

## **PART IV**

### INTERNATIONAL FINANCIAL INSTITUTIONS AND HUMAN RIGHTS

The World Bank, the International Monetary Fund and Human Rights

## The World Bank, the IMF, and Human Rights

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I.	Introduction .....	48
II.	The World Bank .....	52
	A. Introduction .....	52
	B. The Bank's Mandate .....	53
	C. The Evolution in the Bank's Operations .....	55
	D. The Human Rights Implications of the Bank's Operations ...	56
	E. The Human Rights Issues Raised by the Bank's Operations .	59
	F. Protection of Human Rights .....	64
	G. The Institutional Human Rights Issue .....	66
III.	The International Monetary Fund .....	66
	A. Introduction .....	66
	B. The IMF's Mandate .....	67
	C. The Evolution in the IMF's Operations .....	69
	D. The Human Rights Implications of the IMF's Operations. ....	72
	E. The Protection of Human Rights .....	72
IV.	Institutional Issues .....	74
	A. Description of the Issues .....	74
	B. The Response of the Bank .....	76
	C. The Situation of the IMF .....	77
	D. Conclusion .....	78
V.	Some Thoughts on the Contents of an IFI Human Rights Policy. ....	78
	A. The Need for a Human Rights Policy .....	78
	B. The Content of an IFI Human Rights Policy .....	80
VI.	Conclusion .....	89

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## I. INTRODUCTION

At the end of the World Summit for Social Development, the participating States issued the "Copenhagen Declaration on Social Development and Programme of Action."<sup>1</sup> In this Declaration, they stated that sustainable and equitable development must incorporate democracy; social justice; economic development; environmental protection; transparent and accountable governance; and universal respect for, and observance of, all human rights.<sup>2</sup> Thus, the participating States reaffirmed the view that development is a multifaceted process in which, *inter alia*, economic development and human rights are so intertwined that sustainable development cannot occur without both economic growth and the promotion of human rights.<sup>3</sup>

The participating States also called on other members of the international community, including specialized agencies of the United Nations, to support developing countries in their efforts to achieve sustainable development.<sup>4</sup> The call to promote sustainable development could not have been a surprise to the World Bank Group (World Bank)<sup>5</sup> and

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1. Copenhagen Declaration on Social Development in Report of the U.N. World Summit for Social Development, U.N. Doc. A/CONF.166/9 (1995) [hereinafter Copenhagen Declaration]; Programme of Action of the World Summit for Social Development, in Report of the U.N. World Summit for Social Development, *supra* [hereinafter Programme of Action].

2. Copenhagen Declaration, *supra* note 1, para. 26. This perception is consistent with the Declaration on the Right to Development, which also conceives of development as a comprehensive process involving economic, social, cultural, political, and environmental dimensions. G.A. Res. 41/128, U.N. GAOR, 41st Sess., Supp. No. 53, at 186, U.N. Doc. A/41/53 (1986). World Bank officials share this view. See, e.g., Ibrahim F.I. Shihata, Democracy and Development (Oct. 3, 1996) (unpublished manuscript, on file with author) [hereinafter Shihata, Democracy and Development]; Ibrahim F.I. Shihata, *Human Rights, Development and International Financial Institutions*, 8 AM. U. J. INT'L L. & POL'Y 27 (1992); Ibrahim F.I. Shihata, *The World Bank and Human Rights: An Analysis of the Legal Issues and the Record of Achievements*, 17 DENV. J. INT'L L. & POL'Y 39 (1988); James D. Wolfensohn, Speech at the Annual Meeting of the World Bank (Oct. 1, 1995) (transcript available at <<http://www.worldbank.org>>).

3. It should be noted that all aspects of sustainable and equitable development are intertwined. However, in this Article the author has chosen to highlight the intertwining of human rights and economic development in the work of the World Bank Group and the IMF. See Daniel D. Bradlow & Claudio Grossman, *Limited Mandates and Intertwined Problems: A New Challenge for the World Bank and the IMF*, 17 HUM. RTS. Q. 411, 413-16 (1995) [hereinafter *Limited Mandates*]; Claudio Grossman & Daniel D. Bradlow, *Are We Being Propelled Towards a People-Centered Transnational Legal Order?*, 9 AM. U. J. INT'L L. & POL'Y 1 (1993) [hereinafter *A People-Centered Legal Order*].

4. Copenhagen Declaration, *supra* note 1, Commitment 2, paras. (g), (h).

5. The World Bank Group consists of the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Centre for Settlement of Investment Disputes (ICSID). For a more detailed description of the institutions in the World Bank Group, see 2 IBRAHIM F.I. SHIHATA, THE

the International Monetary Fund (IMF).<sup>6</sup> Over the fifty years of their existence, both institutions have dramatically expanded their understanding of the concept of development. Both institutions, in fact, now address social and human rights issues in their discussions with their Member States and, in the case of the World Bank, in their operations in these States.

For example, World Bank-funded operations<sup>7</sup> now promote such economic, social, and cultural rights as health, education, social welfare, jobs, and property. In addition, the World Bank, through its financing and advisory activities, influences the status of women, children, indigenous peoples,<sup>8</sup> and other vulnerable groups<sup>9</sup> in those Member States that borrow from it.<sup>10</sup> The World Bank's governance operations, which address such issues as the rule of law in society, reform of the civil service, and the management of the public sector, have an impact on civil and political rights in Borrower States. Furthermore, the World Bank's new practice of requiring participation by primary stakeholders in the design and

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WORLD BANK IN A CHANGING WORLD, SELECTED ESSAYS (1995); DANIEL D. BRADLOW, UNITED NATIONS INSTITUTE FOR TRAINING AND RESEARCH, THE INTERNATIONAL MONETARY FUND, THE WORLD BANK GROUP, AND DEBT MANAGEMENT (1993). In this Article, the author shall focus on the IBRD and IDA, which collectively shall be referred to as "the World Bank."

6. The IMF, the IBRD, and the IDA are specialized agencies of the United Nations. See Agreement Between the United Nations and the International Monetary Fund, art. IV(2), 16 U.N.T.S. 328, 332 (1948) [hereinafter U.N.-IMF Relationship Agreement]; Agreement Between the United Nations and the International Bank for Reconstruction and Development, art. IV(2), 16 U.N.T.S. 346, 348 (1948) [hereinafter U.N.-IBRD Relationship Agreement]; Agreement Between the United Nations and the International Development Association, G.A. Res. 1594, U.N. GAOR, 15th Sess., Supp. No. 16A, at 17, republished U.N. GAOR, 15th Sess., Annex 2, Agenda item 91 (1960) [hereinafter U.N.-IDA Relationship Agreement].

7. See *infra* Part II.C-D. for a more detailed discussion of the types of activities funded by the World Bank.

8. WORLD BANK, THE WORLD BANK OPERATIONAL MANUAL, Operational Directive 4.20: Indigenous Peoples (Sept. 1991) (discussing World Bank policy on indigenous people) [hereinafter OPERATIONAL MANUAL].

9. OPERATIONAL MANUAL, *supra* note 8, Operational Directive 4.30: Involuntary Resettlement (June 1990) (stating that World Bank policy on involuntary resettlement is designed to ensure that those forced to relocate as a result of a Bank-funded project should still share the benefits of the project). *But see* WORLD BANK, RESETTLEMENT AND DEVELOPMENT: THE BANKWIDE REVIEW OF PROJECTS INVOLVING INVOLUNTARY RESETTLEMENT 1986-1993 (1994) (revealing Bank problems in implementing this policy).

10. Not all Member States are eligible to borrow from the World Bank. Those States that have a per capita income of less than US\$5,295 (in 1995 dollars) can borrow from the IBRD and less than US\$1,465 (in 1995 dollars) can borrow from IDA. In practice, however, only countries with annual per capita incomes of less than US\$905 receive IDA credits. In this Article, Member States that are eligible for IBRD or IDA loans shall be referred to as "Borrower States" or "Member States." The focus of this section of the Article is on the operation of the IBRD and IDA in these States.



implementation of its projects<sup>11</sup> is, in effect, a statement about the importance of political rights in the development process.

The scope of the IMF's Article IV consultations<sup>12</sup> suggests that the IMF is also capable of influencing the human rights situation in its Member States.<sup>13</sup> This can be deduced from the fact that during Article IV consultations, the IMF has been known to engage the Member State in discussions of its policies relating to health care, environment, welfare, housing, unemployment, labor markets, military expenditures, and certain aspects of the management of the State's public sector.<sup>14</sup>

The degree of the IMF's influence varies depending on the Member State's need for financial support. Since the advice given by the IMF in the Article IV consultations may be converted into the conditionalities attached to IMF financing, the IMF is able to exert greater influence over those Member States who need or expect to need its financial assistance.<sup>15</sup>

Given that human rights and the economic functions of the World Bank and the IMF (collectively the International Financial Institutions, or the IFIs) are inherently intertwined, the increasing involvement of the IFIs in

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11. See WORLD BANK, THE WORLD BANK PARTICIPATION SOURCEBOOK (1996) [hereinafter PARTICIPATION SOURCEBOOK].

12. Pursuant to Article IV of its Articles of Agreement, the IMF is required to engage in regular consultations with its Member States about their exchange rate policies. Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, art. IV, sec. 3, 60 Stat. 1401, T.I.A.S. No. 1501, 2 U.N.T.S. 39, 51, amended, July 28, 1969, 20 U.S.T. 2775, amended, Apr. 1, 1978, 29 U.S.T. 2203 [hereinafter IMF Articles]. For a description of Article IV consultations, see, e.g., RICHARD W. EDWARDS, JR., INTERNATIONAL MONETARY COLLABORATION 22, 558-68, 571-80 (1985).

13. While it is mandatory for IMF Member States to hold regular consultations with the IMF, they are not required to follow the advice the IMF offers them in the course of these consultations. However, the IMF's report on the State will be discussed by the IMF's Board of Directors and form part of the data used by the IMF in compiling its semi-annual report, "World Economic Outlook." Consequently, the IMF's opinions may influence how other States and financial actors perceive the Member State. See Executive Board Decision No. 6026-79/13 (Jan. 22, 1979), as amended by 10273-93/15 and 10364-93/67, in SELECTED DECISIONS AND SELECTED DOCUMENTS OF THE IMF 13 (19th ed. 1994) (dealing with Article IV consultations). For general description of the IMF and its operations, see ANAND G. CHANDAVANKAR, THE INTERNATIONAL MONETARY FUND: ITS FINANCIAL ORGANIZATION AND ACTIVITIES (IMF Pamphlet Series No. 42, 1984); A. W. HOOKE, THE INTERNATIONAL MONETARY FUND: ITS EVOLUTION, ORGANIZATION AND ACTIVITIES (IMF Pamphlet Series No. 3, 3rd ed. 1983); TREASURER'S DEPARTMENT OF THE INTERNATIONAL MONETARY FUND, FINANCIAL ORGANIZATION AND OPERATIONS OF THE IMF (IMF Pamphlet Series No. 45, 2d ed. 1991) (discussing functions of IMF) [hereinafter TREASURER'S DEPARTMENT]; BRADLOW, *supra* note 5; see also IMFSURVEY, SUPPLEMENT ON THE IMF (Sept. 1996).

14. See *infra* Part III.C. for a more detailed discussion of this issue.

15. IMF influence is likely to be greatest in Member States that are eligible for Extended Structural Adjustment Facility (ESAF) support. For these countries, IMF policies may be included in the Policy Framework Paper which will ultimately influence both IMF and World Bank support for the State. See OPERATIONAL MANUAL, *supra* note 8 (discussing Policy Framework Papers); TREASURER'S DEPARTMENT, *supra* note 13, at 80-83 (discussing ESAF).

the social and human rights affairs of their Member States is not surprising.<sup>16</sup> However, this involvement raises two important human rights issues.

The first issue, which can be called the operational human rights issue, pertains to the human rights impact of the IFIs' operations in their Member States. It focuses on the IFIs' responsibilities for ensuring that the design and implementation of their projects, programs, policies, and in-country activities are consistent with internationally recognized human rights standards.

There are two dimensions to this operational issue. The first is the *promotion* of human rights, which concerns the obligations of the IFIs to actively seek to improve the human rights situation in their Member States.<sup>17</sup> The second dimension is the *protection* of human rights, which concerns the obligations of the IFIs to help stop human rights abuses perpetrated by their Member States.<sup>18</sup>

The second issue, which can be called the institutional issue, pertains to the internal rules and procedures of the IFIs. It focuses on the responsibilities of the IFIs to ensure that their own internal operating rules and procedures are consistent with internationally recognized human rights standards. This issue highlights the transparency, accountability, and accessibility of the IFIs' internal operating rules and procedures.<sup>19</sup>

Despite the importance of these two human rights issues to the overall efficacy of their operations, the IFIs do not have well-developed, publicly available human rights policies. Those policies that they do have tend to be *ad hoc*<sup>20</sup> and ambiguous.<sup>21</sup>

The lack of a coherent human rights policy has created problems both for the IFI staff and for the other stakeholders in the IFIs' operations.<sup>22</sup> It deprives their staff of clear guidance on the scope of their human rights responsibilities. In addition, it tends, by default, to delegate to the IFI staff the authority to make their own policy decisions when these issues arise in the course of their duties. The resulting decisions often appear to stakeholders in the IFIs' operations to be arbitrary and difficult to

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16. See generally, *Limited Mandates*, *supra* note 3.

17. See *infra* Parts II.D-E., III.C-D. for a more detailed discussion of this issue.

18. See *infra* Parts II.F., III.D. for a more detailed discussion of this issue.

19. See *infra* Part IV. for a more detailed discussion of this issue.

20. See *infra* Parts II.C., III.C. for a more detailed discussion of the evolution of the Bank and IMF's involvement in the human rights policies of their Member States.

21. See *infra* Part II.E.1. for discussion of the "direct and obvious" test and its ambiguities.

22. The stakeholders in IFI operations include those portions of the Member State's population that are directly affected by the IFIs' financing operations (this will be the entire population in the case of IMF and World Bank structural adjustment loans), the Member State itself, the IFI, the suppliers that stand to benefit from the financing operation, and other indirectly affected persons in the States that are members of the IFIs.

understand. This adversely affects the transparency and accountability of the IFIs' operations, and makes it hard for outsiders to predict how the IFIs will deal with future human rights situations.<sup>23</sup>

In this paper I will argue that the IFIs must develop an explicit human rights policy in order to resolve the human rights problems they face. This policy should instruct staff and policymakers on how to appropriately incorporate human rights considerations into all IFI operations. A transparent and predictable human rights policy, provided it were well publicized, would also enable all interested parties to understand what they can expect from the IFIs when their activities have an effect on human rights, and thus, to hold the IFIs accountable for their performance in this regard.

In order to make this case, I shall first describe the evolution of the World Bank's and the IMF's operations over the past fifty years. In these sections I shall also discuss the human rights dimensions of the IFIs' work and the nature of the legal constraints on their ability to consider human rights issues in their operations.<sup>24</sup> Thereafter, I shall discuss the institutional implications for the IFIs of this evolution in their operations. Finally, I shall make some proposals regarding possible human rights policies for the IFIs.

## II. THE WORLD BANK

### A. Introduction

This section of the Article begins with an analysis of the political prohibition in the World Bank's Articles of Agreement. It is followed by a description of the evolution of the Bank's operations and an explanation of how this has influenced the interpretation of the political prohibition. The final part of this section discusses the human rights impact of the Bank's

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23. See *infra* Part IV for further discussion of this issue.

24. The World Bank's Articles explicitly require the Bank to base its decisions only on economic consultations and to not take political factors into account in its decisions. Articles of Agreement of the International Bank for Reconstruction and Development, Dec. 27, 1945, 60 Stat. 1440, T.I.A.S. No. 1502, 2 U.N.T.S. 134, amended, Dec. 17, 1965, 16 U.S.T. 1942 [hereinafter IBRD Articles]; Articles of Agreement of the International Development Association, Jan. 26, 1960, 11 U.S.T. 2284, T.I.A.S. No. 4607, 439 U.N.T.S. 249 [hereinafter IDA Articles]. See *infra* Parts II.B., III.B. for a more detailed discussion of this issue. The IMF's Articles do not explicitly prohibit it from considering political issues; however, the IMF has interpreted the Articles as imposing such a prohibition. JOSEPH GOLD, THE RULE OF LAW IN THE IMF, (IMF Pamphlet Series, No. 32, 1980); Francois P. Gianviti, *Members' Rights and Obligations Under the IMF's Articles of Agreement*, in 3 CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS 1, 10 (Robert C. Effros ed., 1995). For further discussion of this issue, see *infra* Part III.B.

operations and focuses on both the promotional and protective dimensions of the operational human rights issue.<sup>25</sup>

For present purposes it is important to note that the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) will only lend funds to nonmember borrowers if a Member State either guarantees or approves the loan.<sup>26</sup> This means that the Member State is always a participant in an IDA or IBRD financing arrangement. As a result, in principle the IBRD and IDA are always in a position to influence their Borrower States' human rights situations.<sup>27</sup>

### *B. The Bank's Mandate*

The mandate of both the IBRD and IDA (hereinafter referred to collectively as the "Bank") is to assist development efforts in their Member States. The IBRD's Articles of Agreement state that the purposes of the IBRD include "assist[ing] in the reconstruction and development of territories of members," and "promot[ing] the long range balanced growth of international trade and the maintenance of equilibrium in balance of payments . . . thereby assisting in raising productivity, the standard of living and conditions of labor in [members'] territories."<sup>28</sup>

The purposes of the IDA, according to its Articles of Agreement, are to "promote economic development, increase productivity and thus raise standards of living in the less-developed areas of the world . . . thereby furthering the developmental objectives of the International Bank for Reconstruction and Development."<sup>29</sup>

Interestingly, neither institution's Articles define the term "development." The Bank does not disagree with the international community's conception of development as a comprehensive process

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25. A full discussion of the institutional issue is deferred until later in this Article. See *infra* Part IV.

