Environmental Conditionality in the Operations of International Development Finance Institutions

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Introduction

Each year, the World Bank and other international development finance institutions (IDFIs) lend billions of dollars to the less developed countries of the world. That lending is typically made conditional upon the borrowers' taking of certain actions that the IDFIs favor. This practice of conditionality has drawn sharp criticism from many quarters.

Some critics, largely from the highly industrialized countries, argue that conditionality is an ineffective tool. They believe the IDFIs waste resources by "throwing money down rat holes" with no strings attached, making it impossible either to retrieve the money or to ensnare the rats. Other critics, largely from the less developed countries, argue that because those countries desperately need credit, they have no choice but to accept the IDFIs' conditions. These conditions, it is claimed, impose many unreasonable standards and enslave the poorer countries to the whims of the rich industrialized countries and their co-conspirators, the multinational corporations.[1]

[A] new focus of conditionality has emerged: environmental protection and management.

The conditions imposed by the IDFIs have traditionally been designed primarily to ensure a project's economic and financial soundness. Recently, however, a new focus of conditionality has emerged: environmental protection and management. Largely in response to pressure from pro-environment groups and unfavorable publicity over the disastrous environmental consequences of some projects financed by the World Bank, the IDFIs have taken dramatic initiatives to ensure the environmental soundness of the development projects they support.

Such initiatives have been designed to ensure, for example, that the construction of harbor facilities in the Maldives does not destroy the nearby coral reefs, and that the placement of shrimp ponds along the coast of Borneo does not imperil the mangrove swamps there—in short, to see that the process of economic development does not bring with it environmental degradation. These new initiatives may be viewed as imposing "environmental conditionality."

This Article offers some observations on the new environmental conditionality in IDFI operations. The first part briefly describes the IDFIs and their activities. The second part examines three forms that environmental conditionality takes in IDFI operations: loan covenants, project planning and design, and certain non-lending operations. In this respect, the Article describes how the IDFIs have recently incorporated vigorous environmental assessment procedures into the designing of projects for financing, and how this approach can be more effective than relying on environmental loan covenants.

The third part of this Article suggests an analogy between IDFI environmental conditionality and the economic and financial conditionality applied by the International Monetary Fund (IMF). Drawing on that analogy, and in particular on a criticism that borrowing countries often raise against IMF conditionality, the Article focuses on the question of "symmetry" in environmental adjustment. Should the burden involved in adjusting a borrowing country's policies to place it on the course of environmental sustainability be borne entirely by that country, or should there be some "symmetry" in this adjustment, whereby the rich countries will share that burden? The Article concludes with some personal views on this issue and on the role the IDFIs can play in encouraging and enforcing symmetry in environmental adjustment.

IDFIs—An Overview

The World Bank is the largest and most visible of the IDFIs. The World Bank technically consists of two legally distinct institutions—the International Bank for Reconstruction and Development (IBRD) and its affiliate, the International Development Association (IDA).[2] Although both institutions are managed by the same staff and perform similar functions, the terms of the loans they provide, and the sources of funding for those loans, are quite different.

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The IBRD, established in 1945, is owned by the governments of 152 countries. As of mid-1990 it had a subscribed capital of about $125 billion.[3] The United States, Japan, Germany, the United Kingdom, and France hold nearly forty-five percent of this total.[4] Members' voting rights are roughly proportional to the size of their subscriptions. The IBRD lends to developing countries that have achieved more advanced stages of economic and social growth.

The IBRD funds its loan commitments by borrowing, either through public bond issues in the international financial markets or through the private placement of IBRD debt.[5] IBRD loans carry interest charges that reflect the institution's borrowing costs.[6] IBRD loan commitments made in fiscal year 1990 totalled approximately $15.2 billion,[7] and cumulative IBRD loan commitments total approximately $187 billion.[8]

The IDA was established in 1960 to provide special low-cost financing for the poorest countries.[9] Of the IBRD's 152 member countries, 138 are members of the IDA.[10] The IBRD's five largest shareholders are also the IDA's five largest contributors.[11]

Unlike the IBRD, the IDA funds the loans it makes primarily through the contributions of its members. Because the IDA's function is to lend only to its poorest member countries,[12] IDA loans have highly concessional terms. They bear no interest, have maturities of thirty-five or forty years, and have a ten-year grace period on principal payments.[13] Because of these terms, IDA loans are commonly called soft loans, distinguishing them from the hard loans offered by the IBRD on market-based loan terms. IDA loan commitments made in fiscal year 1990 totalled approximately $5.5 billion,[14] and cumulative IDA loan commitments total approximately $58 billion.[15]

The three main regional development banks—the Inter-American Development Bank, the Asian Development Bank (ADB), and the African Development Bank—are fashioned after the World Bank.[16] They are international organizations owned by member countries, and they provide both hard[17] and soft[18] loans to less developed countries. Because they operate only in their respective regions, however, their overall lending volumes are smaller than those of the World Bank. ADB soft loan commitments made in fiscal year 1989 totalled approximately $1.4 billion, and cumulative ADB soft loans total approximately $10 billion.[19] ADB hard loan commitments for fiscal year 1989 totalled approximately $2.2 billion, and cumulative ADB hard loans total approximately $19 billion.[20]

IDFI lending operations

The lending operations of the IDFIs can be divided generally into project and policy-based lending. IDFIs use project lending to finance the construction of public facilities such as roads, port facilities, power plants, and schools.

Project lending formed the backbone of the IDFIs' lending through the 1970s. However, the deteriorating conditions in less developed countries in the 1980s caused the IDFIs to focus more attention on lending in support of policy reform.[21] Policy-based lending is designed to support changes in such things as government spending, services, borrowing, and subsidies, often with an overall goal of improving the borrowing country's balance-of-payments situation.

The World Bank's Structural Adjustment Loans (SALs) have been at the forefront of policy-based lending. In fiscal year 1990, SALs totalled approximately $4 billion, or nearly one-fifth of the World Bank's total loan commitments.[22] The ADB also engages in similar operations under the label of "program lending."[23]

Each IDFI loan is provided under a set of legally binding financing agreements. These always include a loan agreement and may also include guarantee and/or project agreements. For example, an ADB loan for upgrading electrical generation and transmission facilities in the Philippines could be structured in either of two ways. The ADB and the state-owned National Power Corporation could enter into a loan agreement setting forth the obligations to repay the loan and to implement the project according to certain guidelines. In that case, the ADB would require a guarantee agreement with the government of the Philippines. Alternatively, the ADB could disburse the loan proceeds directly to the government under a loan agreement between the ADB and the government. A provision of the loan agreement would require the government to re-lend the loan amount to the National Power Corporation. The National Power Corporation would then have a project agreement with the ADB setting forth the requirements for project implementation.

