SPEECH

SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00
Fax +46 8 21 05 31
registratorn@riksbank.se
www.riksbank.se

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The IMF - Mandate, Means and Governance in a Changing World

The question posed to this panel is "The IMF – a panacea for every illness?". That it is being asked at all indicates that confidence in the IMF is strong today. I agree with those that have great confidence in the IMF. Nevertheless, my answer to the question is no: The IMF is not – and should not be - a panacea for every illness. Allow me to raise a number of issues against this background.

Focus on the core functions

The IMF has a unique mandate – to promote global macroeconomic and financial stability. This is the fundamental basis of sound economic performance. The IMF's mission is certainly not less significant today than it was before.

It was no coincidence that when the IMF was founded, in Bretton Woods in 1944, it was accompanied by the creation of the World Bank and (later) the WTO – with explicit areas of responsibility. It is important to adhere to these in order for each of the organisations to be able to work effectively and efficiently. A stable economic development is the basis of other international organisations' work. So it is vital that the IMF continues to focus on its core functions – and to do it well.

The IMF's objective and instruments

The IMF's mandate is still valid in the main – in spite of the enormous changes that have taken place in the international financial system since the IMF was created. We still need an organisation with the task to foster trade, employment and growth by promoting international monetary cooperation as well as macroeconomic and financial stability.

On the other hand, there is always reason to consider whether the Fund's *instruments* to reach this overall objective should be modified. The IMF's main instruments today are *surveillance, lending* and *technical assistance*. Allow me to say something about each of these.

Surveillance

The IMF's key instrument for reaching its overall objective should be its *preventive activities*, which are primarily carried out within the scope of its surveillance function. The IMF's primarily role is not to treat illnesses but to prevent them from breaking out.

Much can be done to bolster the IMF's surveillance function, both as regards individual countries but also, to an increasing extent, by way of a stronger regional and global focus. This change in emphasis can, among other things, be motivated by the fact that globalisation and increased integration has resulted in a situation where more and more countries' national policies give rise to externalities. A strong 'multilateral' surveillance function could contribute, more clearly than today, to creating a broad international discussion of global imbalances, incorrectly valued exchange rates, etc., which generate risks to stability both in individual countries and in the international financial system as a whole.

In this context, it is crucial that the member countries accept and support the role that has been given to the IMF, including taking seriously its advice and recommendations. We are often more keen to underline the importance of the IMF's surveillance function for *other* countries than we are to be guided by the IMF's analyses of our own countries. This is not beneficial for the IMF's credibility.

Lending

Even though the Fund's surveillance is effective it is likely that there will sometimes be a need for IMF financing in the future as well. This holds for poor countries with very limited or no access to private capital markets, but also for emerging market economies that have access to private capital markets.

In this respect, it is important to differentiate between IMF lending to address 'traditional' current account crises and capital account crises, although this distinction is sometimes hard to do in practice.

In the event of a *traditional current account crisis*, many countries today can obtain loans in private capital markets. This is a result of the increasing liberalisation of the international capital market over several decades. The IMF's role in situations such as this has thus become less important, although probably not done away with entirely. Catalytic financing from the IMF, which is provided in connection with economic policy programs designed to address the underlying account problems, may still be important for resolving crises. The situation is worse when it comes to *capital account crises*. These often stem from sensitivity to fast swings in capital flows, and break out when economic policy lacks credibility. They can also be caused by a combination of domestic problems and contagion from other countries that are considered to be in similar economic situations. At the same time as the free movement of capital increases the potential welfare effects of globalisation, it entails risks that can only be managed through disciplined economic policy. IMF financing for capital account crises should principally aim to quickly restore confidence in the affected countries' economic policies. The intention should be that the loans be paid back to the IMF after a relatively short period of time.

When a serious crisis is at hand, it is hard to say no to a loan request. At the same time, it is important to counter tendencies towards moral hazard, which in the longer term could result in both riskier economic policies and irresponsible lending from private creditors.

This is a genuinely difficult issue. There are no easy solutions. The Nordic-Baltic constituency has argued that the use of the IMF's loan instrument must be based on unambiguous, predictable rules. And that the rules be applied. This has not always been the case, e.g. as regards certain decisions concerning exceptional access, i.e. where the IMF has granted substantial loans without requiring sufficient conditionality. In a number of instances the result has been a longer-term dependence on loans and in several cases recurrent crises as well.

We should now, when the economic and financial situation in the world is relatively calm, take the opportunity to simplify and clarify the rules further, particularly as regards their application. When the next financial crisis occurs it may be too late.

Another aspect of the Fund's function in crisis management is its role when countries are forced to suspend payments. It is possible to further strengthen the instruments available today – *Collective Action Clauses as well as Principles for Stable Capital Flows and Fair Debt Restructuring* – in order to ensure a transparent and predictable debt restructuring process for borrowers and lenders.