26. The IBRD Articles state that if the Member State is not the borrower, "the member or the central bank or some comparable agency" must fully guarantee the loan. IBRD Articles, *supra* note 24, art. III(4)(i). The IDA's Articles of Agreement state that the IDA cannot provide financing for any project "if the member in whose territory the project is located objects to such financing." IDA Articles, *supra* note 24, art. V, sec. 1(e).

27. International human rights law deals with the State's relationship to its citizens. See, e.g., IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* (4th ed. 1990) (describing the scope of international human rights law).

28. IBRD Articles, *supra* note 24, art. I. The other purposes of the IBRD are "to promote private foreign capital by means of guarantees or participation in loans and other investments made by private investors, . . . to arrange the loans made or guaranteed by [the IBRD, and] . . . to conduct its operations with due regard to the effect of international investment on business conditions in the territories of members." *Id.*, art. I, (ii), (iv), (v).

29. IDA Articles, *supra* note 24, art. I.



incorporating economic, social, cultural, political, and spiritual dimensions.<sup>30</sup> Nevertheless, the IBRD and IDA contend that as specialized economic organizations<sup>31</sup> they have a limited mandate. This restricts their permissible activities to the economic aspects of the development process.<sup>32</sup> The other aspects of the development process fall outside the scope of the Bank's permissible range of activities.

In support of its position, the Bank points out that the Articles of Agreement of both the IDA and the IBRD place limits on what factors they can consider in their decisions. For example, the IBRD's Articles require it to ensure that its funds are "used only for the purposes for which the loan was granted with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations."<sup>33</sup> Lest there be any doubt about their economic focus, the Articles of both the IBRD and IDA state that:

The Bank and its officers shall not interfere in the political affairs of any member, nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.<sup>34</sup>

Despite the strong emphasis the Articles place on ensuring that IBRD and IDA decisions are based only on "economic considerations," neither institution's Articles define "economic considerations." Similarly, neither institution's Articles define "political affairs" or "political character."<sup>35</sup>

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30. See *supra* note 2. The international community endorsed this conception of development at the World Summit for Social Development. See Copenhagen Declaration, *supra* note 1, para. 26.

31. The IBRD and IDA are specialized agencies of the United Nations. See *supra* note 6.

32. Ibrahim F.I. Shihata, Issues of Governance In Borrowing Members and the Extent of Their Relevance Under the Bank's Articles of Agreement (Dec. 21, 1991) (unpublished memorandum of the Vice President and General Counsel of the World Bank) (on file with author); see also SHIHATA, *supra* note 5, at 553-78 (discussing governance and human rights in Bank Member States); Shihata, Democracy and Development, *supra* note 2.

33. IBRD Articles, *supra* note 24, art. III, sec. 5(b). The IDA operates under an identical restraint. IDA Articles, *supra* note 24, art V, sec. 1(g).

34. IBRD Articles, *supra* note 24, art. IV, sec. 10; IDA Articles, *supra* note 24, art. V, sec. 6. The Articles of Agreement of these two organizations also stipulate that the Member States shall respect the international character of these organizations and refrain from seeking to influence the officials of these organizations who owe their primary duty of loyalty to the organization. IBRD Articles, *supra*, art. V, sec. 5(c); IDA Articles, *supra*, art. VI, sec. 5(c).

35. It appears from statements made at the Bretton Woods Conference by Harry Dexter White, Lord Keynes, and by the U.S. Treasury that the purpose of the political prohibition was to

This enables both institutions to interpret for themselves the term “economic considerations” in order to determine what issues and activities fall within their permissible scope of operations. They are also free to decide what issues to treat as “political” and thus outside their jurisdiction.

### *C. The Evolution in the Bank's Operations*

Over the past fifty years, the Bank has steadily expanded its understanding of what factors qualify as economic considerations within the meaning of its Articles. In its early years, when the Bank's position was that development referred to economic growth, it interpreted economic considerations as including only those issues that were directly relevant to the financial and technical feasibility of the projects it was funding and to the project's impact on the economic growth potential of the Member State.<sup>36</sup> In this regard it should be noted that the Articles of the IBRD require it to ascertain whether the borrower or the guarantor “will be in a position to meet [their] obligations under the loan.”<sup>37</sup>

One of the benefits of the Bank's original interpretation of economic considerations was that it respected the Borrowing State's sovereignty. It appeared to leave to the Borrowing State all the difficult political judgments, such as which potential projects should be given the highest priority, who should benefit from the project, and how the costs associated with the project should be shared among the citizens of the Borrowing State.

The Bank's initial perception of development did not prove to be sustainable. Beginning in the 1960s, the Bank, faced with the failure of

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ensure that the Bank acted impartially. See United Nations: Statements of U.N. Legal Counsel and IBRD General Counsel on Relations of U.N. and IBRD and Effect of U.N. Resolutions, 6 I.L.M. 150 (1967) (regarding World Bank loans to South Africa and Portugal) [hereinafter Broches Statement].

In 1966, the Bank's Legal Counsel transmitted a memorandum to the United Nations in which he attempted to explain why the IBRD's Articles prohibited it from complying with General Assembly Resolutions requesting the Bank to refrain from extending credit to South Africa and Portugal. The General Counsel argued that the prohibition had two purposes. The first was to prevent the possibility of using Bank financing as leverage against any Bank member to advance the political aims of any other member or group of members. The second reason was to assist the Bank in raising capital from investors who may be concerned that the Bank was basing its lending decisions on political considerations. See *id.*; see also Ibrahim F.I. Shihata, Legal Opinion on Governance (unpublished memorandum, on file with author) [hereinafter Shihata, Opinion on Governance]; BARTRAM S. BROWN, *THE UNITED STATES AND THE POLITICIZATION OF THE WORLD BANK: ISSUES OF INTERNATIONAL LAW AND POLICY* (1992).

36. Broches Statement, *supra* note 35; see also Shihata, Opinion on Governance, *supra* note 35 (explaining that the aim of Bank was to base decisions on impartial and technical criteria).

37. IBRD Articles, *supra* note 24, art. III, sec. 4(v). The IDA Articles do not have this provision. However, they do require the IDA, in its lending decisions, to have regard for the “economic position” of the area in which it lends and for the “nature and requirements of the project.” IDA Articles, *supra* note 24, art. V, sec. 2(b).

economic growth to adequately address the problems of the poor, began broadening its understanding of which activities were included within the scope of its mandate by focusing more directly on poverty alleviation and basic human needs.<sup>38</sup> Thus, in addition to physical infrastructure projects, the Bank began to fund development activities related to health, education, agriculture, and housing. Later the Bank, again responding to its evolving understanding of the developmental problems of its Member States, added policy-based lending, environmental concerns, and gender issues to its list of permissible operations.<sup>39</sup> More recently, faced with the continuing developmental problems of many of its Member States, the Bank has added governance, economic transformation, and private sector development to its repertoire of appropriate operations.<sup>40</sup> It is now also attempting to incorporate public participation into most of its operations.<sup>41</sup>

#### *D. The Human Rights Implications of the Bank's Operations*

Each step in the expansion of the Bank's range of activities has forced it to confront operational issues that require it to make policy judgments. For example, it is not possible for the Bank to fund projects designed to alleviate poverty without making some judgment about who the poor are and who the relative winners and losers in these projects should be.<sup>42</sup> The Bank's failure to adequately consider all aspects of these issues may result in projects that either do not achieve their intended results or that perpetuate discriminatory treatment of certain vulnerable population groups.<sup>43</sup>

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38. EDWARD S. MASON & ROBERT E. ASHER, *THE WORLD BANK SINCE BRETTON WOODS* (1973). For a critical perspective, see CHERYL PAYER, *THE WORLD BANK: A CRITICAL ANALYSIS* (1982).

39. See, e.g., 1 PAUL MOSLEY ET AL., *AID AND POWER: THE WORLD BANK AND POLICY BASED LENDING* (1991); BRUCE RICH, *MORTGAGING THE EARTH* (1994).

40. SHIHATA, *supra* note 5.

41. PARTICIPATION SOURCEBOOK, *supra* note 11.

42. It should be noted that defining who should be the beneficiaries of a poverty alleviation project is not a simple task. For example, a project aimed at helping subsistence farmers might help those who own land but not those who work on other people's land. The latter group may be more numerous and poorer than the subsistence farmers. The same project may also benefit poor men at the expense of poor women. See generally, LAUREN MCGLYNN, *THE WORLD BANK AND THE REALIZATION OF THE RIGHTS OF WOMEN IN AGRICULTURE AND RURAL DEVELOPMENT PROJECTS IN SUB-SAHARAN AFRICA* 15 (1991) (discussing the situation of women in development); JOSETTE MURPHY, *GENDER ISSUES ON WORLD BANK LENDING* (1995); KATRINA A. SAITO & DAPHNE SPURLING, *DEVELOPING AGRICULTURAL EXTENSION FOR WOMEN FARMERS* (World Bank Discussion Paper No. 156, 1992); WORLD BANK, *ADVANCING GENDER EQUALITY: FROM CONCEPT TO ACTION* (1995); WORLD BANK, *POVERTY REDUCTION HANDBOOK* (1993).

43. There are many examples of problems that can arise when the Bank fails to adequately consider all aspects of these issues. See, e.g., BRADFORD MORSE & T. BERGER, *SARDAR SAROVAR: THE REPORT OF THE INDEPENDENT REVIEW* (1992) [hereinafter *SARDAR*

Similarly, the Bank cannot fund adjustment programs without also, at least implicitly, making judgments about the capacity of governments, and even of individual government officials, to implement and sustain the adjustment program.<sup>44</sup>

The complexity and the sensitivity of the issues that the Bank must consider have grown exponentially with the evolution of the Bank's adjustment-related work. As the focus in the adjustment programs has shifted from macroeconomic policymaking to the formulation and implementation of policy at a sector and even sub-sector level, the Bank has become ever more deeply involved in the affairs of some of its Member States.

For example, the Bank's initial concern with macroeconomic policymaking led it to focus on, *inter alia*, problems in the Member State's financial sector. Faced with these problems, the Bank began to fund financial sector adjustment loans that were designed initially to produce market-oriented policy changes in the Borrower State's financial sector. However, the focus on these policy changes highlighted other problems in the financial sector. In response, the Bank broadened its operations to include reform of supervisory and regulatory arrangements in the financial sector. This, in turn, helped raise the issue of the efficacy of the implementation of government regulation in the financial sector. These issues caused the Bank to further expand its scope of activities to include promoting the transparency and enforceability of the legal and regulatory structure in the Borrower State. This focus on legal reform highlighted the problems faced by the judiciary in some Bank Member States and has now led the Bank to fund several judicial reform projects.<sup>45</sup>

This evolution in Bank adjustment lending, together with the Bank's stated concern with poverty alleviation and the development of human resources, has expanded the range of activities now funded by the Bank (in addition to its traditional infrastructure projects) to include: reform of the civil service; reform of the management of public sector enterprises; legal and judicial reform; family planning; improving the quality of education and the equity of access to primary education; reform of universities; development of the private sector; land titling and registration reform; and programs to ensure that vulnerable groups such as women, children, indigenous people, and other minorities get access to health, education, and

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SAROVAR]; RAYMOND F. MIKESELL & LARRY W. WILLIAMS, *INTERNATIONAL BANKS AND THE ENVIRONMENT* (1992); PAYER, *supra* note 38; SIERRA CLUB, *BANKROLLING DISASTERS* (1986).

44. MOSLEY ET AL., *supra* note 39.

45. This progression in Bank lending can be discerned from the description of Bank loans contained in the Bank's annual reports. Similar evolutions in Bank operations have been occurring in all sectors in which the Bank funds the operations in the Borrower State. For further discussion of this issue see *infra* notes 47-48 and accompanying text.



other Bank-funded programs. In addition, during the past two years the Bank has actively promoted public participation in its operations.<sup>46</sup>

A comparison of the IBRD's and IDA's operations in 1990 and 1995 demonstrates the dramatic change in the Bank's operations.<sup>47</sup> In 1990, only one of the 234 loans made by the two institutions explicitly incorporated participation as an element of the project design. By 1995, participation was an element in ninety-two of the 243 projects funded by the Bank. In 1990, the two institutions made no loans for judicial reform. By 1995, they had made five loans designed, at least in part, to promote such reform. In 1990 the Bank funded no projects designed to strengthen property rights or to promote land reform. By 1995, the Bank was funding such projects in countries as diverse as Indonesia, Nicaragua, Bolivia, Thailand, and Russia.<sup>48</sup> In 1990, the Bank's governance operations were focused on improving the efficiency of the management of the public sector and on liberalizing policies in specific spheres of activity. By 1995, the scope of its governance activities had expanded to include strengthening local governments and devolving power from central to local governments; restoring or creating basic governmental functions in the Occupied Territories, Burundi, Rwanda, and Haiti; and restoring public confidence in the integrity and competence of the public sectors in Guatemala.<sup>49</sup> Since 1990, the IBRD and IDA have also funded projects to reform or develop university education; to improve the equity of access to, and the quality of, education; to improve educational opportunities for young girls; to promote health care for women; to provide assistance to indigenous peoples and other minorities; to assist countries in developing legal training programs; and to assist Uganda in laying a foundation for decreasing historic regional inequalities within the country.<sup>50</sup>

This brief description of the Bank's operations illustrates the wide range of human rights issues that can arise from the Bank's activities. For example, the Bank influences the rights of individuals to be free from discrimination and their rights to education and health when it finances projects that promote equity in access to health or education. Similarly, the Bank influences the ability of people to exercise their rights in their interactions with their governments when it finances reforms of the civil service. Also, the Bank raises questions about freedom of expression and association when it finances projects incorporating public participation into their design and implementation. In addition, by financing changes

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46. This information is drawn from various project summaries contained in the World Bank's annual reports. See WORLD BANK, WORLD BANK ANNUAL REPORT 1990, at 137-81; 1991, at 161-78; 1992, at 157-95; 1993, at 145-88; 1994, at 122-43; 1995, at 104-23 [hereinafter ANNUAL REPORTS].

47. See ANNUAL REPORTS, *supra* note 46, 1990 and 1995 project summaries.

48. *Id.* \*

49. See ANNUAL REPORTS, *supra* note 46, 1994 and 1995 project summaries.

50. *Id.*

in the management of universities and in the quality of education, the bank influences academic freedom. Finally, when the Bank finances a program of judicial reform, even if the program is only intended to improve specific aspects of the judiciary's operations,<sup>51</sup> it affects the way in which that judicial system will work for all those who seek its assistance. On a broader level, it also influences every person's access to the judicial system.

In short, it seems reasonable to conclude on the basis of the Bank's present range of activities that its operations have a direct effect on the following human rights in its Borrower States: the right to due process; the right to free association and expression; the right to participate in the government and the cultural life of the community; the right to work; the right to health care, education, food, and housing; and the rights of women, children, and indigenous peoples to nondiscriminatory treatment.<sup>52</sup> In addition, depending on the Borrower State's response to its citizens who take advantage of opportunities created by Bank-funded projects, the Bank can have an impact on human rights associated with the integrity of the person.<sup>53</sup> This will occur if the State or its agents take reprisals against citizens who use the opportunity created by the Bank's invitation to participate in its operations to oppose the projects sponsored by the State.<sup>54</sup>

### *E. The Human Rights Issues Raised by the Bank's Operations*

While there are a number of well-known cases where Bank-funded projects have resulted in human rights abuses,<sup>55</sup> the standard Bank

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51. The Bank has attempted to limit its governance and legal reform efforts to those issues that have a "direct and obvious" economic effect. Consequently its judicial reform projects have tended to focus on judicial administration and the judiciary's ability to deal with economic and commercial issues. See Shihata, *Opinion on Governance*, *supra* note 35; LAWYERS COMMITTEE FOR HUMAN RIGHTS, *THE WORLD BANK: GOVERNANCE AND HUMAN RIGHTS* (1993) [hereinafter *GOVERNANCE*]; LAWYERS COMMITTEE FOR HUMAN RIGHTS, *UPDATE ON GOVERNANCE* (1995) [hereinafter *UPDATE ON GOVERNANCE*]. For a critical analysis of judicial reform, see LAWYERS' COMMITTEE FOR HUMAN RIGHTS, *HALFWAY TO REFORM, THE WORLD BANK AND THE VENEZUELAN JUSTICE SYSTEM* (1996).

52. These rights are drawn from the International Covenant on Civil and Political Rights, Dec. 16, 1966, 999 U.N.T.S. 171; International Covenant on Economic, Social and Cultural Rights, opened for signature Dec. 19, 1966, 993 U.N.T.S. 3 (entered into force Jan. 3, 1976); Convention on the Elimination of All Forms of Discrimination Against Women, G.A. Res. 34/180 U.N. Doc. A/34/46 (Dec. 18, 1979), *reprinted in* 19 I.L.M. 33 (1980); Convention on the Rights of the Child, G.A. Res. 44/25 (Nov. 20, 1989), U.N. GAOR, 44th Sess., Supp. No. 49, at 167, U.N. Doc. A/44/49 (1989); and the U.N. CHARTER.

53. These rights include the right against torture, the right to a fair trial, and the right not to be detained without trial.

54. For a discussion of the Bank's responsibilities in these situations, see *infra* Part V.B.3.

55. See *e.g.*, SARDAR SAROVAR, *supra* note 43; LAWYERS COMMITTEE FOR HUMAN RIGHTS AND THE INSTITUTE FOR POLICY RESEARCH AND ADVOCACY, *IN THE NAME OF DEVELOPMENT: HUMAN RIGHTS AND THE WORLD BANK IN INDONESIA* (1995); JUSTICE

operation gives rise to less dramatic—but no less important—human rights concerns. The following sections discuss these latter concerns in more detail.

