

EVALUATING IMF CRISIS PREVENTION AS A MATTER OF GLOBAL JUSTICE

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I. INTRODUCTION

The previous speaker, Jonathan Fried, masterfully outlined the International Monetary Fund (Fund or IMF)'s recent policy reform efforts, in particular its shift towards crisis prevention, as only an IMF Executive Director could.¹ My goal in commenting is to offer a normative framework through which to evaluate this shift, specifically, to help answer the questions of whether or not the Fund *should* be moving in this direction, and *how*. I am going to approach this as a question of fairness, which means I am going to look at the international financial system from the perspective of justice.² Insofar as the Fund makes decisions involving the allocation of social resources (specifically, hard currencies), its activities are the direct subject of justice theory. The key question is "what normative principles should guide the Fund in its allocation of social goods?"

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1. Jonathan T. Fried & James A. Haley, *Crisis Prevention: The International Agenda* (2007) (unpublished manuscript, on file with the author).

2. On the general subject of fairness analysis in international economic law, see AMERICO BEVIGLIA ZAMPETTI, *FAIRNESS IN THE WORLD ECONOMY: U.S. PERSPECTIVES ON INTERNATIONAL TRADE RELATIONS* (2006); FRANK J. GARCIA, *TRADE, INEQUALITY, AND JUSTICE: TOWARD A LIBERAL THEORY OF JUST TRADE* (2003) [hereinafter *JUST TRADE*]; Robert Hockett, *From "Mission-Creep" to Gestalt-Switch: Justice, Finance, the IFIs, and Globalization's Intended Beneficiaries*, 37 *GEO. WASH. INT'L L. REV.* 167, 179–81 (2005); on the broader question of fairness in international law generally, see THOMAS M. FRANCK, *FAIRNESS IN INTERNATIONAL LAW AND INSTITUTIONS* (1995).

In developing the framework for this analysis, I am going to rely on Rawls' theory of Justice as Fairness in which the fairness of a given distribution of social goods (such as wealth, opportunities, or rights) is evaluated in terms of its benefit to the least advantaged members of the group.³ Applying Justice as Fairness to the question at hand, we would ask whether the proposed shift in Fund priorities, insofar as it affects the way the Fund allocates its resources, works to the benefit of the least advantaged states.⁴

Though I am only at the preliminary stage of this project,⁵ my analysis suggests that, although the Fund's operations are consistent with global justice in several key respects, the proposed shift in priorities does raise some issues. My concern is that while the Fund as an institution plays an important role in promoting fairness, any move to shift resources away from existing Fund programs focused on the least developed countries, and towards macro-economic stability funds for intermediate countries, is only partly justifiable as a matter of fairness. In the Doha Round and elsewhere, we can see the impact which questions about the basic fairness of the international system can have on contemporary global social relations. We therefore cannot afford to ignore questions of justice and injustice, for our own security and prosperity if for no other reason.⁶

II. FAIRNESS AND THE WORK OF THE FUND

Justice as Fairness offers a powerful way to articulate the liberal view of justice as it applies to institutions which allocate social goods, such as wealth, rights, opportunities, and in this case, hard currencies.⁷ In Rawls' theory, the

3. See generally JOHN RAWLS, *A THEORY OF JUSTICE* (rev. ed. 1999).

4. Although I believe a true theory of global justice requires either cosmopolitan or communitarian grounding, or both, I offer neither here, relying instead on a more traditional international law/"society of states" model of justice. See Frank J. Garcia, *Globalization and the Theory of International Law*, 11 INT'L LEG. THEORY 9 (2005) (surveying arguments regarding normative basis of global justice in globalizing social relations). Thus what I am actually engaging in here is more properly an international justice argument, or justice between states and with their citizens, although I believe the substantive conclusions would be quite similar either way.

5. This analysis is part of a larger project I am currently engaged in through which I attempt to employ a normative framework drawn from domestic political theory and first adapted to international trade, to analyze the work of the Fund and the World Bank with respect to global distributive justice. A preliminary statement of some of these themes can be found in Frank J. Garcia, *Global Justice and the Bretton Woods Institutions*, 10 J. INT'L ECON. L. 461 (2007).

6. See Frank J. Garcia, *Trade, Justice and Security, in TRADE AS GUARANTOR OF PEACE, LIBERTY & SECURITY?—CRITICAL, EMPIRICAL AND HISTORICAL PERSPECTIVES* 78 (Padideh Ala'i et al. eds., 2006).