The project implementation requirements, and indeed all other aspects of the project, will have been discussed extensively by the parties during a project preparation phase of several months or years. Also during that phase, the ADB staff will have scrutinized the project on several grounds. The project's design will have been formulated, and other competing project proposals will have been rejected, as a consequence of such scrutiny.[24]

Similar procedures apply to policy-based lending operations. In that context, however, attention focuses on the specific policy adjustment measures that the government is to implement over a short term, usually one to three years. In

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the World Bank context, these adjustment measures are usually enumerated in a "policy framework paper" prepared by the government concerned in collaboration with World Bank and IMF staff. The measures are then incorporated into the formal loan agreement.

IDFI non-lending operations

Although lending operations consume much of the IDFIs' efforts, these institutions also provide a variety of non-lending services. In 1989, for example, the World Bank launched a private-sector development action program to assist member countries in drafting legislation that would foster a supportive business environment and develop market-oriented financial systems.[25] The World Bank also provides grant funding in modest amounts for such operations as the "African capacity-building initiative," which "aims at providing a framework for building capacity in policy analysis and economic management in sub-Saharan Africa."[26] The ADB provides much larger amounts of grant funding. In 1989, technical assistance grants from the ADB totalled $81 million for 235 projects.[27]

The IDFIs also help arrange cofinancing–that is, financing by other lenders to countries receiving IDFI loans. A high proportion of all projects supported by the World Bank attracts some form of cofinancing. In fiscal year 1990, the World Bank helped mobilize approximately $13 billion of cofinancing.[28] The ADB also employs this technique of using its own funds to trigger other financing. In 1989, cofinancing of ADB-supported projects amounted to approximately $1.3 billion.[29]

Forms of Environmental Conditionality in IDFI Operations

An IDFI incorporates conditionality into its operations in three ways. First, in the processing of a loan proposal, the IDFI staff carefully screens the project or policy measures for consistency with the IDFI's guidelines and priorities. Second, the financing agreements often include covenants calling for certain action to be taken. The continued availability of disbursements under the loan can depend on whether these covenants are honored. Third, the IDFI's non-lending operations may constitute an indirect form of conditionality.

Loan covenants and their enforcement

An IDFI's financing agreements contain both standard and loan-specific provisions. Typically, the standard provisions have been approved by the executive directors of the IDFI.[30] Some standard provisions appear in a separately-published set of general loan regulations that are incorporated by reference in individual financing agreements.[31] Other standard provisions appear in the financing agreements themselves. These latter provisions generally cannot be eliminated from the agreement but may be completed or modified to fit the circumstances of the operation. An example of this kind of standard provision would be the following, with the blank filled in as appropriate to the character of the project being financed:

> The Borrower shall cause the Project to be carried out with due diligence and efficiency and in conformity with sound administrative, financial, engineering, _____, and operational practices.

The financing agreements typically will also include several loan-specific provisions, usually called loan covenants. Loan covenants reflect undertakings on the part of the borrower or project executing agency to take prescribed actions. For example, a loan covenant might call for the borrower to set electricity tariff rates at a level adequate to achieve a prescribed debt-service ratio by a stated date.

The primary legal significance of including such a loan covenant in the financing agreements lies in the nexus between the covenant and a particular standard provision found in the separately-published general loan regulations. That standard provision permits the IDFI to suspend, and ultimately to cancel, the borrower's right to receive disbursements under the loan if the borrower fails to perform any obligation under the loan agreement.[32] Disbursements under IDFI loans are made not on a lump-sum basis but rather as project-related expenditures are incurred and documented to the satisfaction of the IDFI. The relationship between loan covenants and the standard suspension/cancellation provision permits the IDFI to make its financing under a particular loan conditional upon the borrower taking the actions prescribed in the specific loan covenants.[33]

The reach of an IDFI's conditionality does not stop there. Failure to take the actions prescribed in a covenant may also affect the borrower's other outstanding IDFI loans. Through another standard provision, if the IDFI suspends disbursements under any loan to the borrower, it may also suspend disbursements under all its other outstanding loans to the borrower.[34]

As concern over environmental matters has increased, the IDFIs have responded, in part, by using this legal framework of standard and loan-specific provisions. In the ADB, for example,[35] the standard provision quoted above was revised in the late 1980s to include the word "environmental." Moreover, increasing numbers of specific loan covenants have

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begun appearing in ADB financing agreements in recent years. As the following examples illustrate, such environmental loan covenants vary in specificity.

> The Borrower shall take all steps to ensure that the Project is designed, constructed, and operated in such a way as to minimize any adverse environmental consequences.

> The Borrower shall monitor water run-off and sediment loading of the watershed, assess the severity of soil erosion, and take appropriate remedial action for soil conservation and watershed management.

> The Borrower shall ensure that all necessary preventative measures will be taken to minimize the adverse effects on mango fruits of dust and fumes emanating from the existing cement kiln. Such measures shall include the monitoring of dust precipitation, analysis of effects, and adoption of appropriate anti-pollution measures.

> The Borrower shall ensure that internationally acceptable environmental controls are included in the design of the Project facilities and that such controls are installed and maintained in good condition.

> The Borrower shall ensure that all necessary steps are taken to mitigate and minimize any adverse environmental effects of the Project on island harbor areas, particularly to protect reef inundation by displaced sediments.

Other loan-specific environmental covenants appearing in ADB financing agreements require action on such subjects as the routing of roads, groundwater monitoring, noise pollution, air pollution, ethnic and cultural environments, waste water disposal, and the disposal of medical solid waste. The covenants may call for laws to be enacted or enforced, for agencies to be established, for studies to be undertaken, and for control devices to be installed. The borrower's failure to comply with these covenants would make that loan, and perhaps all other ADB loans to that borrower, subject to suspension and cancellation by the ADB.