### 1. *The Political Prohibition in the Bank's Articles*

The first human rights issue raised by the Bank's standard operations pertains to how the Bank interprets the political prohibition in its Articles.<sup>56</sup> To date, the distinction the Bank draws between "economic" and "political" factors has been based on the impact the particular factor has on considerations of efficiency and economy.<sup>57</sup> On this basis, the Bank has defined an economic factor, within the meaning of the Bank's Articles of Agreement, as any factor that has a "direct and obvious' economic effect relevant to the [Bank's] work."<sup>58</sup> The Bank uses a three-part test to determine if the economic effect of a particular factor in a Bank operation is "direct and obvious." The economic effect must be (1) clear and unequivocal; (2) preponderant; and (3) when the issue is associated with political actions or flows from political events, the economic effect "must be of such impact and relevance as to make [it] a Bank concern."<sup>59</sup>

The Bank's General Counsel has also attempted to define the term political. He has suggested that the term political relates to "the art and practice of running a country or governing."<sup>60</sup> It includes those factors that would require the Bank to take a side in the political system of its Borrower States, such as favoring one political party or faction over another. It also includes considerations that might result in Bank decisions being influenced by the principles, opinions, or beliefs of the people or parties holding power in its Member States.<sup>61</sup> The General Counsel would exclude from the term "such typical economic and technical issues as the

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DENIED!: HUMAN RIGHTS AND THE INTERNATIONAL FINANCIAL INSTITUTIONS (1994); Request for Inspection-Nepal: Arun III Hydroelectric Project, Nov. 3, 1994, IPN Request RQ 94/1 (available at <<http://www.worldbank.org/ins-panel.html>>); Request for Inspection-Rodonia Natural Resources management Project, IPN Request RQ 95/3 (available at <<http://www.worldbank.org/ins-panel.html>>).

56. IBRD Articles, *supra* note 24.

57. Shihata, Opinion on Governance, *supra* note 35.

58. *Id.*; SHIHATA, *supra* note 5, at 53-97.

59. See Shihata, Opinion on Governance, *supra* note 35. It should be noted that the Bank has always recognized that political developments inside a country can be so important that they affect that country's future stability. In such situations, the Bank is required to consider these political developments because they will influence the project's success and the borrower's ability to perform its obligations under the loan agreement. See Broches Statement, *supra* note 35.

60. See Shihata, Opinion on Governance, *supra* note 35.

61. *Id.*

'management of money or the finances' or more generally the *efficient* management of the country's resources."<sup>62</sup>

The governance issues that the Bank considers inside its mandate demonstrate how the Bank applies these definitions. The Bank considers issues that relate to the degree and quality of the Borrower State's intervention in its economy as falling within the Bank's economic mandate because they have a direct effect on investment prospects in the country. Based on this rationale the Bank supports the Borrower State's efforts to reform its civil service, improve those aspects of its legal system that directly affect the conduct of commerce, increase the degree of accountability for public funds, and foster discipline in the budgeting process.<sup>63</sup>

The ambiguity in the Bank's interpretation of its mandate can be seen in its decision that female genital mutilation is an economic issue. The Bank has justified this decision by pointing to the economic costs associated with female genital mutilation.<sup>64</sup> In contrast, the Bank has not been willing to treat freedom of the press as an economic issue, despite the obvious economic costs associated with the lack of a free press.<sup>65</sup>

These examples suggest that the Bank's interpretation of its direct and obvious test is not based on easily identifiable criteria. The apparent arbitrariness of the direct and obvious test is not surprising. The test is easy to state but very difficult to apply. A key problem is that the test does not stipulate the time period over which the directness and the obviousness of the economic impact of the particular factor should be determined. If the time period for analysis is short, then relatively few nonobvious economic issues will have a direct and obvious effect.

Many Bank projects and programs, however, are implemented over a relatively long period of time and are designed to produce benefits over an even longer period. Consequently, it does not seem unreasonable to measure the direct and obvious effects of certain aspects of these operations over a period of time that roughly coincides with the project time frame. However, given that political and economic factors are inherently

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62. *Id.*

63. *Id.* See also WORLD BANK, *GOVERNANCE: THE WORLD BANK EXPERIENCE* (1994); WORLD BANK, *GOVERNANCE AND DEVELOPMENT* (1992).

64. See George Graham, *Pledge over Female Mutilation: World Bank and IMF Win Commitment by Burkina Faso*, FIN. TIMES, Apr. 22, 1994, at A6.

65. JEAN DREZE & ARMATYA SEN, *HUNGER AND PUBLIC ACTION* 263-64 (1989). Professor Sen has stated that "[t]here has never been a famine in any country that's been a democracy with a relatively free press. . . . I know of no exception. It applies to very poor countries with democratic systems as well as to rich ones." Sylvia Nasar, *It's Never Fair to Just Blame the Weather*, N.Y. TIMES, Jan. 17, 1993, at A1. Another benefit of a free press is information disclosure. This enables investors to identify business opportunities and risks, and allows citizens to hold their government more accountable.





intertwined,<sup>66</sup> it is likely that within such a time frame almost all political, social, and cultural issues will have a direct and obvious economic effect on the Bank-funded project or program and on the Borrower State's ability to perform its loan obligations. Consequently, on the basis of the direct and obvious test, the Bank should treat almost all issues as economic issues.

To cite an example, consider a Bank Member State that decides on human rights grounds to grant all criminal defendants the right to counsel and a fair trial. *Prima facie*, this decision would appear to be a political decision that is not relevant to Bank decisionmaking. However, this decision, over time, can have significant and potentially contradictory economic effects. On the one hand, the resulting improvement in the Member State's human rights situation could lead to an improvement in business confidence, which could result in increased investment, increased employment, and reduced social tensions. On the other hand, the decision could lead to a reallocation of resources towards the criminal justice system, which could result in a reduction of resources available to the civil justice system. The need for police officers to spend more time in court testifying in criminal trials could lead to a reduction in the number of police officers available to prevent crime. In addition, the decision could lead to a budgeting reallocation to the criminal justice system with adverse consequences for other areas of the budget. These developments could adversely affect business confidence leading to a reduction in investment, a rise in unemployment and social tensions, and a decline in the Borrower State's ability to perform its loan obligations.<sup>67</sup> In either case, it is clear that the decision will have direct economic consequences.

The potential effects of this ostensible human rights decision therefore indicate that the Bank should treat the decision to grant criminal defendants the right to counsel as an economic issue. This creates a problem, however, in that it suggests that all issues are economic and that, as a result, there is no issue that is excluded from the scope of the Bank's jurisdiction. The Bank's adoption of such an approach would undermine its role as a specialized international organization and would substantially alter the balance in the Bank-Member State relationship. Nevertheless, it must be recognized that failure of the direct and obvious test to incorporate a temporal dimension either leads to the adoption of this all-encompassing approach or results in decisions that appear arbitrary.<sup>68</sup>

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66. *Limited Mandates*, *supra* note 3, at 413-16.

67. REGINALD H. GREEN, PARTICIPATORY PLURALISM AND PERVERSIVE POVERTY: SOME REFLECTIONS 21 (1989) (discussing the consequences of criminal justice reforms that are inspired by external pressure).

68. This issue will be addressed again in Part V. of this Article, in which the author discusses the contents of a possible IFI human rights policy.

## 2. *The Bank and the International Human Rights Conventions*

The second human rights issue raised by the Bank's operations focuses on the international human rights conventions. The fact that the Bank is not a signatory to any of the major human rights conventions means that the Bank is not required to specifically apply internationally recognized human rights standards in its operations. Similarly, it is not required to follow the decisions or recommendations of any of the specialized human rights agencies.<sup>69</sup> In theory, therefore, the Bank can develop its own human rights standards.

There are, however, limits on the Bank's ability to develop human rights guidelines that do not conform to internationally accepted human rights standards. First, the Bank is a specialized agency of the United Nations and consequently is required to act in conformity with the U.N. Charter.<sup>70</sup> Second, the Bank, as an international organization, is a subject of international law and therefore can not violate customary international law.<sup>71</sup> Thus, for example, it can neither directly nor indirectly fund States that practice genocide or racially discriminatory conduct. Also, the Bank's operations should not undermine the ability of its Member States to live up to their international legal obligations. This suggests that, at least in those countries that are signatories to human rights conventions, the Bank may have an obligation to ensure that its operations do not undermine the country's efforts to abide by these conventions.<sup>72</sup> This would include ensuring that the projects it funds do not distribute their costs and benefits in such a way as to undermine the Borrower State's efforts to meet its international legal obligations.

## 3. *The Bank-Borrower State Relationship*

The third human rights issue raised by the Bank's operations is the amount of influence it has over the development policies, including the human rights policies, of its Member States. The Bank is able to exert influence through its lending operations, policy dialogue, technical assistance, and research programs. The degree of influence will depend on the relative bargaining position of the Bank and the Member State. This

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69. There is no agreement requiring the Bank to abide by the recommendations of the United Nations or its specialized agencies. See U.N.-IBRD Relationship Agreement, *supra* note 6; U.N.-IDA Relationship Agreement, *supra* note 6.

70. DEREK W. BOWETT, *THE LAW OF INTERNATIONAL INSTITUTIONS* (4th ed. 1982); HENRY G. SCHERMERS & NIELS M. BLOKKER, *INTERNATIONAL INSTITUTIONAL LAW* (3d ed. 1995).

71. BOWETT, *supra* note 70; SCHERMERS & BLOKKER, *supra* note 70.

72. Applying this standard will not be easy given the differing interpretations States may have about how to implement their human rights obligations. *Limited Mandates*, *supra* note 3. A satisfactory outcome to this problem would be facilitated by an explicit Bank human rights policy. For more detailed discussion of this issue, see *infra* Part V.A.

will be affected by such factors as the strength of the Bank's views on the Borrower State's needs, the relationship between the relevant Bank officials and the Borrower State, the quality of the State's own development planning, the clarity of the State's own perspective on the services it needs from the Bank, and the State's access to alternative sources of funds.

The Bank is able to use the lack of transparency in its interpretation of the political prohibition in its Articles to enhance its bargaining power. The lack of clear guidelines about what human rights and other political issues fall within its jurisdiction allow Bank officials great discretion in deciding which issues can and which can not be considered in the design and implementation of Bank-funded operations. This may work to the detriment of the Borrower State, which may be seeking to develop policies that are consistent with its international human rights obligations but which may not conform to the relevant Bank official's view of the appropriate policies for the State. It may also harm other stakeholders in the Bank-borrower relationship who may be seeking external assistance in encouraging a State to live up to its international legal obligations.

On the other hand, the lack of clear guidelines can present an opportunity for well-prepared Borrower States. These States, as well as nongovernmental stakeholders in Bank operations, can use their superior knowledge of local conditions and local needs, and their own development planning process to enhance their bargaining position with the Bank. In addition, if they can convince Bank officials to treat their human rights concerns as "economic" issues, they can also harness the services of the Bank to promote their own human rights agenda.

### *F. Protection of Human Rights*

The discussion so far has focused on the Bank's obligations to promote human rights. The Bank, however, also has some obligation to protect victims of human rights abuses from the perpetrators of those abuses. The Bank's obligations in this regard arise primarily when a potential Borrower State is guilty of serious human rights abuses. These abuses could be either directly related to or completely unconnected with the specific Bank operation. An example of abuses related to Bank activities would be where citizens suffer reprisals after accepting the Bank's offer to participate in the Bank-funded operation. An example of unconnected abuses would be where the Borrower State is guilty of widespread arbitrary arrests and detentions without trial, and in which the detainees are held for activities unconnected to the potential Bank-funded operation.

For a number of reasons, the protection of human rights is a much more difficult issue for the Bank than the promotion of human rights. The first reason is that no country in the world has a perfect human rights record. Consequently, if the Bank were to set too high a human rights standard it would not be able to lend to any country. On the other hand, if the Bank does

not set any such standards, it runs the risk of supporting governments that are engaging in gross human rights violations, and thus, which are incapable of promoting sustainable development.<sup>73</sup>

Second, the Bank's efforts to identify human rights situations that require it to take protective action are complicated by the fact that human rights law treats all human rights as being of equal value. Consequently, different States may choose to emphasize different human rights at different stages in their development process. It is not easy for the Bank or any other observer to balance respect for these choices with an assessment of when the State's human rights situation has reached such a serious state that it requires a specific Bank response.<sup>74</sup>

Third, the Bank's ability to protect human rights is limited by the fact that it is a specialized economic organization. Thus, the Bank is unlikely to have the in-house expertise needed to identify those human rights situations that are sufficiently serious to merit a Bank response or to determine what the appropriate response should be. There is, however, a solution to this problem. The Bank should work with specialized human rights organizations and other expert groups to formulate a policy for identifying countries where the human rights situation requires a response by the Bank.<sup>75</sup>

A fourth reason is that even after the Bank determines that the human rights situation is sufficiently serious to warrant protective action, it is not clear what the Bank's response should be. It is possible that any one of the following three mutually contradictory responses could be the most productive: (1) the Bank should cease making any loan commitments or disbursements to the State, (2) the Bank should continue lending on the assumption that the development projects it is funding will ultimately help produce a change in the State's human rights situation, or (3) the Bank should continue lending but only to projects which help empower the victims to defend their human rights.

Historically the Bank has responded by treating the issue of unconnected human rights violations as a political issue that is outside its jurisdiction. However, the Bank's efforts to promote good governance in Borrowing States undermines this position. There are two reasons for this. First, governance operations force the Bank to address issues relating to how the State manages its resources, including its human resources.<sup>76</sup> The management of human resources necessarily implicates human rights considerations. Second, it is difficult for the Bank to argue that

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73. Sustainable Development is a comprehensive process involving economic, social, cultural, political, and environmental aspects. See *supra* note 2 and accompanying text.

74. *Limited Mandates*, *supra* note 3.

75. Some proposals for this policy will be discussed in Part V. of this Article.

76. See WORLD BANK, GOVERNANCE AND DEVELOPMENT, *supra* note 63; WORLD BANK, GOVERNANCE, *supra* note 63.

governments guilty of widespread human rights violations are practicing sustainable good governance.

The question of how to deal with the protection of human rights victims has also acquired greater relevance now that the Bank is promoting participation as part of its standard operating procedure. In this regard the Bank needs to develop guidelines for determining when people have had an adequate opportunity to participate in Bank-funded projects. It also needs to formulate a policy for dealing with situations of inadequate participation and situations in which some person or group, invited to participate in a Bank-funded project, suffers reprisals as a result of their participation in the project design and implementation process.<sup>77</sup>

### G. *The Institutional Human Rights Issue*

The final issue that human rights raise for the Bank relates to its own internal operating procedures. The Bank, as a subject of international law, should ensure that its operations are conducted in a way that is consistent with the internationally recognized rights of the citizens of its Member States. This suggests that the Bank's operating rules and procedures should incorporate such elements of due process as transparent procedures, open communications, and accountability.<sup>78</sup>

## III. THE INTERNATIONAL MONETARY FUND

### A. *Introduction*

In this section I argue that over the past 50 years the IMF has been transformed from a monetary institution with a clearly defined scope of operations into an institution whose activities often appear to focus more on developmental than monetary matters.<sup>79</sup> While the causes of this

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77. See *Limited Mandates*, *supra* note 3; Shihata, *Democracy and Development*, *supra* note 2, at 7.

78. It should be pointed out that these rights coincide with the elements of good governance that the Bank suggests its Borrower States incorporate into their own operating practices. Consequently, it is hard to see what objection there can be to the Bank practicing what it itself preaches. Daniel D. Bradlow, *International Organizations and Private Complainants: The Case of the World Bank Inspection Panel*, 34 VA. J. INT'L L. 553 (1994). The institutional challenges that this creates for the Bank will be discussed in a later part of this Article. See *infra* Part IV.

79. For reviews of the IFI's first 50 years of operation, see, e.g., Robert S. Browne, *Rethinking the IMF on its Fiftieth Anniversary*, in *THE WORLD BANK'S MONETARY SYSTEM* (Jo Marie Griesgraber & Bernhard G. Gunther eds., 1996); Barry Eichengreen & Peter B. Kenen, *Managing the World Economy Under the Bretton Woods System*, in *MANAGING THE WORLD ECONOMY 3* (Peter B. Kenen ed., 1994); *BRETTON WOODS COMMISSION, BRETTON WOODS: LOOKING TO THE FUTURE* (1994); *FIFTY YEARS AFTER BRETTON WOODS: THE FUTURE OF*

expansion in the IMF's operations differs from those of the Bank, the result has been similar. Today, the IMF, like the Bank, exerts some influence over the human rights situation in its Member States.<sup>80</sup> Moreover, the IMF is exerting this influence with an even less developed human rights policy than the Bank.

In order to make this case, I shall begin with a discussion of the IMF's Articles of Agreement and the evolution in its operations. This discussion will be followed by an analysis of the IMF's present involvement in the human rights situation in its Member States.

### *B. The IMF's Mandate*

The IMF, like the Bank, is a specialized agency of the United Nations.<sup>81</sup> It was established to help regulate the international monetary system and to provide financial support to Member States that were experiencing balance of payments problems. According to its Articles of Agreement, the purposes of the IMF, *inter alia*, are to promote monetary cooperation, to promote orderly and stable exchange rates, to assist in the establishment of a multilateral system of payments for current transactions, and to give confidence to Member States by helping them correct balance of payments problems in a manner that is not destructive of either international or domestic prosperity.<sup>82</sup>

Until the collapse of the par value system,<sup>83</sup> the IMF's job was relatively simple. It monitored its Member States' international monetary policies to ensure that they were consistent with the maintenance of their currencies'

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THE IMF AND THE WORLD BANK (James M. Boughton & K. Sarwar Lateef eds., 1995) [hereinafter FIFTY YEARS AFTER].