7. I am not going to try to argue for the applicability of global justice per se at this juncture, but rather to assume the more limited position that liberal states have an obligation to pursue liberal foreign policies. See generally JUST TRADE, *supra* note 2, at 67–70 (discussing normative obligations on foreign policy).

touchstone for whether a particular pattern of distribution is just is not whether it is equal—he assumes and accepts that there will be many inequalities in the world—but whether or not a particular inequality in the distribution of social goods is *justified*. Rawls defines this *justification* as whether or not the distribution pattern benefits the least advantaged players in the system—the so-called Difference Principle.⁸

With respect to the work of the Fund, there are two kinds of inequalities we are concerned with: inequalities in the global distribution of hard currencies, which the Fund does or does not make work to the benefit of the least advantaged; and inequalities in the way the Fund itself re-distributes such currencies, which must themselves be justified by reference to their benefit to the least advantaged.

A. *Fairness and International Monetary Policy*

It is important at the outset to recall that the Fund is a social institution, whose core activity is to allocate primary social goods: access to currency reserves, and the cost of such access. Trade currencies are an exhaustible social resource.⁹ The fact that certain currencies are considered hard, and others are not necessarily creates inequality in the distribution of trade currencies. This inequality in part reflects the fact that currencies are national in nature, since those countries whose economic policies and performance support the hardness of their currency have a built-in advantage in the supply of that currency. It is also in part a function of the larger operation of the global economic system, its inequalities and colonial legacy, which contribute to the hard-currency attributes of some economies, and undercuts such attributes of others.

Those states whose currencies are hard have an abundance of, and a capacity to self generate, such currencies, whereas those states whose currencies are soft are always at risk of scarcity and cannot create this resource indigenously.¹⁰ Given that private economic actors want to be paid in hard currencies, this creates incentives even for states with hard currencies to address these inequalities or else their exporters will not get paid, or will have to accept soft currencies instead.

8. See RAWLS, *supra* note 3, at 11–16 (introducing the Difference Principle); JUST TRADE, *supra* note 2, at 128–43 (discussing international application of Difference Principle).

9. See Rosa Maria Lastra, *The International Monetary Fund in Historical Perspective*, 3 J. INT'L ECON. L. 507, 516 (2000) (Fund resources are finite hence their use is subject to oversight). While it is true that countries whose currencies are hard could in theory print more money, it is in the very nature of hard currency countries that they not pursue such policies or risk the tradability of their currency. Therefore, hard currency is in essence exhaustible even for hard currency countries.

10. I am setting aside for the moment the issue of whether by making better policy choices they could harden their currency. This would not in any case deal with natural inequalities or historical contingencies. See JUST TRADE, *supra* note 2, at 61 (discussing problem of “ambition” in justice theory).

Given these facts, it is rational for states to create a market for currencies. Through such a market, trade currencies can be made available at rates set by the market. Such a market serves the self-interests of borrowers and lenders alike. Lending states put their hard currencies to work in the satisfaction of trade debt owed to their own producers. This generates export volumes and future economic opportunities for themselves, as well as contributing to stability in foreign relations through support for other states' commercial activities. Borrowing states have access to needed goods and services through hard currency supplies they could not generate domestically.

However, due to the same kinds of natural and social inequalities which affect a state's capacity to create or generate a supply of hard currency, not all states can afford to borrow needed hard currencies on commercial terms in the private market. For this sort of reason, it is also rational for states to create an institution such as the Fund, which is institutionally oriented to meet the specific currency lending needs of less wealthy states, and can lend on other than commercial terms.

How does justice come in? The key normative implication of Justice as Fairness for hard currency lending is that states do not in a simple, linear sense *deserve* their relative supply of hard currency, insofar as it is a product, in part, of natural inequalities which are morally arbitrary and compounded by social inequalities.¹¹ This means that states cannot be presumed to be entitled to their particular supply of hard currency, and that resulting inequalities in the distribution of hard currency must be justified. States and the social institutions they create, such as the Fund, must therefore attend to the justice implications of their operations and policies with respect to hard currencies.

What might these justice implications be? That will depend on the particular theory of justice employed. Here, using Justice as Fairness and applying the Difference Principle to the Fund's role as manager of international currency reserves, we can derive the following basic principle of global distributive justice as it affects the work of the Fund:

- (I). In order to justify inequalities in the distribution of trade currencies, states must ensure that access to trade currencies is structured so as to benefit the least advantaged.¹²

In other words, in order for the distributions of a social institution, such as the Fund, to play any role in justifying inequalities, these distributions must benefit

11. Here we again face and defer the problem of ambition-sensitivity, namely how to account for the fact that good social policies contribute to the hardness of a particular currency. See JUST TRADE, *supra* note 2, at 61.

12. *Id.*

the least advantaged states. It does not mean the distribution must necessarily go to the least advantaged states, but it must *benefit* them. Thus, the Fund can play an important role in states' efforts to justify inequalities in the global financial system, depending on its policies. How does the Fund look from this perspective?

