Linah K Mohohlo: The challenges faced by developing countries in the current global environment, and how the IMF could be reformed to meet these countries' needs

Speech by Ms Linah K Mohohlo, Governor of the Bank of Botswana, at the 2007 Executive Directors' Retreat, International Monetary Fund, Washington DC, 20 June 2007.

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Managing Director, Mr de Rato
Deputy Managing Directors, Mr Kato & Mr Portugal
Distinguished Executive Directors, ladies and gentlemen,

It is an honour and privilege that I am in your company this evening. Equally important, I am most grateful that I have the opportunity to share some thoughts with you on the challenges faced by developing countries in the current global environment, and on how the International Monetary Fund could be reformed to meet these countries' needs. These subject matters are the core dimensions of your Retreat discussions and there should be consensus building emerging at the end of the Retreat.

Since these are broad topics, I can only briefly highlight a few points in view of the time constraint. I should also admit that although the topics have a global perspective, it is inevitable for me to draw on my African and Botswana's experience, where I continue to serve in a number of capacities. In sharing my views with you on these matters, I can assure you that none of my remarks are intended to be provocative. However, I am convinced that it is in the best interest of your deliberations that I express my perspective on the issues as candidly as possible.

Global economic trends

I consider the hallmark of my remarks to be opportune for several reasons. This is a time of almost unprecedented increase in global prosperity. World economic growth is not only rapid (estimated at 5.4 percent in 2006); it is also broad-based. In Sub-Saharan Africa, economic growth in 2006 was 5.5 percent, a trend which is forecast to continue through 2007 and 2008, and has, accordingly, given rise to optimism which borders on euphoria.

In fact, some commentators (non-economists presumably) have gone as far as to describe the current situation as a "perfect calm". While this expression or description may be more poetic than accurate, it, nevertheless, helps to draw attention to an important point, and that is, if "perfect calm" is a correct analogy for "anti-storm", then the favourable current conditions should be regarded as exceptional, which means that they will not continue indefinitely. For this reason, the International Monetary Fund and other concerned parties cannot afford to be complacent, for to do so is to ask for trouble. To paraphrase a recent piece by Larry Summers, this is a time when *a lack of fear* would be *cause for concern.*[1]

This is not the time, therefore, to argue that the international financial institutions have become obsolete. On the contrary; given what are commonly referred to as "global imbalances", global monetary stability has become even more uncertain, a situation which calls for the Fund to safeguard global stability now and into the future.

Moreover, the seemingly increased prosperity of many developing countries, although typically from very low levels, may tempt the advanced economies to drag their feet in implementing important previously promised initiatives, including the increase in aid to Africa

[1] L. Summers "A lack of fear is cause for concern". *Financial Times* 27 December, 2006.

by the G8 and pushing for a successful conclusion to the Doha Round of trade negotiations. Failure to fulfil these commitments energetically, and now, risks missing the opportunity afforded by the current favourable global economic conditions to sustain global prosperity. Worse still, it would undermine the very dynamic that underpins the current rapid pace of economic growth. In fact, a well known economist, Joseph Stiglitz, may have exaggerated the current global economic situation, when he described it as being *close* to having conditions where all countries, including the poorest, can benefit. It is my belief, however, that we are still far from achieving that desirable goal, despite the undeniable rapid speed of globalisation.

Globalisation and world trade

Speaking of globalisation, we are aware that, for the most part, it is driven by technological advances that have made diverse means of transport and communication increasingly cheaper. As a national of a developing country, I firmly believe that we should seek to take advantage of the many opportunities offered by globalisation rather than seek to avoid the accompanying challenges. I am convinced that the challenge is to improve levels of productivity as the key to rising living standards; this is a fundamental truth which I never tire to raise.

But how can we maintain this positive approach when so many larger and more developed economies are so wary of some of the effects of globalisation? The scope for avoiding the challenges of globalisation is almost non existent. Even bilateral and regional trade agreements may not be favourable to small developing countries such as Botswana with a population of only 1.8 million, given the world trading system that is increasingly becoming complex and competitive.

Globalisation also affects international financial markets, where the amounts traded are becoming larger and more diverse. You will recall that the Managing Director, Mr de Rato, underscored the point when he characterised these developments in his recent speech to the Bretton Woods Committee, as a “torrent of change”[2]. Faced with this torrent of change, the alternatives are either swimming or sinking, as drifting is not an option.

Changing balance of economic power

Related to the globalization process is the fact that, in recent times, the world has witnessed a change in the balance of economic power. Observers suggest that 50 years ago, 60 percent of global GDP had come from within the original G7 countries and the balance from the rest of the world; but now the situation has reversed. There is no doubt that this change is a challenge to the Bretton Woods institutions. For instance, it so happens that no advanced industrialised country has borrowed from the Fund for more than 20 years, and yet these countries tend to dominate decision-making. On the other hand, other members of the Fund expect the institution to deliver on its mandate fairly and equally to all the 185 members. It is in this context that there remains the legitimate expectation that, in time, there will be a reform of the voting system so that developing countries, a large number of which are in Africa, can be in a position to influence policy in a meaningful manner, both in the Fund and World Bank.