Environmental loan covenants appear to be moderately effective in several respects. They help heighten environmental awareness among government officials and provide ammunition for pro-environment forces in intra-governmental squabbles over financial priorities. For example, a government official responsible for implementing an ADB-financed project can cite environmental loan covenants when resisting attempts by other government entities to eliminate costly environmental controls from the project. Environmental loan covenants also provide a clear basis for including IDFI environment specialists in the process of monitoring project implementation.

On the other hand, the failure to abide by an environmental loan covenant has rarely, if ever, triggered a suspension of disbursements under a World Bank or ADB loan. Indeed, these institutions are reluctant to suspend loan disbursements for any reason except in the most dire of circumstances.

Whatever the actual effect of this covenant-based form of environmental conditionality may be, some critics have considered the IDFIs' efforts to protect the environment to be inadequate. A recent New York Times advertisement called the World Bank and the IMF "the world's leading architects of environmental destruction," and urged an end to the United States' support for these institutions.[36]

Concern over the effectiveness of environmental loan covenants has also arisen within the IDFIs themselves. Staff members of these institutions recognize that environmental concerns often compete with economic concerns. Local government officials often find it difficult to justify costly environmental protection measures that have no apparent and immediate economic benefit. These officials might view environmental protection as a luxury their country can ill afford. Hence, the resources that environmental loan covenants are designed to protect, such as mangrove swamps in Indonesia and coral reefs in the Maldives, are placed at serious risk despite the borrowing country's formal commitment to safeguard the environment.

From loan covenants to project planning and design

Faced with considerable public criticism and cognizant of the shortcomings of loan covenants in guaranteeing environmental protection, the IDFIs have now begun relying much more on project planning and design as another means of imposing environmental conditionality.

Traditionally, project planning and design involved the assessment of projects on technical, institutional, economic, and financial grounds. An IDFI eliminates a project from further consideration if it fails to pass muster on one or more of these criteria.[37] The assessment process constitutes a form of conditionality by making IDFI financing available only for projects and areas of economic development that the IDFI finds acceptable.

Under the IDFIs' traditional approach to project planning

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and design, the environmental impact of a project received only subsidiary attention. Recently, however, the World Bank acknowledged the need for a change.

> During the past decade or so, there has been growing evidence that environmental degradation in its many forms constitutes a threat of growing significance to economic development . . . .
>
> It became apparent that the Bank's response did not match the changing realities either in the degree of effort devoted to environmental matters or in the approaches actually used. This, combined with a few well-publicized cases in which Bank projects actually had negative environmental consequences—such as contributing to the destruction of tropical rain forests and posing threats to wildlife, indigenous people, and established human settlements—prompted the institution to rethink and adjust its policies toward environmental management. In particular, Bank management decided to bring environmental concerns more systematically into the mainstream of its operations.[38]

Describing in detail its new approach, the Bank explained:

> An important development in the Bank's efforts to incorporate environmental considerations into its lending activities was the introduction of the Operational Directive on Environmental Assessment. This directive is meant to ensure that development options are environmentally sound and sustainable and that any environmental consequences are recognized early in the project cycle and taken into account in project design.[39]

The 1990 annual report of the World Bank also reflects this change. The report announced that "[s]ystematic environmental screening of all new projects" had been introduced, "leading to full environmental impact assessments in every project that could have a substantial effect on the environment."[40] The environmental assessment of a project, therefore, has "become, like economic, financial, institutional, and engineering analyses, a standard part of project preparation."[41]

The World Bank's version of this new screening approach has three main elements. First, all projects proposed for World Bank financing are assigned to one of four categories. Category "A" encompasses projects "that may have diverse and significant environmental effects." These include, among others, aquaculture, forestry, irrigation, port, hydropower, water supply, and resettlement projects. Category "B" consists of projects "that may have only limited, specific environmental effects." Category "C" includes projects "for which environmental analysis is normally unnecessary." This category would include most education, family planning, and health projects. Category "D" is for "environmental projects" that focus solely on environmental protection or management.[42]

Second, comprehensive environmental assessments are performed for all projects in Categories "A" and "B" during the project identification and pre-appraisal stage. The results of those assessments influence project site selection and engineering design.

Third, during project appraisal, the World Bank team in its final field visit "reviews the environmental assessment with the borrower, resolves any outstanding issues, evaluates the adequacy of the institution responsible for environmental planning and management . . . and determines if the assessment's recommendations are properly addressed in the project design and economic analysis."[43]

The World Bank's new screening process, therefore, strives to "environmentalize" its lending operations in two ways. First, the screening process requires that the traditional World Bank investment project pass the rigors of an environmental assessment. Consequences of this requirement are already evident. Forty-eight percent of all World Bank loans approved in fiscal year 1990 "contained environmental elements," compared with thirty-eight percent for fiscal year 1989.[44] Second, the World Bank now welcomes projects focusing solely on environmental issues. For example, the IDA recently made a $26 million loan to help finance the first stage of Madagascar's fifteen-year environmental action program designed to protect and manage biodiversity, soil conservation, watershed areas, and forestry and other resources.[45]

The ADB also takes environmental considerations into account in project planning and design.[46] Indeed, the ADB introduced its own extensive screening and review procedures in 1987, well before the World Bank issued its Operational Directive on Environmental Assessment.

This newly introduced environmental screening constitutes a form of IDFI environmental conditionality more binding and pervasive than the inclusion of environmental loan covenants in IDFI financing agreements. Environmental loan covenants rarely create barriers to funding. The covenants operate after the IDFI grants the loan. Even then, the borrower probably realizes that the IDFI is unlikely to suspend disbursements in

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order to enforce the covenant. Environmental screening, on the other hand, is a prerequisite to funding. Unless a project survives IDFI scrutiny on environmental grounds, the borrower will not receive the loan. The issue of enforcement is largely avoided.

Environmental conditionality through non-lending operations

As explained above, IDFI operations also include various forms of technical assistance, training, research, and extensive cofinancing activities. IDFIs devote considerable resources to environmental matters through these non-lending operations. Four examples illustrate this development in the World Bank.

IDFIs devote considerable resources to environmental matters through . . . non-lending operations.