These instruments lay the main responsibility for agreeing on debt renegotiation terms on the borrower countries and creditors. The Fund’s most important function in such circumstances is to provide the parties with the best possible information about the economic situation so as to facilitate agreement. The Fund should also try to contribute to ensuring that economic policies in the debtor country make it possible in the longer run to restore balance and to reduce the country’s debt to a level that is sustainable in the long term. The Fund itself may have to provide some financing to achieve this, but when it comes to countries in highly vulnerable positions Fund financing can only play a limited role.

It will not always be possible to bring about a sustainable debt level in this way without drawn-out negotiations and considerable economic costs. To make these kind of situations more predictable, and also more easy to resolve, it would be desirable to strengthen the existing framework with a final objective to have comprehensive framework for the restructuring of sovereign debt .

Technical assistance

The IMF has unique competence through its ability to combine scientific knowledge and institutional skills with longstanding experience of work in individual countries. This competence often applies to ‘narrow’ areas that a particular country (normally) only seldom requires help with. This includes advice and support regarding how to build up a functioning supervisory authority or how to manage a banking crisis. It is crucial to make the utmost use of this competence.

The IMF has untapped potential

What I have said so far, that the Fund’s mandate and main instruments for achieving it are essentially appropriate, is hardly controversial. Most people agree on this in *theory*. In practice, however, it is more difficult. When it comes to the crunch, we member countries do not always allow the IMF to effectively carry out the functions that we have given it a mandate to perform.

In my opinion, the IMF could play a more important role than it does today. But that is not principally due to its mandate and instruments as such but because we as members do not allow it to fulfil its potential.

Wherein lies the untapped potential? In which of the IMF's main fields could the organisation play an even stronger part?

The problems are not a consequence of shortcomings in the *borrowing instruments*. I do not see any immediate need for new types of lending instruments, such as non-borrowing programs or a reintroduction of Contingency Credit Lines. There are already surveillance methods in place to deal with such situations, and today's borrowing instruments are sufficiently flexible to meet the existing requirements (and demand).

Nor do I believe that the problems to any great extent are due to incorrect *analysis* or erroneous *assessments*, even though the situations faced by the Fund are often difficult and the advice given has been open to question from time to time. Nonetheless, there are a number of things that can be done in this area.

Shortcomings still exist, as I mentioned earlier, as regards the Fund's participation in *crisis resolution*. There is scope for further development of those instruments that exist today. The reason why this has not happened is because some countries oppose it for political reasons. This brings me into the role that "political considerations" play for the IMF to work well.

In my view, the central problems of the IMF are often *political in nature*. These problems exist at several different levels:

- Individual countries are sometimes for political reasons not willing to take the sometimes bitter medicine prescribed by the IMF's staff and Executive Board and engage in serious dialogue. Neither is it unusual, if they do swallow the medicine, that the countries blame any side-effects on the IMF whether they were a result of the medicine or not; that the ownership – to use IMF vocabulary – is weak. At the same time, there may also be scope for the IMF itself to become better at operating in an environment where strong political considerations are present.
- Nor are groups of countries always willing at IMF meetings to raise questions of crucial importance to the world economy as a whole. Larger countries do not want to run the risk of coming under the spotlight. As a result, the big industrial countries normally prefer to discuss imbalances and exchange rates in a narrower circle, if at all.
- Also when dealing with financial crises, political considerations are constantly present. Everyone that follows IMF's work in this area the last 10-15 years, has been able to see that geopolitical considerations sometimes play an important role when defining the conditionality – with mixed results.

What can be done to strengthen the IMF?

There is every reason to approach this question with humility. Many people have reflected on it and plenty of suggestions have been put forward in the debate. Since the crucial problems are political, they are also likely to require political solutions.

In recent years, the discussion has focused on matters to do with quota, voice and representation (QVR). Many countries consider themselves to be underrepresented under the current structure. Almost without exception, countries favour criteria for representation that boost their own influence. This is normal when these kind of issues are discussed, but makes progress difficult. In the eyes of many it is Europe that is overrepresented. But it is enough to read the book 'An Uncertain World', by the former US Secretary of the Treasury Robert Rubin, to realise that it is not Europe that has the real power - it is the United States that essentially calls the shots. This simple example illustrates that there is a big difference between the formal and actual power.

Personally, I come to a number of different conclusions from this discussion. The world has changed since the fall of communism and as a consequence of the positive development in a large number of emerging markets. That gives cause to modify countries' formal influence in the IMF by updating quotas to better reflect recent changes in world economy. Such changes should be implemented step by step, and with as broad support as possible.

