanisms that would allow the Bank to shoulder its fare share of risk. By contrast, other creditors, especially the private sector, have no similar obligation. Logically, the IBRD is meant to grant relief well before others. Its own statutes subordinate its claims. The task of fostering development would explain this decision of its founders.

The way how the Bank chooses not to obey this obligation of its own statutes is highly disingenuous. It simply refuses to acknowledge default, even when countries have not paid anything for six or seven years (Caufield 1998, p.319) Claiming no default as long as debtor countries stay "in mutual respectful contact" (*ibid*.) with it, the IBRD mocks all acceptable accounting rules. Real banks emulating this would definitely not be considered as models of best practice and good governance.

But the IBRD’s statutes go even further. Article IV.4.c confers a right onto members suffering “from an acute exchange stringency” – viz. threatening default - to ask for relief. It stipulates: “If a member suffers from an acute exchange stringency, so that the service of any loan contracted by that member or guaranteed by it or by one of its agencies cannot be provided in the stipulated manner, the member concerned may apply to the Bank for a relaxation of the conditions of payment. … (ii): The Bank may modify the terms of amortization or extend the life of the loan, or both.” Article IV.4(c) specifically demands taking both the Bank’s *and* such member’s interests into account. One notices that no conditions are stipulated for such relief, except the member’s urgent need for help.

Under pressure from private business the IBRD waived the negative pledge clause in its loans in 1993, which would have guaranteed that no creditor's claims could have preference over the Bank's (Caufield 1998, p.323) If the IBRD had been *de jure* preferred there would have been no need for such clause, indeed no point in waiving it, as legal norms always prevail. By waiving this right, the IBRD acknowledged that its claims should not be treated in the same way as private claims, but should be subordinated to them. Checks of the IBRD, *inter alia* by Canada's auditor-general, concluded that it has no preferred status (*ibid*.)

Not specifically mentioning default, IDA's Articles of Agreement are somewhat vaguer. Pursuant to Article V.3, titled "Modifications of Terms of Financing," IDA may "agree to a relaxation or other modification of the terms on which any of its financing shall have been provided." IDA, too, must take "the financial and economic situation and prospects of the member concerned" into account. In the case of maturities of thirty-five, forty, or even twenty years with ten year grace periods and "no interest charge" (IDA prefers to call its 0.75% interest rate a service charge, apparently in line with Islamic banking principles) this leaves little realistic alternatives but outright reductions.

The country has the right to ask for relief. The IBRD may – but need not – grant it. While this does not mean that the Bank has to grant relief whenever asked, it certainly constitutes a general obligation to grant relief when and where appropriate, an obligation hardly reconcilable with the purported preferred creditor status and the Bank's behaviour in the past. Other creditors, most clearly the private sector, have no such obligation. The often heard "argument" that relief for multilateral debts cannot be granted or would make development finance inoperable, was not shared by the IBRD's and IDA's founders formulating their respective Articles of Agreement. Steadfastly denying debt relief and claiming to be a preferred creditor the IBRD is definitely at severe odds with its statutory duties and the truth. Acting in this way the Bank and IDA have inflicted gravest damage on members under duress, Southern countries forced to turn to them for help because of acute foreign exchange stringency. Using the possibilities allowed, even suggested by their statutes - thus obviously intended by their founders - would no doubt have defused quite a few crises.

In IDA’s case the argument was used that debt relief would reduce the volume of future lending, thus endangering development financing, a dander obviously not seen by its statutes. IDA is a fund fed by periodic replenishments and reflows. Reducing reflows is immediately possible without endangering the fund. The argument that amortisations are needed to refill IDA, which would preclude debt relief, is definitely no longer valid since IDA started to distribute grants. IDA 13 foresaw between 10 and 25% of grants depending on absorptive capacity and country performance. Grants to finance basic education or health – as recommended by Raffer and Singer (1996 pp.209f) - do not create re-flows, just like cancelled IDA-debts. Since grants are possible without harming the functioning of IDA, debt relief is logically possible as well. If grant-financing does not endanger the functioning of IDA, debt relief cannot do so either. Undeniably no economic hindrance exists to apply IDA’s Articles of Agreement to the full.