III. THE FUND AND OPERATIONALIZING JUSTICE

A. *The Fund's Basic Mission*

The Fund's very existence and basic mission play a significant normative role in justifying wealthy states' abundance of trade currencies. By putting hard currency to work on near-commercial terms in the economies of states without adequate indigenous supplies of such currencies, the Fund is conferring a benefit on less advantaged states.¹³ Therefore, in its basic mission and role, the Fund is fulfilling an important element of global justice.

However, the demand for hard currency exceeds currency-poor states' ability to pay commercial rates, so if the only access to hard currency was through private banks at commercial rates, economic opportunities would go unrealized.¹⁴ Moreover, whenever there is a general economic crisis or a country-specific crisis, it is much harder for certain states to generate or borrow needed hard currencies. This brings us to the issue of the *terms* on which the Fund makes hard currency available.

B. *Terms of Access to Fund Facilities*

The Fund offers two basic types of facilities: "regular" or non-concessional facilities, such as Stand-by Arrangements, which are not in fact loans but purchase and repurchase agreements offered on near-market terms;¹⁵ and concessional facilities, which are truly trade currency loans to developing countries.¹⁶ The Fund's current concessional facilities consist of the Poverty Reduction and Growth Facilities (PRGFs), which replaced the earlier Structural

13. JOHN W. HEAD, *THE FUTURE OF THE GLOBAL ECONOMIC ORGANIZATIONS: AN EVALUATION OF CRITICISMS LEVELED AT THE IMF, THE MULTILATERAL DEVELOPMENT BANKS, AND THE WTO 95–96* (2005) (documenting the considerable wealth transfers which Fund facilities have effected for the benefit of the least developed members).

14. Exporting states would lose sales, importing states much-needed goods and services, and less advantaged states would be tempted to employ currency controls, devaluations, etc., destabilizing the international monetary system to the detriment of all.

15. See HEAD, *supra* note 12, at 24 (describing operation of SBA and EFF purchase/repurchase obligations).

16. See Lastra, *supra* note 9, at 517–18.

Adjustment Programs (SAPs) and Enhanced SAPs, and charge only 0.5% interest per year.¹⁷

In addition to hard currencies being a social resource, the terms of access to such currencies through each facility are themselves a social resource. In other words, the terms on which the Fund makes its currencies available through regular facilities (preferential rates), and the terms on which the Fund makes its currencies available through concessional facilities (concessional rates) are themselves a further socially-produced, and socially allocated, resource.

Just as a system of purely free trade is not enough to benefit the least advantaged states due to the facts of inequality (hence the WTO's Special & Differential Treatment (S&D) policies),¹⁸ so, too, in hard currency lending a system of pure private market currency transactions, or even a blended system of private bank commercial currency transactions and Fund preferential lending, would not be enough. Because developing countries have limited domestically generated supplies of hard currency and limited resources to borrow such currencies, they cannot get enough through these avenues, meaning that the overall inequality in currency supplies will not work to their advantage.

In terms of the International Difference Principle, this suggests the following corollary to the principle derived above:

- (II). In order that access to trade currencies benefit the least advantaged, states must offer concessional access to development capital.¹⁹

The PRGFs, are in the balance-of-payments lending context, the structural analog to S&D in the trade setting—concessional access to hard currencies as a tool for justifying inequality. They represent that specific aspect of the Fund which directly addresses the inequality in the distribution of hard currencies from the perspective of the least advantaged.

In terms of resource commitments the Fund currently emphasizes its regular facility lending, with PRGF lending a small and underutilized portion

17. See BAHRAM GHAZI, *THE IMF, THE WORLD BANK GROUP AND THE QUESTION OF HUMAN RIGHTS* 13 (2005). One commentator suggests that the category of concessional facilities also includes special facilities such as the oil facility, accelerated procedures such as the emergency financing mechanism, and exceptional facilities such as the supplemental reserve facility and contingent credit line for sudden and disruptive events. See Lastra *supra* note 9, at 519–20. I will follow the narrower approach and restrict my attention to the PRGFs since the rest charge higher, near-market rates.

18. See JUST TRADE, *supra* note 2, at 147–55 (discussing the normative role played by S&D in trade law).

19. *Id.*

of its portfolio.²⁰ Justice as Fairness requires us to evaluate this scheme with reference to our normative touchstone, namely, is this prioritization benefiting the least advantaged? The PRGF program would seem to have the most potential for justifying inequalities in hard currencies by directly making them work for the benefit of the least advantaged. However, despite the evident inequality in the global distribution of hard currency and in the borrowing power of states, most of the Fund's activities nevertheless involve preferential and not concessional lending.²¹

As a function of states' responsibility for global justice, it is part of the Fund's mandate to see that this most valuable social good—access to trade currencies—in fact operates so as to benefit the least advantaged. How does the Fund's shift to crisis prevention look from this perspective?