80. Margaret Conklin & Daphne Davidson, *The I.M.F. and Economic and Social Human Rights: A Case Study of Argentina, 1958-1985*, 8 HUMAN RIGHTS Q. 227 (1986); Michael Lucas, *The International Monetary Fund's Conditionality and the International Covenant on Economic, Social and Cultural Rights: An Attempt to Define the Relation*, 25 R. BEL. D. INT'L 104 (1992); Balakrishnan Rajagopal, *Crossing the Rubicon: Synthesizing the Soft International Law of the IMF and Human Rights*, 11 B.U. INT'L. L.J. 81 (1993).

81. U.N.-IMF Relationship Agreement, *supra* note 6.

82. IMF Articles, *supra* note 12, art. I.

83. According to the original Articles of the IMF, each Member State was required to establish a fixed value for its currency. Each State had to ensure that its currency did not fluctuate in value by more than 1% above or below this par value. (This was later changed to 2.5%.) IMF Member States, therefore, had a legal obligation to take corrective action any time the value of their currency began to deviate from the par value by more than the prescribed amount. Only in cases of "fundamental disequilibrium" could States change the par value of their currency by either devaluing or revaluing it. IMF Articles, *supra* note 12, art. IV (Articles prior to amendments); EDWARDS, *supra* note 12; JOSEPH GOLD, LEGAL EFFECTS OF FLUCTUATING EXCHANGE RATES 3 (1990).

par value. The IMF was also expected to provide its members with short-term financing when they experienced balance of payments difficulties.<sup>84</sup>

The IMF's primary mechanism for monitoring its Member States' exchange rates and balance of payments policies was (and still is) the regular consultations it conducted with these States pursuant to Article IV of its Articles of Agreement. The par value system tended to place some limits on the scope of these Article IV consultations. Since the purpose of these periodic consultations was to determine the State's ability to maintain its par value, the consultations could be limited to those macroeconomic variables that directly affected the external value of the State's currency during the period under consideration (usually one year). Thus, the focus of the consultations tended to be on such issues as interest rates, money supply, government debt, inflation, and the current account of the balance of payments. The scope of these discussions were also somewhat constrained by Article IV which requires that the IMF "respect the domestic social and political policies of members, and in applying these principles . . . pay due regard to the circumstances of members."<sup>85</sup> The IMF has interpreted this provision as a prohibition against considering political factors in its operations.<sup>86</sup>

The par value system also operated to limit the range of conditions that the IMF would attach to the financial support it offered to its Member States.<sup>87</sup> Under a par value system, the exchange rate is the primary anchor for the economy. This meant that, except in exceptional circumstances,<sup>88</sup> the burden of adjustment fell on the domestic economy of countries with balance of payments disequilibria.<sup>89</sup> Consequently, the IMF conditions could be limited to those macroeconomic variables—government debt,

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84. EDWARDS, *supra* note 12.

85. IMF Articles, *supra* note 12, art. IV, sec. 3(b).

86. Joseph Gold, *Political Considerations Are Prohibited by Articles of Agreement When the Fund Considers Requests for Use of Resources*, IMF SURVEY, May 23, 1983, at 146; see also Gianviti, *supra* note 24. It should be noted that the language of the IMF's Article IV is less restrictive than the political prohibition in the Bank's Articles. This suggests that the IMF's Articles provide broader scope for developing a human rights policy than the Bank's.

87. Pursuant to Article V, the IMF must ensure that its Member States use its funds in accordance with the IMF's purposes and that the Member State will be able to resell the funds to the IMF within a relatively short period of time. IMF Articles, *supra* note 12, art. V, sec. 2. In order to execute these requirements the IMF attaches specific performance-related conditions to the use of its financing facilities. These conditions form the basis of IMF conditionality. For a discussion of IMF Conditionality, see, e.g., JOSEPH GOLD, CONDITIONALITY (IMF Pamphlet Series No. 31, 1979); MANUEL GUITIAN, FUND CONDITIONALITY: EVOLUTION OF PRINCIPLES AND PRACTICES (IMF Pamphlet Series No. 38, 1981). For case studies on conditionality, see, e.g., IMF CONDITIONALITY (John Williamson ed., 1983); CHERYL PAYER, THE DEBT TRAP: THE INTERNATIONAL MONETARY FUND AND THE THIRD WORLD (1974).

88. See *supra* note 83. See, e.g., EDWARDS, *supra* note 12.

89. See JEFFREY D. SACHS & FELIPE LARRAIN B., MACROECONOMICS IN THE GLOBAL ECONOMY (1993).



money supply, inflation, budget deficits—that were directly relevant to the attainment of a sustainable balance of payments position, based on a currency with a relatively fixed value. The scope of the issues discussed in each Member State's letter of intent could also be limited to these macroeconomic issues.<sup>90</sup>

In this regard, it should be recognized that the IMF was concerned primarily with the actual attainment of these macroeconomic goals. It only had a secondary interest in how the Member State reached these targets. Consequently, the precise methods used to reach these goals could be left to the discretion of the Member State. This tended to impose some constraint on the IMF's ability to intervene in the policymaking processes of its Member States.<sup>91</sup>

### *C. The Evolution in the IMF's Operations*

#### *1. The End of the Par Value System*

The collapse of the par value system in 1971 changed this relatively simple picture.<sup>92</sup> The par value system was replaced with a market-oriented exchange rate system which allows participating States to let their currencies fluctuate in value.<sup>93</sup> In such a floating exchange rate system, the exchange rate becomes only one of the many economic variables that can influence the country's balance of payments. Floating exchange rates allow a country to correct a balance of payments problem by making adjustments either in the value of its currency or in its domestic economy.<sup>94</sup>

This change expanded the range of issues that the IMF needed to address in its Article IV consultations with its Member States. For example, because such issues as labor, health, and agricultural policies can directly

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90. In order to utilize the resources of the IMF, a Member State must submit a letter, known as letter of intent, to the Managing Director of the Fund. This letter contains a description of the policies the Member State intends to follow to correct its balance of payments problems. For examples of letters of intent, see *THE IMF AND GHANA: THE CONFIDENTIAL RECORD* 61 (Eboe Hutchful ed., 1987) (letter from Ghana); EDWARDS, *supra* note 12 (letter from India); KATHLEEN BURK & ALEC CAIRNCROSS, 'GOODBYE GREAT BRITAIN': *THE 1976 IMF CRISIS* 229 (1992) (letter from United Kingdom).

91. The efficacy of these constraints is open to debate. See, e.g., PAYER, *supra* note 87; BURK & CAIRNCROSS, *supra* note 90; *THE IMF AND GHANA: THE CONFIDENTIAL RECORD*, *supra* note 90.

92. See MARGARET GARRITSEN DE VRIES, *THE IMF IN A CHANGING WORLD 1945-1985* (1986).

93. The market-oriented exchange rate system was enacted by the Second Amendment to the IMF Articles in April, 1978. The Second Amendment also prohibited a Member State from basing its exchange rate on gold. See JOSEPH GOLD, *USE, CONVERSION, AND EXCHANGE OF CURRENCY UNDER THE SECOND AMENDMENT OF THE FUND'S ARTICLES* (1978); see also GOLD, *supra* note 83.

94. SACHS & LARRAIN, *supra* note 89.



affect the value of a country's currency and its ability to adjust to changes in its balance of payments, the IMF needs to consider all these issues in its surveillance of its Member States' monetary policies. In fact, over time the IMF has found it necessary to expand the range of issues included in its consultations. The result is that today, during Article IV consultations, the IMF may discuss such issues as the level of military expenditures, environmental issues, governance issues, and social safety nets (which amount to welfare, housing, and unemployment policies).<sup>95</sup>

The broad scope of the Article IV consultations suggests that the IMF can exert influence over the human rights situation in Member States. Discussions between the IMF and the Member State about such issues as labor policies, health care, and social security can influence economic and social rights in the State. Similarly, when the senior staff of the IMF talks both publicly and privately about the importance of the rule of law and good governance to development, they can influence the state of civil and political rights in Member States.<sup>96</sup>

The extent of the IMF's influence will vary depending on the identity of the Member State. If the State has a healthy economy or is rich enough that it is unlikely to need the resources of the IMF, it is free to accept or reject the IMF's views. On the other hand, poor States or those States that are using or expect to use the IMF's financing facilities can not treat the IMF's advice so dispassionately. Only at a theoretical level do these States have the same capacity as the rich Member States to accept or reject the IMF's advice. Consequently, the IMF tends to have much greater influence over the policies of poorer States than over richer States.

## 2. *The Economic Crises of the 1970s and 1980s*

The oil and debt crises of the second half of the 1970s and the 1980s also caused changes in the operations of the IMF. These crises resulted in a shift in the identity of the countries that make the most extensive use of the services and facilities of the IMF. Prior to these crises, the primary users of the IMF's financing services were industrialized countries. Since the

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95. See, e.g., SOCIAL DIMENSIONS OF THE IMF'S POLICY DIALOGUE, (IMF Pamphlet Series No. 47), excerpted in IMF SURVEY, Apr. 3, 1995, at 97; Robert Brauning, *Summit Sets Standard for Social Policies*, IMF SURVEY, Apr. 3, 1995, at 101 (quoting speech of IMF Managing Director Michel Camdessus at Social Summit); *Gender Issues in Economic Adjustment Discussed at U.N. Conference on Women*, IMF SURVEY, Sept. 25, 1995, at 286 (speech of IMF representative K. Burke Dillon at the Beijing Conference on Women) [hereinafter Dillon Speech].

While the range of issues discussed in the IMF's standby decisions has expanded, the IMF has not explicitly incorporated the full range of social and human-rights-related issues into the conditionalities attached to its financing facilities.

96. See *supra* note 80; see also *Limited Mandates*, *supra* note 3, for citations to other IMF statements on these issues.



advent of these crises the primary users of its services have been developing countries.<sup>97</sup>

The change in the IMF's clientele necessarily produced changes in its operations because the causes of (and the solutions to) the balance of payments problems of developing countries are not identical to those of industrialized countries. The balance of payments problems of developing countries, in part, are attributable to their level of development. Consequently, their balance of payments problems have structural dimensions which cannot easily be resolved within the parameters of the IMF's standard short-term standby arrangement. The IMF responded by developing longer-term financing facilities, such as the Extended Fund Facility and the Enhanced Structural Adjustment Facility (ESAF).<sup>98</sup>

The longer-term facilities lengthened the time period within which the IMF expected its adjustment policies to work. As a result, the IMF was able to change its assumptions about which factors should be treated as fixed and which as variable in the design of its stabilization and adjustment programs. Most significantly, the IMF relaxed its assumptions about the fixed nature of the supply side of a country's economy.<sup>99</sup> This has enabled the IMF to begin including in its conditionality policies some measures designed to produce changes in the Member State's production profile.<sup>100</sup>

A necessary consequence of this change is that the IMF, when deciding how to incorporate supply-side issues into its policies and programs, has begun to pay close attention to the speed at which, and the extent to which people in the country can actually make changes in the production side of the economy. This requires some analysis of the economic, social, and cultural impediments in the Member State.

As the discussion above illustrates, the change in the IMF's clientele has forced the IMF to address the social, cultural, and governance features of its Member State's political economy.<sup>101</sup> The result of these developments is that today almost all IMF standby and ESAF arrangements include

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97. See DE VRIES, *supra* note 92; MANAGING THE WORLD ECONOMY, *supra* note 79; BRETTON WOODS COMMISSION, *supra* note 79.

98. For IMF publications that discuss the ESAF and EFF, see TREASURER'S DEPARTMENT, *supra* note 13. For a discussion of the history of the IMF, see DE VRIES, *supra* note 92, and HOOKE, *supra* note 13.

99. In its standard twelve- to eighteen-month standby arrangements, the IMF tends to assume that the country has very limited ability to increase the amount or the range of goods and services it produces. Consequently, its conditionalities tend to require the country to correct its balance of payments position by decreasing the level of demand in the domestic economy. See GOLD, *supra* note 87; GUITIAN, *supra* note 87.

100. See GOLD, *supra* note 87; IMF CONDITIONALITY, *supra* note 87; GUITIAN, *supra* note 87.

101. See, e.g., SOCIAL DIMENSIONS OF THE IMF'S POLICY DIALOGUE, *supra* note 95; Brauning, *supra* note 95; Dillon Speech, *supra* note 95; see also *Limited Mandates*, *supra* note 3; Robert S. Browne, *Alternatives to the International Monetary Fund*, in *BEYOND BRETTON WOODS 57* (John Cavanagh et al. eds., 1994).

discussions of social safety nets and market-oriented reforms.<sup>102</sup> In addition, IMF officials talk about the importance of transparent and accountable governance and of the rule of law to economic development.<sup>103</sup>

#### *D. The Human Rights Implications of the IMF's Operations*

##### *1. Limits on the IMF's Influence*

The extent of the IMF's influence over human rights is more limited than the Bank's. There are several reasons for this. The first is that the IMF is a monetary, not a development institution. Even though its operations focus on developing countries and their problems, its primary focus still remains on macroeconomic, and in particular, monetary issues. It is less involved than the Bank at the micro-level of the economy, which is the level that the policies and operations of the IFIs most directly affect the human rights situation of the citizens of their Member States.

The second reason for the IMF's more limited human rights influence is that the IMF tends to operate with a much shorter time horizon than the Bank. This is particularly pertinent for human rights issues, which tend to require longer periods for change than do the issues usually focused on by the IMF. Consequently, there is a temptation for the IMF to treat human rights issues as fixed during the period in which the IMF program will be implemented.<sup>104</sup>

Even though the IMF has less influence than the Bank, the IMF still exerts some influence over its Member States' human rights situations through its Article IV consultation process and through its use of conditionalities attached to its financing facilities. Thus, like the Bank, it needs a human rights policy that can inform all the stakeholders in its operations about what they can expect from the IMF in this regard.<sup>105</sup>

#### *E. The Protection of Human Rights*

The third issue relating to the IMF's human rights responsibilities in its operations is that the IMF, as a subject of international law, has some responsibility to help protect the citizens in its Member States from human rights abuses. It cannot be indifferent to situations in which human rights

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102. This can be deduced from a review of the press releases that announce the IMF Board of Executive Directors' standby decisions. These press releases are published in the IMF Survey.

103. See, e.g., Brauning, *supra* note 95.

104. Even in longer-term facilities, the precise performance criteria on which IMF financing is conditioned are only established approximately on a twelve-month basis. See TREASURER'S DEPARTMENT, *supra* note 13, at 83-86 (describing Extended Fund Facilities and ESAFs).

105. See *infra* Part V. for further discussion of this issue.



abuses have become so serious as to cause monetary consequences. For example, during the 1980s, the IMF was forced to recognize that the systematic abuses caused by South Africa's apartheid policy had adverse effects on its ability to meet its obligations as a Member of the IMF. As a result the IMF was forced to limit South Africa's access to the resources and services of the IMF.<sup>106</sup>

It should be noted that the IMF faces a more difficult situation in this regard than the Bank. There are three reasons for this. First, as the manager of the international monetary system, the IMF must balance its responsibilities to the citizens of the violating State against its responsibilities to the other stakeholders in the international monetary system. Consequently, it cannot easily impose sanctions on a State that violates human rights if this would have a substantial adverse effect on the international monetary system.

Second, the IMF has fewer options than the Bank for dealing with human rights abuses. Because the IMF provides financing for general balance of payments support rather than for specific projects,<sup>107</sup> it cannot easily direct the flow of the financing. Consequently its only option when faced with a serious human rights problem is to either deal with the State purely on the basis of its monetary situation or to impose sanctions on the State.

Third, the Articles of Agreement constrain the IMF's ability to use sanctions. The Articles require the IMF to make its financing facilities available to any Member State in good standing who is suffering the type of balance of payments problem that the facility was established to help correct.<sup>108</sup> A member is in "good standing" if it is performing all the obligations of membership in the IMF.<sup>109</sup> These obligations, as stipulated in the Articles of Agreement, do not include human rights performance.<sup>110</sup>

It should be noted that the Articles do not, however, preclude the IMF from raising serious human rights issue in its Article IV consultations with its Member States.<sup>111</sup> It can justify doing so on the grounds that poor human rights performance can have an adverse effect on the State's

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106. See Jim Morell, *A Billion Dollars for South Africa*, INT'L POL'Y REP., Apr. 1983, at 1; Morell, *A Victory over Apartheid*, INT'L POL'Y REP., Apr. 1984, at 1. [hereinafter both Morell articles referred to as International Policy Papers]; see also Daniel D. Bradlow, *Debt, Development and Democracy: Lessons from South Africa*, 12 MICH. J. INT'L L. 647 (1991).

107. See EDWARDS, *supra* note 12, at 12; GOLD, *supra* note 87.

108. See Joseph Gold, *Uniformity as a Legal Principle of the International Monetary Fund*, 7 LAW. & POL'Y INT'L BUS. 765 (1975).

109. *Id.*

110. See IMF Articles, *supra* note 12.

111. See *supra* notes 85-86 and accompanying text (discussing interpretation of Article IV).

balance of payments position.<sup>112</sup> This follows from the fact that a poor human rights situation has economic costs that affect the allocation and utilization of resources, including human resources.

The final human rights issue that the IMF must address is the issue of its human rights responsibilities in regard to its own internal operating policies and procedures. The IMF's institutional human rights obligations will be discussed with those of the Bank in the next section of this Article.

#### IV. INSTITUTIONAL ISSUES

##### *A. Description of the Issues*

As subjects of international law, the IFIs are required to ensure that their operating rules and procedures conform to the standards of international law and do not undermine the efforts of their Member States to satisfy their own international legal obligations. This suggests that the IFIs' operating rules and procedures should be transparent, should provide affected parties with a meaningful opportunity to participate in the design and implementation of their operations, and should hold IFI staff accountable for their actions and decisions.