The common problem of debt relief persists, of course. Unless reductions are financed additionally, loanable funds decrease. Real lending capacity has to be assessed on a "net base" though. Programme credits just granted to allow reflows “on time” must not be counted. Merely substituting (over)due credits by new ones, they do not constitute new resources. The additionality problem also exists with Official Development Assistance (ODA). Where debt reductions are covered by ODA-budgets without making additional resources available, net ODA (ODA minus debt relief) decreases.

The original statutes of all IFIs clearly subordinated multilateral claims. Their founders obviously wanted them to grant relief well before others. Their task of fostering development would explain this decision. Over the years MDBs have reversed this decision in violation of their own statutes. Unlike private creditors they all are statutorily obliged to reduce debts in case of default, but prefer breaching their statutes by not granting debt relief. This is done both to the detriment of debtor member states and of other creditors, who have to accept much larger haircuts than legally necessary.

Contrary to their founders' intentions the IBRD has refused to use statutory debt relief mechanisms and obligations, wrongly asserting that this would make development finance inoperational. This is clearly false. The European Bank for Reconstruction and Development (EBRD) writes off losses and submits to arbitration (also foreseen for the IBRD) - which proves that MDBs, if properly managed, can survive financial accountability and market risk.

2.3 Charging without Delivering

While wrongly claiming preference both BWIs have built up loan loss provisions. In the case of the IBRD this is demanded by their statutes. Once again more vaguely, IDA's statutes (Article VI.12) stipulate "due regard to provision for reserves and contingencies." HIPC and the MDRI have induced IDA to establish substantial loan loss provisions (IDA 2007, p.6) for both initiatives, which were "recorded as a reduction of outstanding development credits and as a charge to income". No doubt, they should be used. The Bank has refused to use its provisions as intended and when needed in spite of statutory obligations. Forced by external auditors, the IMF started to provide for non-payment by building up loan loss provisions. The 1986 audit raised the possibility that the next one might have to be qualified (meaning that the audit would have to warn about the real value of some debts still booked at face value, with negative effects on the IMF’s standing as a creditor because it had failed to provide against losses) if the Fund did not take clear steps to recognise the poor quality of some assets and claims (Boughton 2001, p.814) These reserves are not called loan loss provisions, presumably because that might lead people to conclude that the IMF considers losses unavoidable. Rather, they are called “precautionary reserves.” As the IMF's Public Information Notice 03/64 (22 May 2003), for instance, expresses it quite ornately, the IMF’s margin includes a surcharge to “generate resources for a SCA-1 [Special Contingent Account, KR], established specifically to protect the IMF against the risk of loss of principal resulting from arrears.” What all this complicated wording means is rather simple: the IMF has already charged clients the costs for providing against loan losses, but refuses to use this money when members become incapable of paying. Like the Bank it has charged without delivering. Both “support” their position by wrongly claiming preferred creditor status.

As conditionality was initially not foreseen for IMF drawings, loan loss provisions were considered as unnecessary as a clearly designed dispute settlement mechanism. When conditionality was introduced, no appropriate changes making the IMF financially accountable for its decisions were made. Obviously nobody therefore thought of suggesting provisioning either. Economic facts, however, assert themselves. Repayment problems made the IMF introduce a "burden-sharing mechanism" in 1986 to distribute losses of income equally among its members. In plain English: lenders get lower and borrowers pay higher interest rates.

This is not to criticise the Fund for establishing loan loss provisions. On the contrary, provisioning is economically sound and financially very prudent. Although the IMF’s Articles of Agreement do not demand it, it is not prohibited - in contrast to making capital account liberalisation a loan condition.