The first example concerns research and planning. The World Bank has undertaken to conduct extensive environmental studies in each of its borrowing member countries. Some of these are now complete, as are regional studies concerning Asian watersheds and agroforestry policies in sub-Saharan Africa. The World Bank also has developed an environmental action plan for the Mediterranean area.[47]

The second example concerns environmental assessment. Through the Technical Assistance Grant Program for the Environment, the World Bank provides grants to help borrowers carry out the environmental assessments necessary for project appraisal. This program relies on contributions from Japan and several other industrialized member countries.[48] Moreover, the World Bank's Economic Development Institute conducts seminars and workshops to train local government officials in environmental assessment practices.[49]

The third example concerns global environmental problems. The World Bank has helped establish a Global Environment Facility (GEF) to provide concessional financing to address four global environmental concerns: emissions of greenhouse gases, threats to biological diversity, degradation of international water resources, and depletion of the ozone layer. The GEF is managed by the World Bank, the United Nations Development Program (UNDP), and the United Nations Environment Programme (UNEP). Funding for the GEF comes largely from industrialized countries.[50]

Along with its efforts through the GEF, the World Bank also is devoting additional attention to the problem of ozone depletion by helping the UNDP and the UNEP administer a special fund established by parties to the Montreal Protocol on Substances that Deplete the Ozone Layer.[51] This fund will consist of at least $160 million in contributions from about thirty-five industrialized countries. Approximately three-quarters of the resources will come from the United States, Japan, the Soviet Union, Germany, France, and the United Kingdom. The fund will provide grants to pay the incremental costs of carrying out development projects in ways that reduce or eliminate the emission of substances that deplete the ozone layer.[52]

A fourth example of increased World Bank attention to environmental concerns by way of non-lending operations is the improving relationship between the World Bank and pro-environment non-government organizations (NGOs). World Bank staff members and NGOs have collaborated on various publications, including a book on conserving biological diversity[53] and a booklet on deforestation in Brazil.[54] More importantly, the World Bank has announced its willingness to assist NGOs in arranging debt-for-nature swaps. In these transactions, a country's debt is exchanged for the debtor's commitment to take conservation measures. "NGOs have helped to arrange 10 debt-for-nature transactions in 7 countries."[55] Although the World Bank "has not been directly involved in these transactions," it has "been developing contacts with the main NGOs involved."[56] As a result, the World Bank might in the future coordinate its lending with debt-for-nature swaps.[57]

Partly to support these non-lending environmental activities, the World Bank has greatly increased the number of environmental advisors on its staff. The World Bank recruited its first environmental advisor in 1969.[58] By 1990, it had a total of fifty-four high-level staff members, assisted by over twenty consultants, working in its Environment Department and regional Environment Divisions. In addition, many staff members and consultants in the World Bank's other departments, including its legal department, have some involvement in environmental matters.[59]

The ADB is taking similar initiatives. For example, it provides grants for technical assistance and training in environmental matters, maintains a computerized environmental information retrieval system, and is working to strengthen contacts with NGOs concerned with environmental matters.[60]

These IDFI non-lending initiatives have enhanced environmental conditionality in two ways. First, they have

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imposed environmental screening similar to the screening that occurs as a prerequisite to making loans. Because IDFIs have only limited resources for technical assistance, training, and other non-lending operations, the effect of this environmental screening is that activities lacking environmental components are now less likely than before to receive IDFI support.

Second, the funding of many of the non-lending initiatives seems to reflect a recognition that much of the cost of environmental protection in the less developed countries must, as a practical matter, be borne by the richer countries. This theme also appears in a recent statement by the World Bank that it "will continue to help developing countries to respond to these [environmental] challenges. Industrial countries can contribute to this effort in a variety of ways—through concessional aid, reform of their own domestic policies and practices, and scientific and technical research."[61]

Who Should Pay for Environmental Adjustment—The IMF Analogy

The growing practice of IDFI environmental conditionality may be seen as analogous to the kind of conditionality that the IMF applies. In providing financing to its member countries, the IMF insists that they follow certain macroeconomic and financial policies. This section briefly explains IMF conditionality in order to examine whether one of the objections raised against it might also apply to IDFI environmental conditionality. That objection is that IMF conditionality ignores the obligation of the rich industrialized countries to help bear the burdens of economic and financial adjustment in the poorer countries.

IMF conditionality and the "symmetry in adjustment" criticism [62]

Unlike the World Bank, which was established primarily to provide longer-term financing for reconstruction and development projects, the IMF was established primarily to bring about an orderly system of exchange arrangements to facilitate the making of payments and transfers between countries and thereby encourage the expansion and growth of international trade.[63] These objectives were to be achieved by establishing and administering a code of conduct regarding exchange rate policies and restrictions on payments for current account transactions, by providing members with financial resources to enable them to observe the code of conduct while correcting payments imbalances, and by providing a forum for members to consult and collaborate with one another.[64]

The IMF's presently most visible role is the second of these—providing members with financial resources to meet temporary balance-of-payments difficulties. Since the onset of the international debt crisis in the early 1980s, the Fund has made hundreds of loans to its members for this purpose.[65]

The terms of these IMF loans vary, depending partly on criteria similar to those used by the World Bank in determining eligibility for IDA financing. Many IMF member countries with low per capita gross national product are eligible for loans that carry highly concessional interest rates, now set at one-half of one percent, and a ten-year maturity rather than the usual five-year maturity. [66]

In making most of its loans, the IMF follows policies of conditionality that the IMF summarizes in this way:

> In providing financial support to its member countries, the Fund needs to be assured that their policies are geared toward reducing balance of payments imbalances and are consistent with the provisions of the Fund's Articles and policies. This requirement is known as 'conditionality' . . . .
>
> Under the Fund's policy of conditionality, use of Fund resources . . . is linked to the member's progress in implementing policies geared to restoring balance of payments viability and sustainable economic growth . . . . Fund conditionality is . . . designed to ensure that members who use Fund credit will be able to meet the repayment schedule to the Fund, thereby maintaining the revolving nature of its resources.[67]

The application of IMF conditionality in practice may be illustrated as follows. In granting a loan to a member country, the IMF executive board typically makes a portion (often about one-fifth) of the total loan amount available to the country immediately and provides for the remaining amount to be made available in four equal, quarterly disbursements so long as the country's government meets certain conditions. Most of these conditions take the form of performance criteria.