In recent years, both the Bank and the IMF have experienced problems with their operating rules and procedures.<sup>113</sup> An internal investigation into the Bank's management of its loan portfolio found problems that were attributable, at least in part, to deficiencies in the operational procedures of

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112. The U.S. Congress used this logic in deciding to order the U.S. Executive Director at the IMF to vote against IMF Financing for South Africa during the 1980s. See 22 U.S.C. § 286aa (1988); see also Bradlow, *supra* note 106 (discussing U.S. policy towards IMF financing for South Africa); International Policy Papers, *supra* note 106.

113. See Moises Naim, *The World Bank: Its Role, Governance and Organizational Culture*, in BRETTON WOODS COMMISSION, *supra* note 79, at C-273; Bradlow, *supra* note 78; Lori Udall, *The World Bank's Revised Information Policy and New Inspection Panel: Public Accountability or Public Relations*, in BEYOND BRETTON WOODS, *supra* note 101, at 145; Bruce Rich, *The World Bank: Institutional Problems and Possible Reforms*, Memorandum from Bruce Rich to Interested NGOs, IGC Conferences, Researchers, Bank Watchers, etc. (March 1995) (on file with author) [hereinafter Rich Memorandum]; Report of the Portfolio Management Task Force, *Effective Implementation: Key to Development Impact* [hereinafter Wapenhans Report]; SARDAR SAROVAR, *supra* note 43; Jeffrey Sachs, *Will the Banks Block Debt Relief?*, N.Y. TIMES, Mar. 21, 1989, at A25; *Oversight of the IMF and World Bank, Meeting of a Multinational Group of Parliamentarians Involved in Oversight of the IMF and World Bank Before the Subcomm. on International Development, Finance, and Monetary Policy Trade of the House Comm. on Banking, Finance and Urban Affairs*, 103rd Cong., 2nd Sess., 26-28, 47-48 (1994) (statement of Jeffrey Sachs, Professor of Economics) [hereinafter Inter-Parliamentary Meeting]; *Testimony to Subcomm. on Development, Finance, Trade, and Monetary Policy of the Comm. on Banking, Finance, and Urban Affairs*, 104th Cong., 1st Sess., 8-12, 51-52 (1996) (Statement of Jeffrey Sachs, Professor of Economics); Jeffrey Sachs, *Towards Glasnost in the IMF*, CHALLENGE, May-June 1994, at 4.

the Bank.<sup>114</sup> The IMF has also been criticized for its handling of such situations as the 1994 currency crisis in Mexico and the complex problems resulting from the breakup of the former Soviet Union.<sup>115</sup> The IMF's problems are also attributable in part to deficiencies in its operating practices.<sup>116</sup>

The reasons the IFIs have experienced these problems are not hard to find. Historically, both institutions have not been easily accessible to the public; both have been reluctant to make adequate amounts of information publicly available in a timely manner; and both have been insufficiently accountable to those who are most directly affected by their actions. In addition, staff incentives in both institutions are more responsive to their prior narrower range of activities and the technical issues that arose from them than to the broad ranging and complex policy choices that the institutions now have to make.<sup>117</sup>

In the case of the Bank, this created what the Wapenhans report called a "loan approval" culture which encouraged Bank staff to lend money. This was accompanied by an institutional bias in favor of large, complex projects rather than smaller, simpler projects which, while more labor and resource intensive, are also more amenable to public participation and tend to be more directly responsive to the needs of their intended beneficiaries.

Similarly, the IMF rewards staff for their technical proficiency rather than for taking the time to engage in the wide-ranging consultations and exchanges of information necessary to ensure that the IMF's operations are transparent and sensitive to the interests of those who will be affected by them. In this regard, the IMF tends to limit its discussions to a small number of government ministries. The Articles require the IMF to establish either the Central Bank or the Ministry of Finance as its contact point with the government.<sup>118</sup> There is no obligation on the IMF to broaden its contacts beyond these two governmental actors.

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114. Wapenhans Report, *supra* note 113.

115. Sachs, Inter-Parliamentary Meeting, *supra* note 113; BRETTON WOODS COMMISSION, *supra* note 79; FIFTY YEARS AFTER, *supra* note 79; MANAGING THE WORLD ECONOMY, *supra* note 79.

116. Inter-Parliamentary Meeting, *supra* note 113 (stating, *inter-alia*, that it is harder to get information from the IMF than from the CIA).

117. See Wapenhans Report, *supra* note 113; Rich, *supra* note 113; BRETTON WOODS COMMISSION, *supra* note 79; FIFTY YEARS AFTER, *supra* note 79; MANAGING THE WORLD ECONOMY, *supra* note 79. See generally PROMOTING DEVELOPMENT: EFFECTIVE INSTITUTIONS FOR THE TWENTY-FIRST CENTURY (Jo Marie Griesgraber & Bernard Gunther eds., 1995); RETHINKING BRETTON WOODS: TOWARDS EQUITABLE, SUSTAINABLE AND PARTICIPATORY DEVELOPMENT (Jo Marie Griesgraber & Bernard Gunther eds., 1994) [hereinafter RETHINKING BRETTON WOODS]; THE WORLD BANK: LENDING ON A GLOBAL SCALE (Jo Marie Griesgraber & Bernard Gunther eds., 1996); THE WORLD'S MONETARY SYSTEM: TOWARD STABILITY AND SUSTAINABILITY IN THE TWENTY-FIRST CENTURY (Jo Marie Griesgraber & Bernard Gunther eds., 1996).

118. IMF Articles, *supra* note 12, art. V, sec. 1.

### B. *The Response of the Bank*

The Bank has begun to address these problems. First, it has undertaken an extensive participation learning exercise and is now determining how to incorporate public participation into all phases of its project cycle.<sup>119</sup> Second, it has adopted a new information disclosure policy that increases the amount of public information available about Bank projects.<sup>120</sup> Third, the Bank has substantially expanded and formalized its relations with NGOs.<sup>121</sup> As a result, the Bank President requires all Bank Resident Representatives to hold regular meetings with the NGOs in their respective countries. Fourth, the Bank has established an Inspection Panel that provides private actors harmed by the Bank's failure to abide by its own rules and procedures with a mechanism for holding the Bank publicly accountable.<sup>122</sup> Finally, the Bank has taken steps to incorporate more extensive social assessments into its operations.<sup>123</sup>

The Bank is also addressing the staff incentive problem by changing its operating practices to emphasize the quality rather than the quantity of Bank-funded projects. In addition, the Bank is encouraging its staff to ensure that borrowers and other stakeholders feel a sense of "ownership" in Bank-funded projects. The Bank hopes that these changes will make projects more responsive to the interests of those who are the project's

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119. PARTICIPATION SOURCEBOOK, *supra* note 11; BHUVAN BHATNAGAR & AUBREY C. WILLIAMS, PARTICIPATORY DEVELOPMENT AND THE WORLD BANK (World Bank Discussion Papers No. 183, 1992); *see also* Robert Picciotto & Rachel Weaving, *A New Project Cycle for the World Bank?*, FIN. & DEV., Dec. 1994, at 42.

120. *See* WORLD BANK, THE WORLD BANK POLICY ON DISCLOSURE OF INFORMATION (1994). The Bank has created a Project Information Document which is issued for each project now under consideration at the Bank. This document is available from the Public Information Center. *See* OPERATIONAL MANUAL, *supra* note 8, B.P. 17.50, for a complete listing of the documents that the Bank now makes publicly available through the Public Information Center.

121. Ibrahim F.I. Shihata, *The World Bank and Non-Governmental Organizations*, in SHIHATA, *supra* note 5.

122. World Bank Inspection Panel, Res. 93-10, International Bank for Reconstruction and Development, Res. 93-6, International Development Association, Sept. 22, 1993; IBRAHIM F.I. SHIHATA, THE WORLD BANK INSPECTION PANEL (1994); DAVID HUNTER & JAY UDALL, THE WORLD BANK'S NEW INSPECTION PANEL: WILL IT INCREASE THE BANK'S ACCOUNTABILITY? (Center for International Environmental Law, Brief No. 1, April 1994); Bradlow, *supra* note 78; Daniel D. Bradlow & Sabine Schlemmer-Schulte, *The World Bank's New Inspection Panel: A Constructive Step in the Transformation of the International Legal Order*, 54 ZEITSCHRIFT FÜR AUSLÄDISCHES ÖFFENTLICHES RECHT UND VÖLKERRECHT [HEIDELBERG JOURNAL OF INTERNATIONAL LAW] 392, 554 (1994).

123. *See* World Bank, Guidelines for Incorporating Social Assessment and Participation into Bank Projects (Draft Memorandum, Feb. 14, 1996) (on file with author) [hereinafter World Bank Guidelines on Social Assessment]; Peter Montague, *World Bank Loan for Pakistan*, FIN. TIMES, Dec. 21, 1995, at 3 (Bank has approved loan for dam project in Pakistan that is first project in which an independent panel of social scientists have helped guide project preparation.)

intended beneficiaries. It expects these changes to enhance the sustainability of the projects.<sup>124</sup> The Bank has also begun to broaden the focus of its operations from the project to the country level. This should make it easier for the Bank and the country to shift funds from problem projects to the country's most effective development projects and programs.

Each of these changes is subject to criticism. For example, the information disclosure policy has been criticized for not providing the public with adequate information at a meaningful time in the project cycle. In addition, while information is publicly available in Washington, it is not easily available to people in the Bank's Borrower States, who are, after all, those most directly affected by the Bank's actions. Consequently, some critics argue, the new policy has not materially helped those most vulnerable to, and most directly affected by, the Bank's operations. These vulnerable groups still find it difficult to protect their interests and promote a sustainable and equitable development process.<sup>125</sup>

While these criticisms raise important issues, they should not undermine the potential advances created by the Bank's actions. The changes in the Bank's operating procedures have created opportunities for stakeholders who have the requisite resources to take advantage of them. These stakeholders can use the Bank's information disclosure policies, participation requirements, and Inspection Panel to engage the Bank in a dialogue about human rights and other relevant issues. In addition, they can use these changes in the Bank's operating procedures to increase the likelihood that the Bank's operations will be designed and implemented in a way that is sensitive to the human rights issues that may arise in the course of Bank-funded projects and programs.

### *C. The Situation of the IMF*

The IMF has moved more slowly than the Bank to address the challenges posed by its expanded scope of operations. It has begun to make some efforts to communicate with NGOs; however, it has not yet formalized a process for such communication. In fact, the IMF does not appear to have any explicit staff requirements relating to consultations with NGOs. As a result, the IMF is able to engage in substantial and wide-ranging policymaking consultations with its Member States without engaging in meaningful consultations with interested nongovernmental actors.<sup>126</sup>

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124. WORLD BANK, *GETTING RESULTS: THE WORLD BANK'S AGENDA FOR IMPROVING DEVELOPMENT EFFECTIVENESS* (1993).

125. Udall, *supra* note 113, at 145. For criticism of the other changes in Bank operations, see Bradlow, *supra* note 78, at 563; Naim, *supra* note 113; Udall, *supra* note 113; Udall & Hunter, *supra* note 122; Rich Memorandum, *supra* note 113.

126. Since it tends to focus its attention on the Finance Ministries and the Central Banks in its Member States, the IMF is also able to make policies without necessarily consulting all interested line ministries in the country's government.



The IMF has also made minimal efforts to publicly disclose information about its activities. To date, its most significant attempt to develop better information flows was to suggest that its Member States publicly release the reports prepared at the end of the Article IV consultations.<sup>127</sup> Nevertheless, the IMF remains such a closed institution that one commentator was moved to note that it is often harder to get information from the IMF than from the CIA.<sup>128</sup>

In addition, stakeholders in the IMF's operations have no real means for holding the IMF directly accountable for its actions. Unlike the Bank, the IMF does not have a *post hoc* independent audit department that can provide the directors and governors of the IMF with an independent review of the efficacy of its operations.<sup>129</sup> In addition, it has no formal mechanism, like the Bank's Inspection Panel, for handling complaints from non-state actors who allege that they have suffered or are threatened with material harm caused by a failure in the IMF's operating procedures.

#### D. Conclusion

The above description of the institutional responses of the IFIs suggests that they are failing to live up to the same standards of good governance that they themselves advocate to their Member States.<sup>130</sup>

### V. SOME THOUGHTS ON THE CONTENTS OF AN IFI HUMAN RIGHTS POLICY

#### A. The Need for a Human Rights Policy

The Bank and the IMF both lack adequate policies for dealing with the human rights implications of their operations. While the Bank has taken measures to address both the operational and the institutional dimensions of the human rights impact of its operations, it has not yet developed a coherent and publicly available human rights policy. Its present human rights policies must be deduced from the writings and statements of its

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127. Switzerland established the precedent of releasing these reports. It should be noted that the IMF originally did not support the Swiss initiative.

128. Sachs, Inter-Parliamentary Hearings, *supra* note 113.

129. The Bank's Operations Evaluation Department conducts *post hoc* reviews of Bank operations. It is independent in the sense that it reports directly to the Bank's Board of Directors and not to the Bank's Management.

130. It should be noted that all these criticisms are the subject of ongoing international NGO campaigns. See, e.g., RETHINKING BRETTON WOODS, *supra* note 117; FIFTY YEARS IS ENOUGH: THE CASE AGAINST THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND (Kevin Danaher ed., 1994).



management and staff, and from its actions.<sup>131</sup> These statements and actions, however, do not provide adequate clarity. They tend to acknowledge that human rights are important to development and, therefore, to the work of the Bank; however, by emphasizing the constraints on the Bank's ability to deal with human rights issues, these statements suggest that many human rights issues are outside the Bank's mandate.<sup>132</sup> Thus, even when the Bank appears to base its decisions on human rights grounds—for example denying funding to countries such as Kenya or Malawi under former President Banda—it tends to emphasize the economic rationale for its decision, thereby implying that human rights are outside its mandate.<sup>133</sup>

The IMF's policy on human rights is even harder to detect. The primary evidence of an IMF position on human rights is found in the writings and statements of its representatives. Like the Bank, the IMF sends contradictory signals in these statements. For example, in his public speeches, the Managing Director has recognized the importance of human rights to the development process. At the same time, he and other authorities on the IMF have also suggested that the IMF can not play a role in promoting human rights.<sup>134</sup> However, they do not explain why, if human rights are so important, the IMF can ignore them in its operations and policies.

The result is that to outside observers the decisions the IFIs make when confronted with human rights issues appear to be *ad hoc* and somewhat arbitrary. In fact, the IFIs seem to use the constraints imposed by their Articles to justify extending the scope of their operations to areas they want to deal with and as an excuse to avoid those human rights problems they do not wish to address.<sup>135</sup> This situation makes it difficult for the various

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131. See SHIHATA, *supra* note 5; Wolfensohn, *supra* note 2; GOVERNANCE, *supra* note 51; UPDATE ON GOVERNANCE, *supra* note 51 (discussing lending decisions regarding China after Tienamin Square, and Malawi and Kenya in the late 1980s and early 1990s). For earlier evidence, see Broches Statement, *supra* note 35 (discussing lending decisions regarding South Africa and Portugal in 1966); Victoria E. Marmorstein, *World Bank Power to Consider Human Rights*, 13 J. INT'L L. & ECON. 113 (1978). It should be noted that the Bank's Board of Executive Directors has not made all the Bank's General Counsel's legal opinions relevant to this issue publically available.

132. For the most recent example of this, see Shihata, *Democracy and Development*, *supra* note 2.

133. GOVERNANCE, *supra* note 51; UPDATE ON GOVERNANCE, *supra* note 51.

134. See Brauning, *supra* note 95, at 101; Dillon speech, *supra* note 95, at 287; *Excerpts from closing address by Managing Director Michel Camdessus at 1994 Annual Meeting of the IMF*, IMF SURVEY, Oct. 17, 1994, at 328; *Excerpts from closing address by Managing Director Michel Camdessus at 1995 Annual Meeting of the IMF*, IMF SURVEY, Oct. 23, 1995, at 334-35. Joseph Gold states: "The swimmer who goes out too far may seem to be waving but he is drowning. The Fund that swims out too far even, in a moral cause, will risk drowning. It will have lost the full confidence of its members. It will be less able to promote universal prosperity. That task is the Fund's moral cause." Gold, *supra* note 86, at 148.

135. For example, the Bank has not allowed its political prohibitions to preclude it from considering such issues as gender equality and special treatment for indigenous people and



stakeholders to know what they can expect from the IFIs in terms of promoting and protecting human rights. It also makes it difficult for the IFI staff to know how they are expected to handle the human rights issues that arise in the course of their duties. Finally, the lack of a human rights policy complicates the international community's efforts to hold the IFIs accountable for their human-rights-related decisions. In order to avoid these problems, therefore, the IFIs each need to develop a principled and transparent human rights policy.

### *B. The Content of an IFI Human Rights Policy*

An IFI human rights policy should address both the operational and institutional human rights issues raised in the course of the IFIs operations. These two dimensions to the human rights challenges facing the IFIs can be further divided into the following four issues: (1) the interpretation of the constraints imposed by their Articles of Agreement, (2) the IFIs' responsibility to promote human rights, (3) the IFIs' responsibility to protect the planned beneficiaries of their operations against human rights abuses, and (4) the IFIs' responsibilities in regard to their internal operating policies and procedures. Each of these issues will be discussed separately.