Already three years ago “precautionary balances” ranged from 13.9% (the IMF in April 2005) to over 30 % of credit outstanding, as much as the Asian Development Bank had already put aside by end of October 2003. Due to the loss of business by the IMF these reserves now cover a multiple of the Fund’s coverage then. Fears are justified that they may be used to cover the Fund’s present income shortfalls, although they were not established for this purpose. But the Rule of Law is not what the IMF applies. Substantial chunks of losses are already covered by all borrowers paying insurance fees against default. Arguing that countries would have to start paying for reductions if these were granted means economically demanding that debtors pay twice in order to get relief once. This is comparable to an insurance company cashing in appropriate insurance premia but refusing to pay once the event covered occurs. Naturally, no civilised legal system would allow this to happen and the insurer to get away with such behaviour.

3. Financial Accountability: Enforcing the Rule of Law and Economic Reason

Statutory arrangements apart, one further, and very powerful argument for not treating the BWIs better than other creditors is their substantial involvement in debtors’ economic decisions. So far they have taken economic decisions without shouldering appropriate risks and liabilities. The BWIs have largely abolished the risk of losing money by making other creditors lose more. The two HIPC-Initiatives are some kind of exception: the BWIs lose as well, but less than others. The MDRI is based on the promise to refund all official costs of debt reduction to the BWIs, once again shifting the burden onto others. The argument that the BWIs charge interest below the debtor’s market rate, is generally (but not always) true. Economically it is nevertheless flawed and legally irrelevant.

The IBRD is not the only MDB whose statutes know legal liabilities comparable to private consultants, which are indeed a necessary part of any civilised legal system: whoever causes damages by tortious action must provide financial redress. But they are, once again, not obeyed. Commercial banks have usually not interfered with their clients' economic policy, bondholders even less so. By contrast the BWIs have strongly influenced the use of loans, exerting massive pressure on debtors, to the extent of provoking the question whether countries actually "own" these economic policies. They have routinely taken economic decisions but refused to participate in the risks involved. They insist on full repayment by clients, even when damages negligently caused by their staff have occurred. A high rate of BWI-failures therefore renders adjustment programmes necessary, which are administered by the BWIs for a fee, just as failed programmes are likely to result in new programmes, as long as unconditional repayment to them is upheld. No protection granted by contract or tort law to anybody else applies to the poorest of the world. Even wilfully and unlawfully inflicted damage does not presently confer any right to compensation.

In spite of the impression created over years, the BWIs are by no means legally exempt from this principle of the Rule of Law. At Bretton Woods normal legal redress was seen as a matter of course. Article VII.3 of the IBRD's Articles of Agreement explicitly allows actions against the Bank except by members or persons acting for or deriving claims from members. Property and assets are "immune from all forms of seizure, attachment or execution *before* [emphasis added] the delivery of final judgment against the Bank." Actions may be brought against the Bank in courts of competent jurisdiction in the territories of members in which the Bank has offices, appointed agents for the purpose of accepting service or notice of process, or issued or guaranteed securities. The Bank's founders had no intention to exempt and protect it from legal and economic consequences of failures. Accountability was not initially meant to be removed. Suing the Bank before national courts was therefore considered normal. Later on it tried to get immunity from lawsuits by "encouraging" members in need of being financed to bar lawsuits against it by municipal legislation, as the IBRD recently attempted in Bangladesh. Such attempts go directly against the intentions of the institution’s founders. The statutes of IDA (Article VIII.3), which is more relevant for the poorest countries, mirror the respective IBRD-clauses.

Members are not allowed to sue the IBRD because they were given another alternative: arbitration. Obviously the reason is the same as for waivers of immunity stipulating courts in OECD jurisdictions for settling disagreements with private creditors: the Bank’s founders might well have been concerned about the sufficient neutrality of national courts. But full legal relief is provided. Like the IBRD's former *General Conditions* (Section 10.04) its present *General Conditions for Loans* (of 1 July 2005, Section 8.04) stipulate: “Any controversy between the parties to the Loan Agreement or the parties to the Guarantee Agreement, and any claim by any such party against any other such party arising under the Loan Agreement or the Guarantee Agreement which has not been settled by agreement of the parties shall be submitted to arbitration by an arbitral tribunal as hereinafter provided (‘Arbitral Tribunal’)”