C. Crisis Prevention: Normative Implications

As I am in the early stages of this project, I must, in this section be suggestive rather than definitive. Nevertheless, looking through the lens of global justice theory, one can see that the proposed shift in Fund priorities does raise several fundamental questions. Most basically, we must ask what effect this shift will have on current Fund priorities with respect to allocation of Fund resources, and in particular on the balance of concessional versus preferential lending. Our normative criterion is whether this shift to crisis prevention efforts is calculated to benefit the least advantaged states. This involves a determination as to how this shift alters which states get Fund resources and Fund attention.

It appears as if the shift to crisis prevention will involve a shift away from an emphasis on existing programs, such as the PRGF, which benefit the least advantaged, rather than an effort to ensure the least advantaged make full use of programs such as the PRGF. To take one example, it has been proposed that the Fund offer a new crisis prevention facility, the Reserve Augmentation Line (RAL).²² The current form of the proposal to create a RAL suggests that the target states are intermediate states, neither so strong in both resources and policies as to be largely self-sufficient in terms of trade currencies, nor so weak

20. International Monetary Fund [IMF], *Annual Report of the Executive Board for the Financial Year Ended April 30, 2006*, Appendix II, (2006), <http://www.imf.org/external/pubs/ft/ar.2006/eng/index.htm> (last visited March 22, 2008).

21. See Charles Abugre, *Still Sapping the Poor: A Critique of IMF Poverty Reduction Strategies*, WORLD DEVELOPMENT MOVEMENT, June 2000, <http://www.wdm.org.uk/resources/reports/debt/stillsappingthepoor01062000.pdf> (last visited Mar. 22, 2008) (discussing declining economic conditions and increasingly inequitable distribution of wealth in numerous countries despite Fund activity).

22. See Fried & Haley, *supra* note 1, at 14–15.

that they constitute the less developed Fund clients.²³ This means that by definition, the RAL will not itself be available to benefit the least advantaged states. Therefore, by itself the creation of the RAL does nothing to address the immediate needs of the least advantaged, or justify inequalities in the global financial system. Moreover, if it is to be successful, the RAL will require massive amounts of capital.²⁴ Thus, if the Fund implements the RAL, it will have created a new facility for preferential lending, one which will require tremendous resources if it is to be successful. This will tilt the overall balance of the Fund's lending away from concessional lending.

This does not mean by itself, however, that the RAL is unfair. Rather, it means we must examine whether offering the RAL to intermediate states will in some way benefit the least advantaged states in a secondary manner. The fairness of the RAL depends upon any consequential benefits to least developed countries; absent such benefits, it shifts the system as a whole further away from basic fairness.

There are two important ways in which the RAL might benefit the least advantaged states, and therefore to that extent be consistent with Justice as Fairness. First, to the extent that such intermediate states constitute important export markets for less developed states, preventing a crisis among such states preserves vital export opportunities for less developed states, which is of course a benefit. Second, and perhaps most importantly, by helping to avert a local, regional or global financial crisis (assuming the Fund proposals can do so), the shift helps the least developed countries that would be affected by such a crisis, since they are generally the states least able to weather such crises on their own.²⁵

Insofar as the shift to crisis prevention can offer such stability, benefits indirectly go to least advantaged states. Then this shift may, to this extent be normatively justifiable and consistent with global financial justice. Nevertheless, such a second order benefit must be balanced against any losses or reductions in support which least advantaged states might experience from a reorientation in Fund priorities, particularly if, as has been recommended, such a reorientation include a reduction in PRGF style lending.²⁶

23. See generally IMF, *Further Consideration of a New Liquidity Instrument for Market Access Countries—Design Issues*, (Feb. 13, 2007), <http://www.imf.org/external/np/pp/eng/2007/021307.pdf> (last visited Mar. 22, 2008) (reviewing RAL proposal).

24. See Fried & Haley, *supra* note 1, at 14–15.

25. See *supra* note 13 and accompanying text.

26. External Review Committee, *Report of the External Review Committee on Band Fund Collaboration: Final Report*, at 43–45 (Feb. 2007) (recommending reduction in IMF long-term financing activities in developing countries).

IV. CONCLUSION

It seems clear from even a preliminary analysis that, in discharging its basic function, the IMF is offering a service which helps inequalities in hard currency distributions work to the benefit of the least advantaged. The Fund's preferential lending facilities further reinforce this contribution towards global financial justice. However, it is critical that, in shifting from crisis resolution to crisis prevention, the basic normative orientation suggested by Justice as Fairness not be lost.

The question of whether least advantages states benefit more from direct PRGF-style lending than they would from the crisis prevention benefits of a reoriented Fund is of course partly an empirical question. One benefit of a normative analysis, such as the present study, is to suggest that such research must be undertaken in order to formulate any decisions on Fund priorities, so as not to move the international financial system further away from basic fairness.