Performance criteria are intended to measure the government's success in following certain economic and financial policies agreed upon earlier by the government and the IMF staff. Typical performance criteria place ceilings on total government spending and external debt. If all the performance criteria are met in a particular quarter, the next disbursement will be made automatically. However, if one or more of the performance criteria are not met, the next disbursement will not be made unless the IMF executive board grants a special waiver.[68]

IMF conditionality has elicited sharp criticism. Some

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critics argue that IMF conditionality unfairly places all the burden of economic and financial adjustment on the poorer countries and overlooks the richer countries' obligation to share in the costs of such adjustment. This is known as the "symmetry-in-adjustment" criticism.[69]

The argument for symmetry in adjustment is based on the economic truism that every balance-of-payments deficit evidences a corresponding surplus. Critics argue that when the causes of a country's balance-of-payments deficit lie largely outside the government's control, the responsibility for overcoming deficits should be shared by the countries having the surpluses. On this basis a call has been made for "the development of the principle of symmetrical adjustment which means that States with a surplus on their balance of payments must take actions to promote balance of payment adjustment."[70] Some commentators have asserted that such a principle may in fact already exist.[71]

Some of the same arguments that support the call for symmetry in adjustment in the IMF context could be applied to the IDFIs as well.

How does the symmetry-in-adjustment argument apply to the IMF as an institution, as distinct from its individual member countries? Some commentators suggest that article IV of the IMF charter authorizes, and perhaps obligates, the IMF to require symmetrical adjustment.[72] Article IV requires all members to "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." This formulation is said to have been "deliberately chosen to encompass actions by countries in surplus as well as those in deficit."[73]

In sum, the proponents of symmetry in adjustment assert that the IMF should require the countries with stronger economies and higher standards of living to pay at least part of the costs of bringing less developed countries to a position of economic sustainability, in which revenues and expenditures are in balance over the medium and longer term.

Responding to the call for "symmetry in adjustment"—The IMF and the IDFIs compared

The IMF's application of economic and financial conditionality, as summarized above, is analogous to the emerging practice of environmental conditionality in IDFI operations. In both cases, the lending institution aims to ensure that its financing is made available only so long as borrowers take actions and implement policies that the institution favors.

The analogy does not end there. Some of the same arguments that support the call for symmetry in adjustment in the IMF context could be applied to the IDFIs as well. The IDFIs have adopted the rallying cry of environmental sustainability. They make their loans conditional upon changes in the borrowing countries' environmental policies and practices. Proponents of symmetry in adjustment would claim that the richer countries of the world have an obligation to bear at least part of the burden imposed by such conditionality and that the IDFIs should do what they can to enforce that obligation. The following paragraphs offer some observations on that claim by comparing the steps taken by the IMF and the IDFIs in requiring or facilitating symmetry in adjustment.

Initiatives by the IMF. Until recently, the call for symmetry in adjustment elicited only a modest positive reaction from the IMF and the rich industrialized countries that control it. The IMF's traditional position has had two elements. On the one hand, it has maintained that as a general matter the responsibility for addressing a country's balance of payments problems lies with the country itself, regardless of the sources of those problems.[74]

On the other hand, however, the IMF has acknowledged, increasingly over time, that because such problems often fall outside the country's control, special financing should be made available in certain circumstances. Accordingly, the IMF established the "buffer stock financing facility" in 1969, the "oil facility" in 1974, and the "cereal facility" in 1981, to provide financing to guard against, or respond to, changes in world prices of commodities, oil, and cereals.[75] A more broad-based facility, the Compensatory Financing Facility, was established in 1963 (and substantially expanded later) to provide funds to compensate for short-term declines in export earnings caused by drops in world prices, crop failures, or other causes beyond the control of the exporting state.[76]

More recently, the Compensatory Financing Facility was replaced by the Compensatory and Contingency Financing Facility (CCFF). The "contingency" portion of the new facility was designed to help borrowing countries meet unanticipated adverse shocks beyond their control.[77] Since its inception in 1987, the CCFF has evoked strong disagreements over what role the IMF and the creditor nations should play in

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protecting the less developed countries from the rigors of international economic competition.

These developments within the IMF were dramatically upstaged in March 1989 with the announcement of the Brady Plan.[78] In a reversal of long-standing policy, the United States called for commercial banks to negotiate arrangements with debtor nations for reductions in principal and interest payments. The IMF quickly endorsed the plan and soon established two procedures to help implement it.[79] Under a "set-aside" procedure, a portion (usually twenty-five percent) of an IMF loan can be used to help finance debt buybacks or other debt-reduction programs with other creditors. Under an "augmentation" procedure, the amount of an IMF loan can be increased by up to forty percent if the country succeeds in negotiating debt relief arrangements with its commercial creditors.[80]

Both borrowers and lenders have strong incentives to enter into such arrangements. For the debtor country, successful negotiations yield additional IMF financing, usually on highly concessional terms.[81] For the creditor banks, successful negotiations give greater assurance of recovering at least a portion of their investment.

Although the actual impact of the Brady Plan so far on the international debt crisis has disappointed some observers, the significance of the IMF's role in implementing the plan may extend far beyond its short-term results. Viewed in the context of the symmetry-in-adjustment criticism, the IMF's encouragement of operations to reduce debt and debt service obligations might signal that a corner has been turned toward placing much more responsibility on the richer countries for shouldering the costs of economic adjustment in the poorer countries.

This is only a partial response, however, to those who argue for symmetry in adjustment. Other measures could be taken to facilitate economic adjustment in countries with balance-of-payments deficits. As Richard Edwards points out:

> There are many actions a surplus country can take to improve payments equilibria besides providing financing to deficit countries. These include reducing subsidies to exports, improving access for imports to its markets by lowering tariffs and liberalizing import controls, liberalizing currency exchange restrictions, controlling inward capital movements, permitting the exchange rate of its currency to appreciate in the market or establishing a new higher rate, and adopting domestic policy actions such as easing credit conditions or reducing taxes or increasing government spending that spur demand for goods and services (including imports) within its economy.[82]

Edwards also notes that several proposals have been made for objectively allocating the burdens of balance-of-payments adjustment between surplus and deficit countries, but none has been adopted.[83] It appears that as long as economic conditionality applies, as a practical matter, only to the countries that use IMF resources, symmetry in adjustment will be difficult to attain.