Bank and loan parties appoint one person each. Both sides agree on a third arbitrator. The President of the International Court of Justice or the UN Secretary General appoint this third person if parties fail to agree. Readers might have noted that these Sections describe precisely the same nomination procedure proposed for Raffer’s (1989 p.60, 1990 pp.304f) debt arbitration. IDA’s *General Conditions for Credits and Grants* (dated 1 July 2005) repeat the IBRD’s nearly literally (“Financing Agreement” instead of “Loan Agreement” is one difference) Most other IFIs have basically similar statutes. As mentioned above, the European Bank for Reconstruction and Development has actually submitted to arbitration.

As IDA’s statutes differ from the Bank’s by restricting arbitration to disagreements between IDA and former members and “any member during the permanent suspension of the

Association“, Article VII.1 of its *General Conditions* explicitly clarifies that no party “shall be entitled in any proceeding under this Article to assert any claim that any provision of these General Conditions or of the Legal Agreements is invalid or unenforceable because of any provision of the Articles of Agreement of the Association.”

The IMF differs from all MDBs. Art. IX.3 of its Articles of Agreement grants it total immunity “except to the extent that it expressly waives its immunity for the purpose of any proceedings or by the terms of any contract”. Obviously, this is explained by the fact that conditionality was not originally foreseen. The Fund was to help member countries to overcome short-term dollar/gold-parity problems by unconditional short-term drawings (=loans) It would be difficult to perceive any need for legal procedures and redress in the case of an emergency helper giving money unconditionally. Nevertheless, its founders did not wish to exclude proper legal dispute settlement totally, but inserted this option. When conditionality became enshrined in the IMF's statutes in 1969, the appropriate change regarding immunity was not made for whichever reason, although its founders would doubtlessly have stipulated the possibility of legal redress as in the case of the IBRD if they had approved conditional drawing. Be that as it may, the IMF may not only submit to arbitration or courts, but contractual clauses stipulating this are expressly allowed. Nothing in its statutes prevents the IMF from applying civilised legal standards. On the contrary, the existence of this waiver may be seen as an encouragement to do so if and when appropriate.

Suffice two illustrations of the problem of the IMF’s unaccountability. Stiglitz (2000) had heard about an IMF country team that had copied large parts of the text of one country’s report into another country’s report, forgetting to remove the original country’s name in a few places. Legal implications - including consequences under penal law in most if not all jurisdictions - are absolutely clear in any other case.

Evaluating the Fund's role in Argentina The Fund's own Independent Evaluation Office (IEO) found many clear cases of at least grave negligence if not worse (IMF 2004) It clarified that a "program was also based on policies that were either known to be counterproductive ... or that had proved to be 'ineffective and unsustainable everywhere they had been tried' ... [A]s expressed by FAD [=IMF's Fiscal Affairs Department] at the time." (*ibid*. p.91) Another "critical error" (*ibid*. p.75) in 2001 was, e.g., that no sufficiently clear understanding existed what to do should the approach fail. The Board supported "a program that Directors viewed as deeply flawed" (*ibid*. pp.81f) The "September 2001 augmentation suffered from a number of weaknesses in program design, which were evident at the time. If the debt were indeed unsustainable, as by then well recognized by IMF staff, *the program offered no solution to that problem*." (*ibid*. p.89, emphasis added) The IMF not only "failed to use the best analytical tools" (*ibid*. p.109), but "Available analytical tools were not used to explore potential vulnerabilities in sufficient depth." (*ibid*. p.110) It goes without saying that the Fund was again and repeatedly unduly "optimistic" in its forecasts, as the Report documents, an old problem that has caused considerable damage to its clients. This is just a small choice from a limited part of the period evaluated. It should be sufficient to show that - if the IMF were a consultancy firm and Argentina its client - the plaintiff's lawyers would have a feast. But the IMF is not a consultant and Argentina has to pay for programmes that - as the IMF had apparently known, as its own document proves – would contribute to her ruin. The IMF gets more interest income from Argentina than it would have got if it had refrained from such strategies. One cannot but concur with the Statement of the Argentine Governor: "Recognizing errors is, however, just the first step in a healthy self-criticism exercise. The second step is bearing responsibility for failures, namely sharing the burden of redressing their consequences." (*ibid*. Annex)