#### *1. The Constraints Imposed by the Articles of Agreement*

Obviously, each IFIs' human rights policy must be consistent with its Articles of Agreement. This means that the Bank should develop a human rights policy that is consistent with the political prohibition in its Articles which state that the Bank should not be influenced by the "political character" of its Member States.<sup>136</sup> To date, the Bank has not formally defined the term political character or explained the political considerations that are outside its mandate.<sup>137</sup> Instead the Bank has stated

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other minorities, but it has refused to explicitly consider human rights issues when extending credit to countries with well-documented human rights problems like China, Indonesia or Mexico. GOVERNANCE, *supra* note 51, UPDATE ON GOVERNANCE, *supra* note 51. Similarly, in the early 1980s, the IMF refused to explicitly consider the human rights implications of apartheid when making financing available to South Africa. It did, however, later stop assisting apartheid South Africa. Bradlow, *supra* note 106, at 656; International Policy Papers, *supra* note 106.

136. IBRD Articles, *supra* note 24, art. IV, sec. 10; *see also, id.* art. III, sec. 5 (b).

137. The Bank's General Counsel in his legal opinion on governance has provided a general definition of "politics," but not "political character," the term used in Article IV, section 10. His definition ("politics" relates to the art and practice of running a country or governing) is too general to be operationally useful in defining the outer limits of the Bank's jurisdiction. Many factors that the Bank treats as "economic" are encompassed within this definition of "politics" (for example, reform of the public sector enhances the environment for the private sector). *See* Shihata, Opinion on Governance, *supra* note 35, at 26.

that it can take political considerations or the political character of the Borrower State into account in its decisions when these considerations have a “direct and obvious” economic effect.<sup>138</sup>

The Bank’s General Council has identified four political considerations that the Bank can treat as falling within the scope of its mandate. These are (1) the binding decisions of the U.N. Security Council relating to peace and security; (2) international sanctions affecting the economic prospects of a potential borrowing country; (3) an escalation of armed conflict that affects the viability of Bank projects and the safety of Bank personnel; and (4) where it can be unequivocally shown that political phenomena have demonstrably adverse economic consequences.<sup>139</sup>

As discussed above, all human rights can be shown to have direct and obvious economic effects.<sup>140</sup> Consequently, the political prohibition should not be interpreted so broadly as to preclude the Bank’s involvement with internationally recognized human rights. Rather it should be construed narrowly to only preclude the Bank from interfering in domestic partisan political affairs. The Bank should abstain from considering issues such as which political party or faction should hold political power, who should win specific political debates, or which official should be appointed to which post.<sup>141</sup> In addition, any purely domestic affairs that have no relation to the international responsibilities of the Bank should be excluded from the scope of the Bank’s mandate.

The IMF faces a weaker political constraint than the Bank. The IMF’s Articles only require it to “pay due regard” to domestic, social, and political affairs in its Article IV consultations.<sup>142</sup> This provision has been interpreted to preclude the IMF from basing its operations on political considerations.<sup>143</sup> A literal reading of this provision, however, does not preclude the IMF from having its own opinion on these issues and from acting on the basis of its own perception of the member’s political situation. The provision merely requires the IMF to treat the Member State’s perception of these issues seriously. Thus, the Articles provide the IMF with the flexibility it needs to take human rights considerations into account in its operations. The IMF could therefore facilitate the development of a human rights policy by explicitly adopting an interpretation of its Articles that allows it to take internationally recognized human rights standards into account in its Article IV consultations.

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138. See *supra* Part II.E.1. for more detailed discussion of this issue.

139. See Shihata, Opinion on Governance, *supra* note 35.

140. See *supra* Part II.E.1.

141. This interpretation would be consistent with a liberal reading of the General Counsel’s Legal Opinion on Governance. Shihata, Opinion on Governance, *supra* note 35.

142. See IMF Articles, *supra* note 12, art. IV.

143. See GOLD, *supra* note 24; Gianviti, *supra* note 24.

A final point to note in regard to interpreting the political constraints on the IFIs is that they are institutions subject to international law.<sup>144</sup> This means they have an obligation to act in conformity with international law and to ensure that their operations do not undermine the ability of other subjects of international law to act in conformity with their own legal obligations. In this sense, the IFIs should see the consideration of human rights in the course of their operations as a requirement and not as a possible political consideration that is outside their mandates.

## 2. Promotion of Human Rights

The IFIs' responsibility in regard to the promotion of human rights is to ensure that the design of all their operations enhances the human rights situation of those affected by their operations. While this principle is easy to state, it is extremely difficult to apply. Nevertheless, it is possible to identify three indicators that can help determine if an IFI operation will promote human rights.<sup>145</sup> These are (1) the level of public participation in the operation, (2) the expected impact of the operation on human rights, and (3) the degree of public accountability of the decisionmakers in the specific operation.

### *a. Participation is the First Human Rights Indicator*

The first indicator of a human-rights-promoting operation is significant stakeholder participation. Achieving this participation requires identifying all the stakeholders in the operation. The stakeholders are those groups affected both directly and indirectly by the proposed operation. Their role in the design and implementation of an operation is a critical factor in determining whether or not the project promotes human rights. Consequently, the IFIs should ensure that each group of stakeholders is able to participate in the design and implementation of the IFIs' operation. The extent of their participation should be related to how directly and substantially the operation affects them.

Stakeholders can adequately participate in the operation only if they possess sufficient freedom of association and expression, and have access to sufficient information to make informed decisions about the operation. Consequently, this first indicator relates to freedom of expression, freedom of association, and access to information pertaining to the operation.

The IFIs, when evaluating performance on this criteria, must consider more than the existing legal regime in the Borrower State. They must also

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144. See BOWETT, *supra* note 70; FREDERIC L. KIRGIS, JR., INTERNATIONAL ORGANIZATIONS IN THEIR LEGAL SETTING (2d ed. 1993); SCHERMERS & BLOKKER, *supra* note 70.

145. This discussion is based in part on the World Bank's guidelines on social impact assessments and the work of Tomashevski on human rights impact assessments. See KATARINA TOMASHEVSKI, DEVELOPMENT AID AND HUMAN RIGHTS REVISITED (1993); World Bank Guidelines on Social Assessment, *supra* note 123.

consider whether stakeholders, in fact, feel able to exercise their rights. Stakeholders, even though they have the legal right to do so, may feel unable to freely express their opinions for a number of reasons. These include a governmentally created climate that chills free speech and freedom of association, the *de facto* inability of stakeholders to obtain adequate information on the proposed IFI operations, and the lack of capacity to participate. This lack of capacity can be caused by cultural barriers such as gender relations and the status of minority groups in the society.

This means that the Bank should only decide a project meets satisfactory human rights standards if it is confident that the stakeholders in the project in fact are able to freely express their opinions about the project and to organize themselves to advocate for their interests. In addition, the Bank needs to be sure that the stakeholders have access to sufficient information to make an informed decision about the project.

Similarly, the IMF should only find that a standby arrangement promotes human rights if it is satisfied that the citizens<sup>146</sup> of the particular State have an adequate opportunity to express their views on the policies that the standby arrangement will support. An IMF finding that citizens are provided with an adequate opportunity to express their opinions should be based on their ability to organize, the level of freedom of speech in the country, and the ability of citizens to obtain information on the proposed policies.

In cases where they find problems that affect the ability of stakeholders to actually participate in the project, the IFIs should consider what steps they can take to facilitate participation by all stakeholders. For example, the IFIs could create a mechanism through which stakeholders or their authorized representatives could communicate their views directly to the IFIs.<sup>147</sup>

### *b. The Expected Human Rights Impact is the Second Indicator*

The second indicator of a human-rights-promoting operation is that the expected impact of the operation should be to improve the human rights conditions of all stakeholders. This implies that the design of such operations should include an assessment of the expected change in the human rights condition of the stakeholders over the duration of the operation.

It is clearly easier to conceptualize and describe this indicator than to operationalize it. This difficulty can be overcome, however, if it is remembered that the primary function of the indicator is to ensure that the

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146. IMF standby (or other financing) arrangements are macroeconomic in focus and, therefore, affect all the citizens in the particular State.

147. See *Limited Mandates*, *supra* note 3, at 429, for further discussion of this point.

human rights effects of an operation receive adequate attention from the IFIs.

This indicator therefore requires the IFIs to explicitly identify in their planning documents which human rights are likely to be affected and to describe how they will be affected by the operation. For example, in a Bank-funded health project, the Bank will need to identify the impact the project will have on the health of all stakeholders. In addition, the Bank will have to identify what other impacts the health project will have on each group of stakeholders. This means that the IFIs will need to identify who will receive the other social, political, and economic benefits associated with the project. These benefits may include jobs, income, and access to political authorities. In addition, the Bank staff should attempt to assess how the project might affect the relations between different groups of stakeholders, such as men and women.

The IMF in its operational planning should also engage in this human rights impact analysis. It should consider both the short- and long-term impact of its operations on different social groups and on the relations between these different groups. While this human rights impact analysis may be qualitative and not very accurate, it should enable the IMF and other stakeholders in the operation to assess the likely effects of the proposed policies. In this sense, the indicator will contribute to IMF operations that promote human rights in that they are sensitive to the needs of all stakeholders in the operation, enhance transparency in IMF operations, and enhance IMF accountability.

In developing a human rights impact analysis the IFIs must deal with the reality that not all sustainable and equitable operations produce only positive human rights results. The project may result, for example, in involuntary resettlement or loss of income for some stakeholders. The analysis must therefore incorporate some methodology that IFI staff can utilize to decide when to proceed with an operation that will produce some adverse human rights consequences. In this regard, the staff can look at the following criteria: the existence of less harmful alternatives, the duration of the negative human rights impacts, the adequacy of the opportunity for the stakeholders who will suffer the negative human rights impacts to participate in the design and implementation of the project, the availability of a means for the stakeholders to petition the operation's decisionmakers for redress of the grievances which arise during the course of the operation, and the nature and quantity of compensation available to those who suffer losses as a result of the operation.

There is no doubt that the proposed human rights impact analysis will complicate the work of the IFIs. Not only is the analysis itself difficult and time consuming, but its speculative nature is likely to generate controversy. While these costs are real, they do not outweigh the benefits provided by undertaking this analysis during the design phase of an operation. The analysis, which necessarily will require public

participation, should stimulate public debate and promote public knowledge about the proposed operation. Thus, while this analysis may complicate the design phase of the operation, it should facilitate implementation of the operation. It should also help ensure that IFI operations are responsive to the needs of the stakeholders and the constraints of the context within which they will take place.

It should be noted that a modified version of this approach may be required in situations of crisis, where time is of the essence and decisionmakers need to act with discretion to avoid market actions that would undermine their IFI-supported stabilization strategies. In these cases more emphasis will need to be placed on *post hoc* mechanisms, such as appeals processes, to ensure that all stakeholders are treated fairly. In addition, a more human rights-sensitive proposal can be applied once the acute phase of the crisis is over.

### *c. Accountability is the Third Human Rights Indicator*

The third indicator relates to the accountability of the decision makers in the specific operation. This indicator focuses on both the ability of the stakeholders to identify the decisionmakers in the operation and on the stakeholders' access to a mechanism for holding these decisionmakers accountable. It will be noticed that since the decisionmakers in IFI-funded operations include IFI staff, this indicator requires the IFIs to assess both their own accountability to these stakeholders and that of the decisionmakers in the Borrower State.

The latter point raises the issue of the acceptable level of IFI involvement in the affairs of the Member State. In this regard it is useful to recall that specialized human rights organizations do evaluate the accountability of decisionmakers in Member States in the course of reviewing the reports of signatories to the various international human rights conventions.<sup>148</sup> The IFIs could capitalize on the expertise of these organizations by either utilizing the information gathered by these organizations or by working with them to conduct their evaluations.<sup>149</sup>

Another aspect of this issue is determining what the IFIs should do when the Borrower State's methods of accountability are found to be deficient. In such cases the IFIs could work with the relevant international organizations and with other interested parties to determine how serious the deficiencies are and whether the project can achieve its objectives despite these deficiencies.

In order to ensure adequate accountability, the IFIs also need to incorporate some *post hoc* evaluation mechanism into their operations. The purposes of this mechanism would be to determine if the operations actually

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148. See GUIDE TO INTERNATIONAL HUMAN RIGHTS PRACTICE (Hurst Hannum ed., 1984).

149. See *Limited Mandates*, *supra* note 3, for a more detailed discussion of this issue.



produced the expected benefits, and to learn more about what makes for successful human-rights-promoting operations. The Operation Evaluations Department performs this function for the World Bank.

#### *d. The Problem of Non-Ideal Projects*

The three indicators discussed above are designed to help the IFIs identify and produce an ideal human-rights-promoting operation. However, no operation is likely to achieve a perfect rating on all indicators. Consequently, the IFIs' human rights policies will need to include some means for determining what constitutes acceptable derogations from the ideal situation. Acceptable derogations may be so case specific that it will be extremely difficult for the IFIs to develop general principles in this regard. However, in order for their operations to be confidently viewed as human rights promoting, they will need to publicly and explicitly justify each operation that derogates in any significant way from the ideal situation.

### *4. Protection of Human Rights*

#### *a. Defining the IFIs' Responsibilities*

The IFIs can not be expected to play the leading international role in protecting the victims of human rights abuses from the state actors perpetrating these abuses. This responsibility lies with the specialized international human rights organizations, and with other state and non-state actors in the international community. The IFIs, however, do have a responsibility to ensure that their operations do not exacerbate problematic human rights situations.<sup>150</sup>

While the IMF has not publicly addressed this issue, the Bank has made some relevant statements. The Bank's General Counsel has advised that the Bank would not be able to undertake operations in countries that are the target of binding U.N. Security Council decisions relating to peace and security, in which international sanctions are affecting the economic prospects of the target country, in which armed conflict threatens the viability of Bank projects and the safety of Bank personnel, or in which it can be unequivocally demonstrated that political phenomena have adverse economic effects.<sup>151</sup> While none of these criteria specifically mention human rights, they can be interpreted as including situations with serious human rights problems. In fact, the Bank's General Counsel has stated that

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150. See, e.g., Marmorstein, *supra* note 131; *The Impact of Financial Institutions on the Realization of Human Rights: Case Study of the International Monetary Fund in Chile*, 6 B. C. THIRD WORLD L.J. 143 (1986); David Gillies, *Human Rights, Democracy and 'Good Governance': Stretching the World Bank's Policy Frontiers*, in THE WORLD BANK: LENDING ON A GLOBAL SCALE, *supra* note 117.

151. See SHIHATA, *supra* note 5, at 560-61.

an extensive violation of human rights, to the extent that it has a direct and obvious economic effect, could become a factor in Bank decisions.<sup>152</sup>

The General Counsel's opinion represents an important advance in the Bank's acceptance of its obligation to protect human rights. Nevertheless, it does not go far enough. It does not acknowledge that the Bank has a responsibility to protect people from human rights abuses that occur as a direct result of participating in a Bank-funded operation. The Bank needs to develop a policy for dealing with this situation. It is irresponsible for the Bank to invite people to participate in its activities and then fail to protect them when its interventions result in reprisals from the Borrower State or its agents.

The General Counsel's opinion also fails to give clear guidance on how the Bank should treat the recommendations and opinions of international organizations other than the Security Council. For example, it does not indicate how the Bank should respond to the findings of the United Nations Human Rights Commission or the regional human rights commissions that a certain country is experiencing serious human rights problems or is refusing to respect a ruling of a regional human rights court.

While these recommendations and opinions may not be legally binding on the Bank, they cannot be ignored.<sup>153</sup> There are two reasons for this. First, the Bank as a subject of international law has an obligation to ensure that it does not enhance the ability of other subjects of international law to ignore binding international norms. Extending financial support to States that, for example, ignore the rulings of international tribunals, could facilitate the State's continued efforts to ignore such rulings. Second, a State that fails to respect the ruling or findings of a human rights tribunal that it is legally bound to respect may also ignore its other legal obligations, including those contained in its agreements with the Bank. As a matter of prudence, therefore, the Bank should refrain from lending to the offending State.

The IMF's responsibilities to protect human rights are similar to the Bank's. The IMF, however, has not made any public statements addressing this issue. In practice, it has been able to avoid some of these issues because it has made no effort to make its operations participatory. This does not mean that the IMF has any less obligation than the Bank to become more participatory or to become more respectful of the recommendations and opinions of specialized international human rights organizations. It merely means that the IMF has been less willing than the Bank to take steps that are designed to meet its obligations to protect human rights.

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152. Shihata, *Opinion on Governance*, *supra* note 35.

153. This is a complex issue and a full exploration of it is outside the scope of this Article. See *Limited Mandates*, *supra* note 3, for a more detailed discussion of the issue.

*b. The IFI Response to Human Rights Abuses*

The next aspect in developing the IFIs' policy to protect human rights is to define the type of action the IFIs should take to protect people who are suffering human rights violations. It should be noted that the IFIs' responses to these situations may be constrained by the political prohibition in their Articles of Agreement. However, as was discussed above, these prohibitions should limit their ability to intervene in purely domestic political issues but not their ability to deal with situations with international implications, which include cases of significant human rights abuses.<sup>154</sup>

One possibility is for the IFI to work with the offending government and, where appropriate, international human rights organizations to stop the abuse. For example, the IMF could raise the human rights issue with the violating State during the Article IV consultations and make recommendations on how to deal with the situation. Similarly, the Bank could make recommendations during the Bank's ongoing policy dialogue with the Member State.

An alternative, although more controversial approach, would be for the IFIs to condition any assistance on the correction of human rights abuses.<sup>155</sup> The sanction attached to this condition could take a number of forms. For example, the IFIs could deny future requests for financing. Alternatively, they could suspend existing funding commitments. The feasibility of the latter approach would depend on the terms of the existing arrangements between the particular IFI and the Member State.

The Bank does have another option in dealing with human rights problems. It can limit its operations in the offending State to those activities which it is satisfied will not facilitate the government's continued human rights abuses and which will enhance the victims' ability to protect themselves against the perpetrators of such abuses.