The IDFI approach. Although the IMF has taken some important steps to facilitate a sharing of the burden of adjustment, its efforts have been only a partial response to the symmetry-in-adjustment criticism. A more complete response would be to require economic policy adjustments by surplus countries. Although the IMF might have adequate legal authority to impose such requirements, there is no indication that the IMF will soon change its practice of applying conditionality only to borrowers.

If, as seems likely, a similar demand is made for symmetry in *environmental* adjustment, how might the IDFIs be judged on meeting that demand? It appears that the IDFIs have done a better job in some respects than the IMF has done.

For one thing, concessionality provides a longer lever for IDFIs than it does for the IMF. With maturities of thirty-five to forty years and no interest charges, soft loans from the IDA and the ADB are nearly free to borrowers.[84] Therefore, the incremental costs of making projects financed by such loans environmentally sound fall largely on the donor countries. Moreover, grant financing is provided by IDFIs for various environment-related purposes, an option not available to the IMF. On another front, the recent enthusiasm expressed by the World Bank over debt-for-nature swaps and its involvement in other cooperative efforts with governments and NGOs roughly parallels the IMF's initiatives to support the Brady Plan. In particular, the World Bank's role in the GEF and in the special fund to protect the ozone layer provides valuable support for multilateral efforts by the richer countries to absorb some of the costs of making economic development environmentally sustainable.

Unlike the IMF, however, it is unclear whether the IDFIs can make a great deal more progress at this stage toward symmetry in environmental adjustment. The IMF has a broader mandate than the IDFIs, in that its charter gives it broad authority over the international economic system as a whole. It has grounds for exercising some jurisdiction over all its member states, whether they are debtors or creditors, in

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deficit or in surplus, poor or rich. In contrast, the IDFIs were given a narrower mandate: to provide financing for economic reconstruction and development. Extraordinary creativity may be required in order for the IDFIs to move beyond the response they have given thus far to the call for symmetry in environmental adjustment.

What further response might the IDFIs make? To paraphrase Richard Edwards' observations[85] and apply them to environmental concerns rather than to economic concerns, there are many actions that a rich industrialized country might take to improve global environmental sustainability besides providing financing to poorer countries. Rich industrialized countries could prohibit the exportation of hazardous waste, provide incentives (perhaps through preferential tariff rates) for imports from countries with monitored and approved environmental policies, and adopt domestic policies designed to reduce demand for products whose production contributes to environmental degradation or depletion.

For someone who sees a very direct relationship between both the environmental health and the economic health of the less developed countries and the quality of life in the rich industrialized countries, it seems obvious that the rich countries have obligations to take actions such as these. Some of these obligations may be moral, some legal, some founded on a self-interested cost/benefit analysis. Assuming such obligations exist, what role can and should the IDFIs play in encouraging or even requiring the rich countries to recognize and fulfill such obligations?

For the present, the role of the IDFIs in this area is limited by both legal and practical constraints. First, the IDFIs' charters do not give them the same degree of jurisdiction over their member countries as does the IMF's charter. It is difficult, therefore, to find a firm legal basis for an IDFI to require one of its richer member countries to reduce domestic demand for certain products—for example, lumber from the dwindling forests of the Philippines. Second, and more fundamentally, the IDFIs' ability to press members to action is limited by the strength of the concept of state sovereignty as an organizing principle of international relations.

For the future, perhaps the IDFIs can take on a larger role in the area of environmental protection and management at both the national level and the global level. A radical change in that direction, however, would depend on a contraction of the principle of state sovereignty and a corresponding expansion of the authority of international organizations. Should that occur, responsibility for environmental sustainability in economic development would fall not just on the IDFIs but on other international organizations as well.

Whether such a radical change is warranted, or what specific form it might take, is beyond the scope of this Article. However, the IDFIs' focus on environmental concerns over the last few years should not be ignored. By expanding the use and effectiveness of environmental conditionality in their operations, and by taking initiatives to see that the richer countries share the burden of environmental adjustment in the poorer countries, the IDFIs have shown that they are more than willing to shoulder their part of the responsibility for bringing about environmental sustainability.

Notes

*Some information included in this Article derives from the author's experience and from discussions with staff members at the International Monetary Fund, the World Bank, and the Asian Development Bank. The views expressed here, however, are those of the author and not necessarily the views of those institutions.

1. No attempt is made here to catalogue the many criticisms leveled against the IDFIs. These criticisms go far beyond the issue of conditionality. For example, one critic calls for the World Bank's withdrawal from the less developed countries, alleging that its activities "block the best possibilities for constructive change." C. PAYER, THE WORLD BANK—A CRITICAL ANALYSIS 351 (1982).
2. THE WORLD BANK, WORLD BANK ANNUAL REPORT 1990 3 (1990) [hereinafter WORLD BANK ANNUAL REPORT 1990]. The IBRD has two other affiliates: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA). The IBRD, the IFC, and the MIGA are sometimes referred to as the World Bank Group. *Id.*
3. *Id.* at 77.
4. *Id.* at 194-97. Other countries holding more than 3% of the IBRD's total subscribed capital are the Netherlands, China, India, and Canada. *Id.*
5. IBRD bonds usually trade at a small premium over United States Government securities because the bonds are backed by the callable capital of the IBRD.
6. In recent years the IBRD has largely shifted from fixed-interest loans to variable interest loans. For the second half of fiscal year 1990, the variable lending rate was 7.75%. *Id.* at 74-75. Fiscal year for the IBRD and the IDA is July 1 to June 30. *Id.* at 16. IBRD loans are disbursed largely in three currencies: the U.S. dollar, the Japanese yen, and the German deutsche mark. *Id.* at 74.
7. *Id.* at 156-57.
8. *Id.* at 178-81.
9. Countries with an annual per capita gross national product of