Relief is no doubt needed and was obviously intended by the IMF's founders. Unless one distinguishes between people on the base of their passports, there is no defence for such behaviour and no reason not to make the IMF compensate damages it has inflicted knowingly, thus *mala fide*. By using the possibilities stipulated in their very statutes, the BWIs could immediately be subject to market discipline and good governance. Sound economics and the Rule of Law could immediately be applied if it were decided to do so. Arbitration pursuant the IBRD's statutes could be implemented at once. The IMF can waive its immunity.

Regarding financial accountability, it is indicated to differentiate between programmes and projects because proving liability is much easier in the case of projects, although there might be several special cases not fitting any of the two, such as the IBRD (1999 p.2) knowing "the relevant institutional lessons" of capital account liberalisation since the early 1990s without duly warning its Asian members before 1997. From its analysis of Chile's BWI-produced catastrophe in the 1980s the Bank knew that the policies recommended to Asian "tigers" would produce a crash, but continued to encourage these very policies.

Apart from extreme examples such as Argentina's above or the case Stiglitz described, it is extremely difficult to prove tortious behaviour. Naturally, duty of care applies for all programmes. But proving it is normally difficult. Success or failure is not a sufficient criterion. Even meticulously designed programmes may fail and cause damages. Risk is a fact of life. This risk always remains the client's. But any client has a right that its advisor/consultant works with due diligence and obeys established professional standards.

Financial accountability would also be highly beneficial to the BWIs themselves. It would give their staff a good argument against pouring money into regions just because of lending targets as well as against political interference by important shareholders including demands to bail out other creditors. It would finally bring those benefits of the market to the BWIs, which they have so eagerly breached to others.

3.1 Projects

Economically viable projects earning their amortisation and interest payments, pose no problem. But when (the record mandates not to use if) projects go wrong, the need arises to determine liability. If there is lender liability, the simplest case is an agreement on sharing costs fairly. Otherwise, arbitration used between business partners, transnational firms and countries, or within North American Free Trade Association (NAFTA) and the World Trade Organisation (WTO) in cases of disagreement, solves the issue. This mechanism is plain vanilla in the field of international investments. If disagreements between transnational firms and host countries can be solved that way, there is no reason why disputes between IFIs and borrowing countries could not be solved by this mechanism as well, even if it were not already part and parcel of the IBRD's statutes and IDA's norms.

An international court of arbitration - different from *ad hoc* insolvency arbitration proposed by Raffer (1989, 1990), although it could be composed in the same way – seems best. Historical record suggests (cf. Raffer 2005 and sources quoted there) that such cases might be more frequent than sovereign insolvencies, which suggests a permanent court. If necessary this court might consist of more than one panel. Arbitration on projects could, of course, also be done by a panel ("chamber" in the terminology of its Art. 26) of the International Court of Justice or be part of another, appropriate international entity.

Arbitrators would decide on the percentages of loans to be waived to cover damages for which the BWIs are found liable. The right to file complaints should be conferred on individuals, Non-Governmental Organisations (NGOs), governments and international organisations. As

NGOs are less under pressure by the BWIs or governments their right to represent affected people is particularly important. Giving non-official entities the right to file complaints is not new. The IBRD's inspection panel and the IDB's investigation mechanism were specifically established to allow NGOs to do so. Unfortunately, they just stopped short of real redress. Official recognition that one was wronged alone does not cover damages. The court of arbitrators would, of course, have the right and the duty to refuse to hear poorly prepared or obviously ill-founded cases. The need to prepare a case meticulously would deter abuse. The possibility of being held financially accountable would act as an incentive to the Bank and other MDBs to perform better and protect the poor from damages done by ill-conceived projects. Last but not least, enabling victims of development cooperation to receive damage compensation would force the Bank and IDA to respect human rights and fundamental legal norms when financing projects.