Given the severity of most of these sanctions, they would only be appropriate for serious human rights abuses. In addition, the Bank should only impose the harsher sanctions when it is convinced that there is no possibility to undertake any constructive development activity in the country. The IMF should contemplate these sanctions when it is convinced that the State, because its human rights abuses are so extensive, cannot reasonably be expected to live up to its monetary obligations. Both IFIs should consult with specialized human rights organizations in reaching these decisions.

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154. See *supra* Part V.B.1.

155. This is the approach adopted by a number of bilateral aid donors. It is, however, a more complex approach for the IFIs to adopt because it may lead to charges that the IFIs are promoting the political agenda of a specific group of countries. See Gillies, *supra* note 150.

#### 4. *The Institutional Human Rights Issue*

The final aspect of the IFIs' human rights policy is ensuring that their own operating procedures are consistent with international human rights law. There are four aspects to the IFIs' responsibilities in this regard. First, the IFIs need to ensure that their own operating practices and procedures conform to the principles of good governance they advocate to their own borrowers. Thus their operating rules and procedures should be transparent and easily understandable to all interested parties. Moreover, all the operating rules and procedures should be publicly available.<sup>156</sup>

Second, the IFIs need to provide interested parties with the opportunity for meaningful communication with the IFIs about their operations. For these purposes, the term "meaningful communications" means communications at a time that will enable the interested parties to adequately protect their interests in the project. It also means that the IFIs need to make information about their planned operations publicly available in a timely fashion.

Third, the IFIs need to provide stakeholders with the means to hold both institutions accountable for their actions. This requires the IFIs to improve public access to their internal evaluation reports. It also will require the IFIs to develop mechanisms, like the Bank's Inspection Panel, that allow private actors to hold them and their staff accountable for their actions and decisions.

The fourth aspect to the IFIs' institutional obligations is that they need to educate their staff about human rights. Such education would sensitize the staff to the human rights dimensions of the IFIs' operations. This will assist them in responding to the many difficult human rights issues that can arise in the course of their work in the IFIs' Member States. These educational activities should be undertaken in conjunction with the specialized international human rights organizations and the relevant nongovernmental organizations.<sup>157</sup>

## VI. CONCLUSION

The operations of the IFIs, in fact, have a significant impact on the human rights situation in those Member States that choose to utilize their services. In order to ensure that they have a positive impact on these human rights situations, the IFIs need to develop an explicit human rights policy. This policy should include both a standard for determining when human rights issues have a sufficient economic impact to be considered part of the

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156. Many, but not all, of the Bank's operating rules are available through the Bank's Public Information Center. The Bank needs to ensure that all the rules are available not only through the PIC but also from each of its Resident Missions.

157. See *Limited Mandates*, *supra* note 3, for a more detailed discussion of this issue.

IFIs' mandate, and a definition of the term "political" so that all stakeholders can identify what issues are outside the IFIs' mandate. Such a policy would help the IFI staff perform their duties in a manner that conforms to the IFIs' responsibilities to promote and protect human rights. It would also help other stakeholders in these operations understand what they can expect from the IFIs in this regard and hold the IFIs accountable for their human rights performance. Finally, this policy would help ensure that the IFIs' own operating policies and procedures follow the same principles of good governance—transparency, accessibility, and accountability—that they advocate for their Member States.

## **PART V**

### **SOCIALLY RESPONSIBLE INVESTING**

An experiment in creative financing to promote reconciliation and development in South Africa



## American University Washington College of Law

Washington College of Law Research Paper No. 2008-07

### AN EXPERIMENT IN CREATIVE FINANCING TO PROMOTE SOUTH AFRICAN RECONCILIATION AND DEVELOPMENT

Daniel Bradlow

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An Experiment in Creative Financing to Promote South African Reconciliation and Development<sup>1,2</sup>  
Daniel D. Bradlow<sup>3</sup>

The Reconciliation and Development Project (R&D Bonds) was originally conceived as an attempt to involve the South African expatriate community in the process of national reconciliation that began with the end of apartheid. It has evolved into a broader effort to create a financial instrument capable of raising financing from both expatriates and the domestic market for small scale revenue generating development projects that will produce jobs, services, and opportunities for poor and historically disadvantaged South Africans. Through this evolution, it has become clear that the project, which if implemented will be unprecedented, has the potential to teach some interesting and generally applicable lessons on the roles that private financial markets can play in attracting both domestic and international funding for sub-commercial development projects and in promoting reconciliation in post-conflict societies.

The paper is divided into three sections. The first section will describe the genesis of the R&D Bonds Project. The second will discuss the design of the R&D Bonds. The final section will highlight some of the interesting development financing issues that arise from the project.

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<sup>1</sup> DO NOT QUOTE OR DISTRIBUTE WITHOUT PERMISSION OF THE AUTHOR.

<sup>2</sup> This paper was prepared for a conference in November 2006 on “Engaging the African Diaspora to Finance Africa’s Development”, sponsored by the Institute for African Development, Cornell University, Ithaca, NY.

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## Section 1: Genesis of the R&D Bonds Project

The R&D Bond Project grew out of the author's interest in the work of the South African Truth and Reconciliation Commission (TRC or Commission). This historic Commission effectively documented the tragic history of apartheid and promoted accountability for its perpetrators. However, its attempts at redressing the injuries caused by apartheid were less comprehensive. They were limited to an acknowledgement by the state of the wrongs that apartheid had produced and to the payment of compensation to those identified as victims of state violence, inter-group violence or "liberatory" violence in the TRC's report<sup>4</sup>. Thus, the reconciliation work of the Commission was ultimately focused on repairing the important relationship between the South African state and black South African citizens.

The TRC did not directly seek to promote reconciliation between ordinary black and white South African citizens—although the Commission, of course, hoped that its report would contribute to this process. This meant that the TRC itself did not establish any mechanism through which individual white South Africans could acknowledge that they had been beneficiaries of the apartheid system and could make a gesture of reconciliation. It also did not address the issue of how the South African "diaspora", that is those people who grew up in South Africa and benefited from its wealth and opportunities but who no longer live in the country, should and could contribute to reconciliation and development in South Africa.

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<sup>4</sup> Section 2, §11 Truth and Reconciliation Commission of South Africa Report (2003)

The R&D Bond Project began as an attempt to address this unresolved issue of reconciliation between private citizens. It was premised on the idea that reconciliation between the different social groups who benefited from and those who suffered under apartheid requires some meaningful gesture of support from the former to the latter group.

In principle, there are many forms that this gesture can take. Nevertheless, the history of the most successful example of reconciliation—the reconciliation of Germany and Jews following the end of World War II—demonstrates that one key component of effective reconciliation is providing those who suffered under the old order with the means to establish a life that is materially more comfortable and that offers them and their children better opportunities and more dignity than what they had under the old order<sup>5</sup>. This is important because, as their circumstances improve, the sufferers are better able to bear the psychic cost that must be paid if they are to move beyond their pain and anger and reconcile with those who previously oppressed or harmed them.

The initial goal of the Project was to design an appropriate vehicle through which private citizens could make meaningful and explicit contributions to the process of reconciliation in South Africa. Given the poverty of many black South Africans and their lack of access to jobs, services and opportunities, the project's objective was to structure a mechanism through which interested white South Africans, both those living in the country and

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<sup>5</sup> The lesson from the case of German reparations has been confirmed in a study of reparations in the Czech Republic. See Roman David & Susanne Choi Yuk-ping, *Victims on Transnational Justice: Lessons from the Reparation of Human Rights Abuses in the Czech Republic*, 27 *Human Rights Quarterly*, 393 (2005)

expatriates, could make financial contributions to support projects that would create jobs, services and opportunities for poor black South Africans. It came to focus on using debt instruments for the purpose of promoting reconciliation through development through a process of elimination.

Its starting point was that the most obvious means of raising money for reconciliation and development was to establish a charitable entity to which those who wish to make gestures of reconciliation can make donations. This entity could then make grants to development projects that are designed to create jobs, services and opportunities for poor black South Africans.

The success of such a charity's contribution to South African reconciliation and development depends on its ability to satisfy three "reconciliation-financing" criteria. First, it requires that sufficient numbers of white South Africans contribute to the entity so that it has enough money to make a meaningful difference to the situation of poor black South Africans. Second, the contributions must come from a large enough number of people to demonstrate a serious community-wide interest in reconciliation. Third, the charity must be able to use the money effectively enough to satisfy both those who contribute funding and those who benefit from it that the charity can make a noticeable impact on solving the problems caused by apartheid.

Using charitable donations to promote reconciliation in South Africa, in fact, was tried and it failed<sup>6</sup>. Based on the relatively small number of people who contributed to the charitable entity, it could be argued that it failed because there are not enough white South Africans of goodwill who are willing to work for the reconciliation and development of the country. However, this does not seem to be an adequate explanation. There is evidence demonstrating that most South Africans, including most white South Africans, in fact do make charitable contributions.<sup>7</sup>

This would suggest that there are other reasons for the failure to attract donations to promote reconciliation. One important contributing factor seems to be that many South Africans are skeptical about the ability of the existing charitable organizations to effectively address the problems of poverty. In other words, this effort to use charitable giving to promote reconciliation was unable to satisfy the third reconciliation-financing criterion.

If charities cannot succeed in funding reconciliation, the alternative is to offer people an opportunity to invest in reconciliation and development in a way that allows them to earn a financial and social return on their investment. This approach would enable people interested in reconciliation and development to monitor the stream of financial and social returns generated by their investments and to use these returns as indicators of the

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<sup>6</sup> Following the release of the TRC report, a group of South Africans established the “Home to All Campaign”. This Campaign included a variety of efforts to promote reconciliation, including the establishment of a Development and Reconciliation Trust that would accept donations from the public and would make grants to projects to promote literacy and other poverty-fighting efforts in South Africa. The Trust has collected some funds and has awarded some grants but the amounts were relatively small. The author has worked with the Campaign and the Trust in developing the R&D Bonds Project.

<sup>7</sup> David Everatt & Geetesh Solanki, *A nation of Givers, : Social Giving among South Africans*, The State of Social Giving in South Africa Report Series, Research Report # 1

developmental and poverty alleviating impact of their investments. Such investments therefore should satisfy the three reconciliation-financing criteria identified above. First, because they will yield a real market-based financial return, they have the potential to attract sufficient numbers of investors to both demonstrate an interest in promoting reconciliation and to fund enough development projects to have a meaningful impact on poverty, inequality and unemployment in South Africa. Second, if the investments are required to meet certain financial and social standards, they should be able to demonstrate that they are in fact contributing to the building of a better future for all South Africans.

There are two ways in which such investment vehicles can be structured. The first is to establish an investment fund that makes equity investments in projects, such as small and micro-businesses and low income housing projects, which are designed to help those who historically were denied access to jobs, services and opportunities. An equity fund is attractive as a development financing mechanism because of its risk sharing features. Thus, the investors do not earn a return on their investment until the projects are generating a profit. However, equity investments are problematic vehicles for promoting reconciliation. They can be perceived as a way for the beneficiaries under the old order (whites in South Africa) to both profit from the hard work of those who suffered under that order and to control (through the voting rights associated with equity) the efforts of those they previously oppressed.

The second way to structure such investments is to use debt to finance projects that provide jobs, services and opportunities to poor black South Africans. Debt has a number

of attractive features for the purposes of promoting both development and reconciliation. Since debt is a fixed term contractual relationship between the debtor and the creditor, it leaves the debtor, after it has fully performed its contractual obligations, both independent of the creditor and in a materially better condition than before the debt transaction. Second, the debtor, through its reliable servicing of the debt, can establish a credit history which should enhance its prospects for accessing future financing. Third, if it is possible for the debt arrangement to be structured so that the borrower receives the funding on better terms than are available from any other available funding source<sup>8</sup>, the transaction can facilitate better relations between debtor and creditor, thereby serving the goal of promoting reconciliation. The extent to which this approach promotes development and reconciliation depends, to a significant extent, on this last point because if the terms of the debt are perceived by the borrower to be too harsh, the debt transaction can undermine rather than promote these objectives.

The above analysis underscores the potential for debt financing to promote both development and reconciliation. In order for it to satisfy the first two reconciliation-financing criteria, the funds should be raised through a retail bond that is designed to appeal to as broad a group of individuals as possible. Such a bond, even though it is issued on the South African domestic market, should also be attractive to those expatriate South Africans living around the world who still have strong emotional, family and

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<sup>8</sup> It should be noted that the small scale revenue generating projects that will be funded through the R&D Bond Project find it difficult to obtain grant financing precisely because they generate a return. Consequently, the funding options available to them are likely to require some form of repayment commitment.

economic ties to South Africa and therefore have an interest in promoting reconciliation and development in the country.

Complying with the third reconciliation-financing criterion is more difficult, because it requires the proceeds raised by the bond to be used to effectively support those types of projects that will both produce meaningful developmental opportunities for those without access to jobs, services and opportunities and an adequate return to service the bonds.

This means that the bonds will need to support those projects that are the hardest to fund anywhere in the world – those projects that are both “too rich” for grant funding because they generate a return that can be used to service a certain level of debt and “too poor” for commercial funding either because of the size of the project or because its rate of return is too low to be attractive to a commercial lender. Examples of these types of projects are new small and micro-enterprises and projects related to low income housing.

Given the realities of distributing and servicing retail bonds, any attempt to use them for reconciliation and development purposes must satisfy a fourth reconciliation-financing criterion—it must be attractive to financial institutions. The reason is that these institutions are needed to help promote and distribute the bonds. Their participation is helpful in convincing potential investors that this is a serious financial transaction in which they can earn both a reasonable financial return and produce noticeable social benefits for South Africa and its poor people. They can also provide the distribution network through which the bonds are sold.

The R&D Bond Project thus has become an effort at creating and issuing a bond that is capable of meeting all four reconciliation-financing criteria. Its proposed structure is described in the next section.

## Section 2: The Structure of the R&D Bond Project

In designing the R&D Bond, the author consulted with a broad range of financial, developmental, reconciliation and legal experts working in financial institutions, law firms, development organizations, government, trade unions, universities, church groups, reconciliation groups, and other civil society organizations. The bond described in this section, therefore, has been tested and has proven able to address all the conceptual concerns expressed by these experts.

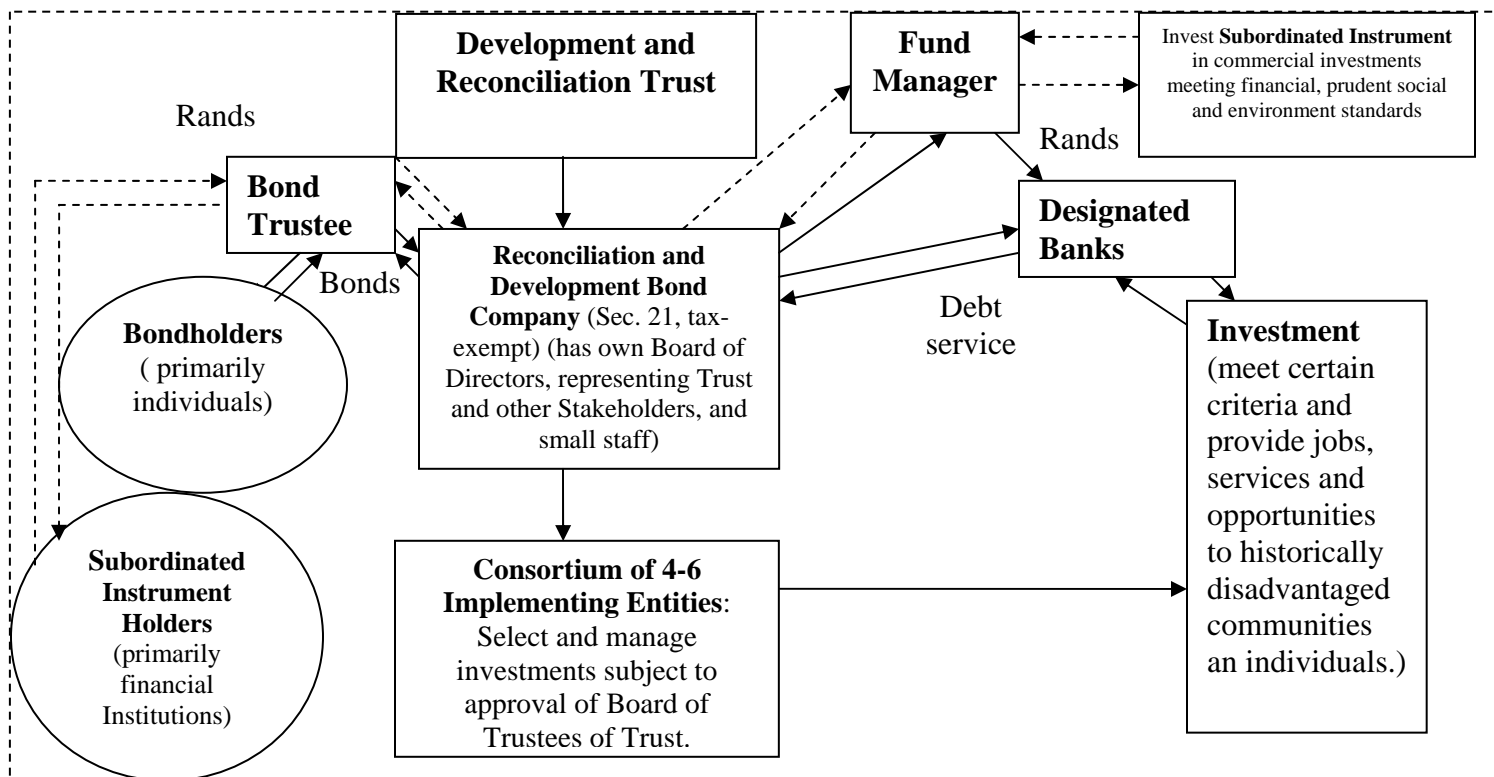
The structure, which is illustrated in Diagram 1, is designed to raise R1 billion<sup>9</sup> to fund a range of development projects through 2 instruments—a Subordinated Instrument (SI) and the retail R&D Bond. Both instruments will seek to raise R500 million for a term of 10 years.