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$650 or less, measured in 1988 dollars, are eligible for IDA loans.
10. *Id.* at 3.
11. As of June 30, 1990, the United States had contributed $14.8 billion, Japan $10.5 billion, Germany $6.3 billion, the United Kingdom $4.6 billion, and France $3.2 billion. *Id.* at 213-15.
12. In fiscal year 1990, IDA loans were made to 28 countries in Africa, 9 countries in Asia, 2 countries in Latin America, 1 country in the Caribbean, and 3 countries in the Middle East. *Id.* at 156-57.
13. The IDA has sometimes charged a fee on the amount that has been committed under a loan but not yet disbursed. The amount of the commitment fee has always been relatively small. In April 1988, the executive board of the IDA decided to set an upper limit of one-half of 1% on commitment fees. For fiscal year 1990, the commitment fee was set at zero. *Id.* at 77-79.
14. *Id.* at 156-57.
15. *Id.* at 178-81.
16. The Inter-American Development Bank was established in 1959, the African Development Bank in 1963, and the Asian Development Bank in 1966. A new bank, the European Bank for Reconstruction and Development, recently began operations. Its operations will focus on Eastern Europe. A similar regional development bank was recently proposed for the Middle East.
17. ASIAN DEVELOPMENT BANK, ASIAN DEVELOPMENT BANK ANNUAL REPORT 1989 95 (1990) [hereinafter ADB ANNUAL REPORT 1990]. As with the IBRD, the ADB's hard lending operations are financed by international borrowing. For calendar year 1989, ADB borrowings totalled approximately $645 million. *Id.* The ADB's fiscal year is the calendar year.
18. *Id.* at 4. At the ADB, soft loans are made through the Asian Development Fund (ADF), which is operated by the Bank as a separate set of accounts rather than as a separate legal entity. The ADF resources mobilized through the end of 1989 for soft lending total approximately $12.2 billion. *Id.*
19. *Id.*
20. *Id.*
21. WORLD BANK ANNUAL REPORT 1990, *supra* note 2, at 4.
22. *Id.* at 53-55.
23. ADB ANNUAL REPORT 1989, *supra* note 17, at 37.
24. *See generally* W. BAUM, THE PROJECT CYCLE (1982) (available from the IBRD).
25. WORLD BANK ANNUAL REPORT 1990, *supra* note 2, at 68-70.
26. *Id.* at 98.
27. ADB ANNUAL REPORT 1989, *supra* note 17, at 48. Some grants were funded by the ADB, while others were funded by alternate sources and implemented by the ADB.
28. WORLD BANK ANNUAL REPORT 1990, *supra* note 2, at 81.
29. ADB ANNUAL REPORT 1989, *supra* note 17, at 55.
30. The World Bank has 22 executive directors. Each of the 5 member countries with the most shares of capital stock appoints 1 director. The remaining member countries organize themselves into fairly stable groups or constituencies, which elect the other 17 directors. WORLD BANK ANNUAL REPORT 1990, *supra* note 2, at 15; *see also* Articles of Agreement of the International Bank for Reconstruction and Development, art. V, sec. 4, *done* Dec. 27, 1945, T.I.A.S. No. 1502, at 1402, 2 U.N.T.S. 134, 162-64. The ADB has 12 directors. The United States, Japan, and the People's Republic of China appoint one director each. Constituencies of other member countries elect the other 9 directors. ADB ANNUAL REPORT 1989, *supra* note 17, at 192; *see also* Agreement Establishing the Asian Development Bank, art. 30, *done* Dec. 4, 1965, T.I.A.S. No. 6103, at 1440, 571 U.N.T.S. 132, 174-76.
31. *See* INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, GENERAL CONDITIONS APPLICABLE TO LOAN AND GUARANTEE AGREEMENTS (Jan. 1, 1985) [hereinafter IBRD GENERAL CONDITIONS]; ASIAN DEVELOPMENT BANK, ORDINARY OPERATIONS LOAN REGULATIONS (July 1, 1986) [hereinafter OOLR].
32. *See* OOLR, *supra* note 31, at §§8.02(c), 8.02(d), and 8.03. For corresponding World Bank provisions, see IBRD GENERAL CONDITIONS, *supra* note 31, at §§6.02, 6.03.
33. *See supra* note 32. These provisions impose conditions subsequent on a borrower's right to withdraw loan proceeds. In addition, there are sometimes provisions in IDFI financing agreements that can be characterized as conditions precedent, usually called conditions to loan effectiveness or conditions to loan disbursement. This additional form of IDFI conditionality is a hybrid between the loan covenant form of conditionality and the project planning and design form of conditionality.
34. *See* OOLR, *supra* note 31, at §8.02(e).
35. Some information in the following paragraphs regarding ADB practice is derived from the author's experience and discussions with the staff of the ADB.
36. N.Y. Times, Oct. 14, 1990, at A5 (advertising insert).
37. *See generally* W. BAUM, *supra* note 24, at 11-17.
38. THE WORLD BANK, THE WORLD BANK AND THE ENVIRONMENT—FIRST ANNUAL REPORT, FISCAL 1990 11 (1990) [hereinafter ENVIRONMENT REPORT 1990].
39. *Id.* at 7.
40. WORLD BANK ANNUAL REPORT 1990, *supra* note 2, at 12.
41. *Id.* at 65.
42. *Id.* at 64-65.
43. *Id.* at 65.
44. *Id.* at 66.
45. ENVIRONMENT REPORT 1990, *supra* note 38, at 5, 51; *see also* WORLD BANK ANNUAL REPORT 1990, *supra* note 2, at 65-66.
46. ADB ANNUAL REPORT 1989, *supra* note 17 at 56-57.
47. WORLD BANK ANNUAL REPORT 1990, *supra* note 2, at 66, 127.
48. *Id.* at 65 n.22.
49. ENVIRONMENT REPORT 1990, *supra* note 38, at 83.
50. WORLD BANK ANNUAL REPORT 1990, *supra* note 2, at 67 n.24.
51. ENVIRONMENT REPORT 1990, *supra* note 38, at 8, 78; *Report to the Second Meeting of the Parties to the Montreal Protocol on Substances that Deplete the Ozone Layer*, U.N. Environment Programme (Agenda Item 7) at 42, 47-48, 50, U.N.E.P. /Ozl. Pro.2/3 (1990) [hereinafter *Montreal Protocol*].
52. *Montreal Protocol*, *supra* note 51, at 50. The significance of the fund goes beyond the funding that has been made available for it thus far. It is seen as a pilot program for future means by which the industrialized countries would finance environmental protection in

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less developed countries.

53. *See* ENVIRONMENT REPORT 1990, *supra* note 38, at 3.

54. D. MAHAR, GOVERNMENT POLICIES AND DEFORESTATION IN BRAZIL'S AMAZON REGION (1989).

55. ENVIRONMENT REPORT 1990, *supra* note 38, at 8.

56. *Id.* at 78.