Some argues that the *criteria* used for determining countries' influence should be modified. I am not convinced that this is the right way to move forward. There is much symbolism in this issue, which makes it a difficult one. For obvious reasons, it is also difficult to find criteria that balances the need for both borrowing countries and creditors to get reasonable influence, and, at the same time assures that the organisation functions well. The world is changing quickly and it is only a couple of years since several of the big emerging markets, which now according to a GDP criterion should be given greater influence, were in need of support from the very countries that today by the same criterion would have to scale back their role. We do not know what the situation will be in five or ten years. Maybe, there are reasons to aim for more regional representation? A very difficult question – which I do not think can be ignored – is if the level of "democracy" or "governance" in individual countries' should be a factor when determining countries influence in the IMF. Whatever the answer to this question is, it will have potential consequences for the legitimacy of the organisation.

Finally, we should not be led to believe that a changed representation per se, resolves the problems of the IMF. There are a number of other things that could, and should, be done that may even play a more important role.

Allow me to indicate a number of areas where more could be done, and where the prospect of progress is probably higher than in the QVR-field. I myself have positive experiences of a similar gradual process of reform within the framework of the Bank for International Settlements (BIS).

i. Much has been done to increase *transparency* in various ways at the IMF. *Greater openness* is probably the most important way to develop the organisation's analysis and surveillance activities. In a longer perspective, openness can also be vital to create a political pressure for change in individual countries. In the same way, openness with regard to current imbalances lends support to change in different countries and for considerations in the financial markets. I myself would very much like to see more transparent application and assignment procedures for posts *at all levels* within the IMF. The best candidate should get the job regardless of the applicant's country of origin.

ii. For the IMF to have enough weight, it is necessary that the *key issues* for the world economy *really are discussed* at the IMF's table and not at others. Those who wishes to strengthen the IMF – and are serious about it – could therefore not create new forums outside the IMF with a view to discussing matters that fall within the IMF's mandate. If this is done, the organisation will, in practice, be undermined.

iii. One way of reducing the need for creating new fora, and, at the same time, in a pragmatic way approach issues of representation, would be to work more actively in the Executive Board with various (small) *committees/subcommittees* (similar to those in many national parliaments and in the Executive Board at the World Bank). For example, there could be a committee for global exchange rate issues, in which the large currency blocs are represented; another committee focused on poverty issues, where poor countries and major donor countries have a high representation; and a committee for crisis resolution, in which creditors have a strong position, etc. Reforms in this direction could also increase the *efficiency* of the Executive Board. It could also imply that a small increase in the number of chairs would be manageable. The problem that a number of countries would end up outside some of the discussions, should not be exaggerated particularly if the consequence of total changes is that IMF gets a more central role in the international discussion than today. To the extent that the problem remain, it should be possible to manage through a high degree of openness.

iv. The role of the Executive Board should be stronger and more clearly defined in relation to the IMF's management. The current principle whereby the IMF's managing director is both chairman of the Board and responsible for executing the Board's decisions is open to question. With a more *clear division of responsibilities*, the IMF management could be more effective and, in practice, possibly stronger. It is also vital that the Board is represented at a high enough level with full confidence from the capital level in order for the Board to be able to become an effective arena for central policy discussions.

v. The IMFC could be reinforced. The IMFC Deputies group could also be strengthened by convening also in between the annual and the spring meetings. It is important that all countries participate at a high level (today, many countries participate with their Executive Directors). One likely reason that the BIS functions more smoothly, a part from the fact the issues discussed are of a less political nature, is that those who take the decisions on the domestic front are the same people that meet in Basel.

vi. Overhaul the IMF's *internal organisation*. As multilateral surveillance becomes more important, the country departments should work (even) closer with the departments that possess knowledge of institutions and institution building. It is also reasonable that the IMF's current resource base, which primarily consists of economists, be broadened with people that have a financial background and practical experience of policy work and institution building in their own countries.

Concluding remarks

To sum up:

- The IMF's overall objective is still valid;
- The IMF's *instruments* for reaching this objective – surveillance, lending and technical assistance – are, in general, functional and effective, *in theory;*
- *In practice*, however, many of the IMF's member countries do not allow the Fund to play the role that it could have. The IMF has untapped potential, not least in the area of surveillance;
- The untapped potential is closely related to political issues. Many countries do not seriously consider the recommendations given to them by the IMF and/or blame the Fund for its own problems. Other countries want to avoid that the consequences of their own policy actions, for the rest of the world, are discussed within the IMF or prefer to discuss them elsewhere.
- To increase the legitimacy of the IMF, there are reasons to consider the formal governance issues, (i.e. the QVR-issues). A consensus has to be built, step by step, on how to deal with this. However, to increase the efficiency of the Fund, a number of other reforms could be implemented that are as important as the QVR-issue. In these areas it is possible start moving forward at once.

Thank you.