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<sup>9</sup> The exchange rate between the South African Rand and the US Dollar fluctuates between about SAR 6-7.5 to USD 1. Thus R1 billion is equal to about USD143 million.



Diagram 1: Reconciliation and Development Bond Project



**Key =**

----- = flow of Subordinated Instrument Funds

\_\_\_\_\_ = flow of R&D Bond Funds

*The Project Issuer*

Both the SI and the R&D Bond will be issued by a special purpose entity that will be created for this purpose. This entity (“the Project Issuer” or PI) will be a non-profit, tax exempt company that has a board of directors that includes representatives of the financial institutions that are the primary investors in the SI and experts from civil society who are well respected in South Africa for their integrity, financial and development expertise and who have credibility with all sectors of the South African society. The Project Entity will have a small staff whose job will be to manage its relations with the other actors in the project and to ensure that the PI meets all its obligations to its investors in a timely manner.

#### *The Subordinated Instrument (SI)*

The SI will raise R500 million for 10 years from financial institutions, corporations, and foundations. The funds raised through the SI will be managed on behalf of the PI by a small group of well respected and experienced fund managers who are already in the business of fund management. Each fund manager will be allocated a portion of the SI funds and will be contractually obliged to invest the proceeds in commercial projects that satisfy a set of agreed prudential, financial, social, and environmental criteria. They will be expected to produce a target rate of return that is based on commercial and market considerations. The income generated by these managers will be used to pay all operating costs for the issuing entity and to help service the R&D Bonds, at least in the early years of the project.

The SI will offer investors the following benefits:

1. On maturity, the purchasers of this instrument will receive a lump sum payment equal to their original investment plus a stipulated pro rata share of the surplus remaining after all other Project related obligations have been satisfied.
2. The project's investments should entitle qualifying SI holders to score points towards their transformational charter obligations.<sup>10</sup> In addition, purchase of the Subordinated Debt Instruments should count towards any Government requirement that South African businesses invest a stipulated portion of their assets in socially responsible investments.
3. Based on preliminary conversations with tax experts it is likely that SI holders will qualify for a tax benefit<sup>11</sup>. Financial institutions that invest in the SI can claim this benefit by arguing that the purchase of the SI is an expenditure laid out or extended for the purpose of trade within the meaning of Section 11(a) of the Income Tax Act 58 of 1962. Based on this provision they can argue that because they are in the business of investing in financial instruments and are making a below market purchase of a debt instrument, they are entitled to a tax deduction in year 1 equal to the difference between the face value of the instrument and the net

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<sup>10</sup> Under the Broad Based Economic Empowerment Act (53) 2003, all sectors of the South African economy are required to develop charters that establish standards, dealing with equity ownership, management, procurement and investment, for transforming that sector so that it is more open to and representative of the whole South African population. Companies that fail to comply with these standards may be precluded from doing business with the government and may become less attractive to other private companies with whom they do business (because of the implications for the latter group of companies' own procurement requirements). The most relevant charter for the R&D Bonds project is the Financial Services Charter, which, *inter alia*, requires financial institutions to make significant investments in low income housing; small medium and micro-enterprises, and certain infrastructure projects that are designed to help develop previously underserved communities, See Financial Sector Charter (2003), available at <http://www.treasury.gov.za/press/other/2003101701.pdf>.

<sup>11</sup> A definitive determination of the tax consequences of this transaction will require a formal decision from the South African Revenue Service, SARS. At this stage, no effort has been made to obtain such a decision from SARS.

present value of the future stream of payments that it generates, in this case the lump sum payment that they will receive at the end of 10 years. Under this rationale, the government will be able to claw back the tax deduction in subsequent years as the net present value of the repayment increases. However, with appropriate tax planning, investors should be able to avoid this tax obligation. This interpretation of the tax law is supported by the decision in Warner Lambert SA (Pty) Ltd v. Commissioner for South African Revenue Service 2003, 65SATC346.

4. The banks that are holders of the SI will benefit from the banking business generated by the Bond project. Each actor in the transaction will need a bank account for funds related to the Project. They will be required to maintain this account with a bank chosen from the list of banks that have invested in the Subordinated Debt Instrument.
5. The project structure will enable interested SI holders to form linkages with the Implementing Agencies (IAs) that will be responsible for investing R&D Bond proceeds in revenue generating projects that create jobs, services and opportunities for poor and historically disadvantaged individuals and communities. These linkages will give them an opportunity to identify other business opportunities with the IAs and to learn about the risks and rewards of doing business in the markets in which the IAs operate. In this regard it is important to note that the Project will allow the investors, particularly the financial institutions, to see if investing in this segment of the market is a business they would like to become directly involved in or if it is one which they would

- like to enter indirectly by funding a set of intermediary entities that are expert in this type of business. Their interactions with the IAs may also help them identify intermediary entities in which they could invest.
6. The holders will profit from the goodwill created by their participation in the Project. In this regard, it should be noted that the Project may also create additional business opportunities for the SI investors. This will occur as the projects supported by the R&D Bonds and their beneficiaries succeed so that they become “bankable” more quickly than might otherwise have occurred, thereby creating new business opportunities for the SI investors.
  7. All SI investors will receive an annual report describing the projects being funded by the R&D Bonds and detailing the social benefits that have or are expected to accrue from these projects.

### *The Retail R&D Bonds*

The R&D Bonds, which will raise R500 million for 10 years, will be issued as a non-tradable debenture with a periodic interest payment. It will be sold, for R500 per bond. It is expected that the bond will be bought by those South Africans with some disposable income, expatriate South Africans and friends of South Africa.

Bondholders will be able to purchase either a tangible or intangible version of the bond. Each bond will have identical terms except that the intangible form of the R&D Bond will offer a higher interest rate. The intangible form of the R&D Bonds will offer a fixed

market-related interest rate that is payable once a year. The rate will be equal to the rate offered by the Government of South Africa on its 5-year Government Retail Bond<sup>12</sup>. The tangible form of the R&D Bond will offer an interest rate that is 150 basis points below this rate. In return for accepting the lower interest rate, the tangible bondholder will receive a bond certificate that is an attractive poster, with the interest coupons included in the design of the poster<sup>13</sup>. Consequently, if the tangible bondholder wants to receive the interest payments, he/she will need to tear the coupon off the poster, thereby destroying its aesthetic appeal. In addition, all bondholders will receive an annual report describing the projects being funded by the Bonds and detailing the social benefits that have or are expected to accrue from these projects.

Even though the interest on the bond is paid annually, the R&D Bond principal will be repaid in a single payment at the end of the 10 year term of the R&D Bond.

All the proceeds raised through the R&D Bond will be invested in projects that meet the goals of the R&D Bond Project. This means that they will be invested in projects that are both “too rich” for grant financing because they are revenue generating projects and, because of their size or rate of return, are “too poor” for commercial financing.

Moreover, the projects to be funded by the Bonds will all be designed to produce jobs, services and opportunities for those people who suffered under apartheid.

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<sup>12</sup> See [www.rsaretailbonds.gov.za](http://www.rsaretailbonds.gov.za)

<sup>13</sup> The idea of the collectible bond has been used in Germany approximately 17 times. The experience of three of these transactions indicates that between 25-75% of the bondholders keep the poster and do not actually collect either the interest or the principle payments due to them. These transactions raise complex legal and planning issues relating to the obligations of the issuer. However, it should be possible to structure the terms of the bonds so as to reduce the complexities of these issues and to make the planning of the bonds more certain.

The Project Issuer will be responsible for arranging for the investment of these funds. In order to ensure that this responsibility neither requires a large organization nor seeks to duplicate the efforts of other organizations working in these areas, the PI itself will not directly invest in projects. Instead it will enter into contractual arrangements with 4-6 “Implementing Agencies” (IAs). These IAs will be organizations that either have 8-10 year track records of doing business in the types of projects that the Bonds are designed to support or the key people in these organizations will have 8-10 years experience in this type of development work. These IAs will be responsible for identifying the projects to be supported by the Bonds and for providing them with the support that they need in order to be able to repay their debts to the IAs. It is important to note that ultimately it is the IAs that bear the responsibility to repay the funds to the Project Issuer.

It should be clear from the above description that the contract between the IAs and the Project Issuer needs to be carefully drafted to include adequate safeguards designed to make sure that the Bond proceeds are only used to fund qualifying projects. The contracts will include 3 sets of provisions intended to achieve this objective. First, the contract will stipulate that the funds can only be used to finance projects that meet a set of agreed criteria. These criteria will both establish a principled basis for holding the IAs accountable for their use of the money and a predictable basis on which the Project Issuer can reject non-conforming project proposals.

Second, the contract will provide that the IA is committed to investing a stipulated amount of money over a number of years and will grant the IA the right to access up to a specified portion of this amount each year. However, it will also state that the IA cannot access the funds until it provides the Project Issuer with a proposal for a project that the Project Issuer deems to conform with the terms of its contract with the IA. Until this point, the R&D Bond proceeds will be parked with and invested by a fund manager in projects and investments that meet stipulated financial, prudential and social responsibility criteria. Once the Project Issuer approves the project, it will authorize the fund manager to transfer the applicable amount to a dedicated bank account to be controlled by the IA and the Project Issuer. The funds will only be disbursed from this account upon showing of proof that they will be used for approved project related expenditures.

It is important to note that this arrangement will result in there being, in the early years of the project, a pool of R&D Bond funds that are committed to be invested over time in appropriate development projects but that will not be needed until a reasonably predictable future date. Consequently, these funds can be invested by the fund manager for a predictable period. The income earned on these investments will be used to service the R&D Bond's debt obligations, thereby helping to subsidize the interest rates charged to the IAs and the projects that they fund. The result will be that the projects will obtain funding on terms that include relatively long grace periods and interest rates that are substantially below market rates.



Third, the contract will make clear that the IA is responsible for repaying, together with the stipulated interest rate, the funds advanced by the Project Issuer. Thus, in the R&D Bond transaction it is the IAs that bear the risk of non-payment. One consequence of this arrangement is that it places a premium on identifying and contracting with the most effective and efficient development organizations possible to be IAs.

In addition to these 3 devices, the Project Issuer will seek to diversify its risks by pacing the funds with 4-6 IAs. There are 2 reasons for selecting this number of IAs. First, it allows for some variety in the skills, experience and scope of operations of the IAs, thereby creating both some variation in the IA operations supported by the Bonds and for some diversification of risk. Second, the relationships between the Project Issuer and this number of IAs can be managed by a small staff. This avoids the risk of the IA needing a large staff that “eats” a significant portion of the funds raised by the Bonds.

#### *Current Status of R&D Bond Project*

At the time of writing (February 2007), the R&D Bond Project is a fully conceptualized project that is waiting to be implemented. The author is now involved in discussions with a few financial institutions and financial experts regarding the potential for implementing the project. In addition, the author is in the process of hiring a consultant to do a study of development organizations that will be used to identify the 10 best potential IAs in South Africa.<sup>14</sup>

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<sup>14</sup> This study is being funded by a grant from the Wallace Global Fund.

### Section 3: Issues Arising From the R&D Bond Project

The R&D Bond Project raises a number of interesting issues that merit further investigation. Unfortunately, until the project is actually implemented and begins to produce empirical data, it is only possible to describe these issues. Their resolution will have to wait until the project is implemented.

First, the Project suggests that it is possible, at least in countries with sufficiently developed financial markets, for private actors to use domestic bond instruments to raise funds for small scale development projects. The purchasers of these bonds will be people living both inside and outside the country who have some level of disposable income. These instruments can attract investors from outside the country, even though they are only marketed in the country, because the expatriate community has sufficiently strong connections to their home country to learn about these bonds and to arrange to invest in them. Consequently, the bonds can become a useful way for a country to simultaneously raise funding from its local middle and upper classes and its diaspora without having to incur the considerable costs involved in issuing bonds on international markets.

It should also be noted that it is possible that the country's friends in the international community—in the case of South Africa, this means those people around the world who were supporters of the anti-apartheid struggle—will invest in the bonds as well. This group of people, like the diaspora community, has the kinds of connections to South

Africa that will enable them to learn about the bonds and the motivation and interest to invest in a rand denominated and domestically issued bond.

Second, the Project raises an interesting question about the nature of the investment approaches used by most financial institutions. One of the reasons that the projects that the R&D Bonds Project is designed to support find it difficult to raise funding is that they do not meet either of the two sets of criteria that financial institutions use in making their lending decisions. These two sets are those used for commercial lending and those used in making socially responsible investments. As explained above, either because of their scale or rate of return, the projects to be funded by the R&D Bonds do not meet the criteria financial institutions use in extending credit on commercial terms. In addition, because they generate a stream of income, these projects are not viewed as attractive candidates for funding from the “social responsibility window” of the financial institution. The reason is that financial institutions tend to see this window as being a grant making facility and so are not inclined to use it to fund revenue generating projects, no matter how socially beneficial they may be. In addition, there may be a concern that if this social responsibility window funds projects which earn a return that it will undermine the public relations benefit the institution hopes to gain from this window—it wants to be seen as acting in a “purely” generous fashion and without any expectation of a financial return.

The fact that a substantial number of revenue generating projects that create jobs, services and opportunities for poor people cannot fit into this binary analytical framework

suggests that financial institutions, particularly those in poor countries, need to rethink their approach to doing business and social responsibility. Instead of seeing all their investment activities as falling into either one of these two categories, they should see these categories as being the end points of a spectrum of activities that range from profit maximizing activities at the one end to “goodwill generating” activities at the other. The R&D Bond Project offers these institutions an opportunity to experiment and to learn more about how to identify other points along this spectrum.

Conversely, the R&D Bond Project will offer foundations and other grant makers the opportunity to learn lessons about how they can support sub-commercial revenue generating projects that produce jobs, services and opportunities for poor people. It should provide them with useful data on how they can adapt their grant making expertise to investing in new categories of development work.

Third, the Project raises an interesting question about how to identify appropriate projects for this type of debt financing. The Project’s approach to this issue is to rely on the expertise of the IAs. Provided the Project can demonstrate that the IAs have the requisite expertise and experience and that they will be guided by mutually agreed social and economic standards, this should be adequate for the purposes of the Bonds. However, the data collected by the IAs and the Bond issuer can be used to study this issue more systematically. Consequently, the information generated by the Project should help interested persons develop a methodology for doing social and credit assessments of sub-commercial revenue generating projects. This methodology should be applicable in other

sorts of development financing transactions. The development of an effective methodology will make it easier to scale up and replicate the R&D Bond Project.

A fourth issue, which is related to the third issue, is that the Project challenges us to think about how to evaluate the social returns generated by the projects being supported by the Bonds. A detailed annual report on the investments being made by the IAs should satisfy R&D Bond Project that their contributions are generating satisfactory social gains for the Project's intended beneficiaries. It should also be an adequate means for holding the IAs and Project Issuer accountable for their decisions and actions in regard to using the Bond proceeds. However, the empirical data generated by the Project can be used by interested parties to test methodologies for measuring social returns on investments. Such methodologies are necessary if this project or future ones like it are to be able to unequivocally demonstrate that they are meeting the third reconciliation-financing criterion, namely that the funds are being used in a way that has a meaningful impact on poverty alleviation and development. They are also necessary to enable potential investors to comparatively evaluate different socially attractive investment options.

Fifth, the Project raises some interesting contractual issues. In particular, it will challenge the Project Issuer to draft covenants that effectively and enforceably require the IAs to invest in projects that meet adequate financial and social criteria. In addition, the PI will have to work with the IAs on crafting similar covenants to be included in the IAs agreements with the projects that they fund with their allocation of R&D Bond monies.

Some guidance in this regard can be gained from the contracts that have been developed in the context of micro-lending<sup>15</sup>.

Sixth, the Project will need to consider what additional credit enhancements it can use to give particularly the SI investors additional confidence that they will get their money back. There are a number of ways in which this could be done. First, the Project Issuer could require that the IAs obtain alternative forms of collateral from the projects in which they invest<sup>16</sup>. Second, the PI could obtain credit enhancements to support the agreements between the Project Issuer and the IAs. Based on preliminary discussions it would seem that such credit enhancements may be available from some official agencies and some foundations.

Seventh, the Project raises an interesting question about future truth and reconciliation efforts in post-conflict societies. The project suggests that it is possible to use innovative applications of traditional financial instruments to promote reconciliation. This is particularly important given the evidence that financial compensation is one of the most effective ways to promote reconciliation.

## Conclusion

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<sup>15</sup> See *Commercial Loan Agreements: A Technical Guide for Microfinance Institutions*, (Consultative Group to Assist the Poor, The World Bank, 2006)

<sup>16</sup> For an interesting discussion of this point see R. Dyal-Chand, “Human Value as Collateral”, available at <http://www.aals.org/am2007/schoDyal-Chand.pdf> or [http://www.ssrn.com/sol3/papers.cfm?abstract\\_id=939587](http://www.ssrn.com/sol3/papers.cfm?abstract_id=939587)

The R&D Bond Project was originally intended as a vehicle for promoting reconciliation but it has evolved into an innovative development financing project. The reason for this transition is that it turns out that private efforts at reconciliation cannot be based on mechanisms for making grant financing available to development projects. Instead they must adapt traditional financial instruments to new purposes. In order to do this, the reconciliation project needs to offer potential investors both a reasonable financial and social return. The conceptualization of a retail bond for this purpose turns out to be an effective means for addressing to a number of difficult development financing issues. Interestingly, the R&D Bond Project, if successfully implemented, has the potential to be replicated in a number of different countries and regions, including Africa.