The close scrutiny of how loans are used, which would result from implementing the proposals made above, does not mean the end of concessional lending. Projects and programmes actually financed under normal accountability would have a much better rate of success and much more positive impacts on development. Totally lacking any form of financial accountability the BWIs – like ODA-donors - have neglected appropriate care, a textbook-type moral hazard problem that must not be allowed to continue.

3.2 Programmes

As already mentioned, it is difficult to pin down tort in the case of programmes, unless very grave shortcomings, unimaginable in the case of commercial lenders or consultants exist, as they unfortunately do at present. But there is an easy way of holding the BWIs financially accountable. Instead of attempting to determine precise shares in failed programmes, all multilateral institutions must lose the same percentage of claims as other creditors once a country becomes unable to repay fully. Having taken/enforced decisions on the country’s economic policies, they are at least co-responsible. Instead of an undue “preferred creditor” status, treating them at least symmetrically as the Raffer (1989, 1990) Proposal requests, is mandatory: equal treatment of all creditors of one insolvent country is but fair to all other creditors. However, considering their special status and duties as international public financiers as well as their statutes, subordinating BWI-claims to those of other creditors seems to be more advisable. One might thus change Raffer’s initial model by demanding subordination of IFI-claims. Their important role on enforcing economic policies – very much unlike other or mere creditors - further corroborates this point. In poor countries with high BWI-involvement, which have been forced to orient their policies according to BWI-"advice" for quite some time, this solution is particularly justified. As the shares of multilateral debts are relatively higher in the poorest countries, protecting the BWIs from losses is done at the expense of particularly poor clients, whose scarcity of experts has often made them extremely dependent on solutions elaborated by BWI-staff.

It should not go unmentioned that both IBRD and IDA have violated their statutes by programme lending. Article III.4.vii of the Bank’s Articles of Agreement stipulates that loans “shall, except in special circumstances, be for the purpose of specific projects“. Art.V.1(b) of IDA's Articles of Agreement repeats this restriction literally. The IBRD and IDA increased the percentage of "programmes" in violation of their statutes, apparently to increase their influence. During the recent past, the IBRD’s shares of present nonproject lending, now called development policy lending have clearly been beyond what “except in special circumstances” could be stretched to mean. Over one third of all lending, even 64.5% in 2002, is definitely not the odd-out special case. Originally, the IMF too was to provide unconditional emergency finance not to do any programmes. Briefly, the BWIs were not meant to engage strongly in programme lending. Rightly so, as their record proves.

As the long and successful record of national insolvency laws shows, establishing neutral, disinterested entities is not only fair, but also the only economically wise and workable arrangement. Refusing to do so is the main cause of unsuccessful debt management. The powerful position of official and especially multilateral creditors vis-à-vis poor countries, HIPCs in particular, makes an independent entity all the more urgent. The long and catastrophic record of official debt management underlines the need to change the present situation where official creditors are allowed to be judge, jury, bailiff, expert and even the debtor's lawyer at the same time, ridiculing the very foundations of the Rule of Law, economic common sense, and efficiency.

4. Conclusion

Introducing good governance and respect of the foundations of the Rule of Law is an urgent, necessary and overdue measure. This means first and foremost making the BWIs obey their own statutes even if and when this would not be in the interest of major shareholders but of poor Southern countries. As initially foreseen, financial accountability for unlawfully inflicted damages, the principles of tort law, must be brought to bear. This return to their origins can be easily done, simply by observing rather than breaching the statutes of the BWIs. It would end unjustifiable discrimination of Southern members and protect the poorest in line with what these institutions' founders wanted. But it would also safeguard the legitimate interests of private creditors, who have been forced to pay for IFI negligence, failures, even for damages caused *mala fide*. Eventually applying the Rule of Law and the market mechanism to the BWIs as requested by their founders would enhance their performance substantially, giving credence to the BWIs when they preach these principles to others.

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