57. *Id.* at 79. For a comprehensive survey of the development and record of debt-for-nature swaps, see Comment, *The Debt-for-Nature Swap: A Long-Term Investment for the Economic Stability of Less Developed Countries*, 24 INT'L LAW. 1071 (1990).

58. ENVIRONMENT REPORT 1990, *supra* note 38, at 11.

59. *Id.* at 11-12.

60. ADB ANNUAL REPORT 1989, *supra* note 17, at 57.

61. ENVIRONMENT REPORT 1990, *supra* note 38, at 10.

62. This discussion of IMF conditionality is radically abbreviated and simplified. For a more complete discussion of IMF conditionality, see M. GUITIAN, FUND CONDITIONALITY—EVOLUTION OF PRINCIPLES AND PRACTICES (IMF Pamphlet Series, No. 38, 1981); J. GOLD, CONDITIONALITY (IMF Pamphlet Series, No. 31, 1979) [hereinafter J. GOLD, CONDITIONALITY]; J. GOLD, FINANCIAL ASSISTANCE BY THE INTERNATIONAL MONETARY FUND—LAW AND PRACTICE 19-24 (IMF Pamphlet Series, No. 27, 1980); A. HOOKE, THE INTERNATIONAL MONETARY FUND—ITS EVOLUTION, ORGANIZATION, AND ACTIVITIES 32-40 (IMF Pamphlet Series, No. 37, 1981). For a discussion of the IMF and the international monetary system, see generally R. EDWARDS, INTERNATIONAL MONETARY COLLABORATION (1985).

63. *See* Articles of Agreement of the International Monetary Fund, art. I, pts. (ii)-(iv), *done* Dec. 27, 1945, T.I.A.S. No. 1501, 1 U.N.T.S. 39, reprinted in B. WESTON, R. FALK & A. D'AMATO, BASIC DOCUMENTS IN INTERNATIONAL LAW & WORLD ORDER, 513-14 (2d ed. 1990) [hereinafter IMF Charter].

64. INTERNATIONAL MONETARY FUND, THE ROLE AND FUNCTION OF THE INTERNATIONAL MONETARY FUND 3 (1985); *see also* R. EDWARDS, *supra* note 62, at 4-8.

65. Unlike World Bank loans, IMF provisions of financing are technically referred to as arrangements. The bulk of these are stand-by arrangements provided from the IMF's general resources account. These arrangements are, for reasons grounded in the IMF's structure and history, characterized by the IMF itself as unilateral decisions of the IMF's executive board that create certain entitlements for the member country receiving the financing, but that do not create legal obligations, either for that country or for the IMF, of the sort that arise from bilateral loan agreements. In most respects, the arrangements are equivalent to loans, and for the sake of simplicity, they are referred to herein as loans. For a discussion of the peculiar legal character of such arrangements, see R. EDWARDS, *supra* note 62, at 267-69.

66. *International Monetary Fund, Fund Provides Resources to Members Under Various Policies*, IMF SURV.—SUPPLEMENT ON THE FUND, Aug. 1989, at 9-10 [hereinafter *IMF Policies*].

67. *International Monetary Fund, Financing and Adjustment Should Work in Tandem*, IMF SURV.—SUPPLEMENT ON THE FUND, Aug. 1989, at 1, 15.

68. Most IMF loans are conditioned also on the borrowing government's observance of non-quantitative performance clauses requiring structural adjustment measures such as changing pricing policies for commodities or streamlining customs procedures. These clauses operate in much the same way as quantitative performance criteria. The government's failure to take the required action will interrupt loan disbursements unless the IMF's executive board grants a waiver.

69. For a review of some of the many other criticisms leveled against IMF conditionality or the IMF generally, see B. WESTON, R. FALK, & A. D'AMATO, INTERNATIONAL LAW AND WORLD ORDER 535-38, 545-47, 558-61 (2d ed., 1990).

70. E. DENTERS, IMF CONDITIONALITY 235, 237-40 (1988); *see also* R. EDWARDS, *supra* note 62, at 611.

71. *See, e.g.*, R. EDWARDS, *supra* note 62, at 611-19; E. DENTERS, *supra* note 70, at 235.

72. R. EDWARDS, *supra* note 62, at 613.

73. Denters claims that the principle of symmetrical adjustment "may well be founded on the principle of international solidarity," elements of which he finds in the EEC treaty. E. DENTERS, *supra* note 70, at 242; *see also* R. EDWARDS, *supra* note 62, at 611.

74. J. GOLD, CONDITIONALITY, *supra* note 62, at 24. For Sir Joseph Gold's view of IMF "firm surveillance" as a means of ensuring symmetry in adjustment, see Gold, *Symmetry as a Legal Objective of the International Monetary System*, 12 N.Y.U. J. INT'L L. & POL. 423, 471-77 (1979) [hereinafter Gold, *Symmetry*].

75. *See* R. EDWARDS, *supra* note 62, at 281-83, 293-94.

76. *Id.* at 277-78.

77. *IMF Policies, supra* note 66, at 2, 11-12.

78. For general expositions on the Brady Plan, see *International Monetary Fund, World Bank Report Reviews Initiatives to Reduce Debt and Debt Service*, IMF SURV. Jan. 8, 1990, at 1, 12-15.

79. Dooley & Watson, *Reinvigorating the Debt Strategy*, 26 FIN. & DEV., Sept. 1989, at 8-9.

80. *Id.* at 10.

81. *IMF Policies, supra* note 66, at 12.

82. R. EDWARDS, *supra* note 62, at 612-13.

83. *Id.* at 617-19. Sir Joseph Gold, writing in 1979, traced the development of such proposals, beginning with the recognition by Keynes in 1943 that the international monetary system should have a mechanism "by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium *in either direction*, so as to prevent movements which must create for its neighbors an equal but opposite want of balance." Gold, *Symmetry*, *supra* note 74, at 429 (quoting J. M. KEYNES, PROPOSALS FOR AN INTERNATIONAL CLEARING UNION, md. No. 6437 (1943)). Gold concludes that the only workable means of imposing such pressure is through the IMF's policy of "firm surveillance" over the general economic policies of its members, including surplus members.

84. A concessionality factor of about 90% is generally assumed to apply to IDA loans. The exact level of concessionality applicable to a particular loan depends on several factors, including prevailing market rates and the actual schedule of disbursements.

85. *See supra* note 82 and accompanying text.

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