Indeed the role of China and other countries in its league, as major economic players in the world, has made it imperative and urgent to change the quota system. Hence the decision of the Fund’s Board of Governors to increase the voting power of China, Korea, Mexico and

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2 R. de Rato, “Steering a Course Through the Torrent of Change: Principles for Reform of the International Monetary Fund”. Speech to the Bretton Woods Committee, 12 June 2007.

Turkey. While this is a laudable decision, a lot more needs to be done on the Fund's quota system and, therefore, voting power, so that it can be reflective of the member countries' economic weight, while ensuring that the voice of low income countries can have a meaningful impact in decision-making.

Quota reform

While the Fund's Medium Term Strategy has several complementary elements, the centre piece is still the issue of quota and voice reform. It was heartening to see that some progress is being made as reported in the communiqué of the International Monetary and Financial Committee (IMFC) following the 2007 Spring meetings. Nevertheless, we have only heard fine statements of principle, and hardly any reports on concrete agreements. For instance, the quota and voice reform brief on the IMF website, currently states that "*Following the endorsement received in Singapore last September, IMF staff and the IMF Executive Board have looked at several of the key issues, many of which are complex and require careful deliberation and broad consultation".* This may be true, but it is hardly informative.

Of course, it is true that collective action requires consensus building and a "give and take" approach in order to make progress. But for quota reform, two salient points stand out. First, a situation where we rely on the current voting system to produce reform of itself in a manner that would be acceptable to all members, inevitably requires more giving than taking by those wielding more voting power due to their economic weight.

Second, the basic issues of quota reform, and the basis of their resolution, appear very straightforward to many of us. Continued delay can only risk a wider malaise. If I may quote again, a recent IMF working paper entitled "Rethinking The Governance of the International Monetary Fund" submitted that: "*a major revision of the quota formulas is long overdue, and leaving this unaddressed raises serious questions regarding the IMF's governance which could develop into a core mission risk and jeopardize the relevance of the institution"*[3]. For this reason, observers have called for meaningful progress such that the quota review can be completed in time for the 2007 Annual Meetings[4]. It is encouraging that the Fund's Managing Director has recently indicated that the Executive Board is earnestly working towards accelerating the quota review timetable. In this endeavour, it is legitimate to expect that the views of a diverse spectrum of interested parties will continue to be canvassed in order that an amicable consensus can be reached.

Role of the international financial institutions

I thought I should also comment on the role of the international financial institutions. Admittedly, there have been benefits derived from these institutions since the end of the Second World War. In particular, the contributions of the Fund, World Bank, World Trade Organisation and the OECD have been remarkable. It was inevitable that, over time, the Fund would change in many ways from its original role of policing a fixed exchange rate system among the major economies. In this regard, only a few weeks ago, the Independent Evaluation Office reported on Exchange Rate Surveillance for the period 1999-2005 and concluded, among others, that "*the IMF was simply not as effective as it needs to be in both its analysis and advice, and its dialogue with member countries"*[5]. This shows that, in this case, there is unanimity that there is need for change.

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[3] A. Mirakhor & I Zaidi (2006) "Rethinking the Governance of the International Monetary Fund" IMF Working Paper WP/06/273.

[4] R. Cooper & E. Truman E. (2007) "The IMF Quota Formula: Linchpin of Fund Reform".

[5] Independent Evaluation Office (2007), "IMF Exchange Rate Policy Advice, 1999-2005: An IEO Evaluation".

On a related matter, the Policy Support Instrument (PSI), which was introduced in October 2005, was in recognition of the fact that fewer countries need to borrow from the Fund. While it is acknowledged that one contributing factor to the reduced need for Fund lending is the extent of success of IMF programme implementation in the past, this reduced recourse to Fund resources should not lead to member countries ignoring the Fund's reform programmes and policy advice, because doing so would be counter-productive. I hasten to add that, although not a borrower of Fund resources for programme assistance, Botswana values her long-term partnership with the Fund. There is absolutely no doubt that Fund advice has largely been beneficial; so too has technical assistance.

However, in the advent of the PSI, we should ask whether it has moved far enough from the Poverty Reduction and Growth Facility (PRGF). Is there still too much prescription and not enough discussion? Is the Fund's endorsement of policies still so important for member countries, given the increased opportunities for funding provided by financial globalisation? And what are members to do when the assessments by the Fund and World Bank differ radically? It will be interesting to see the number of countries, if any, that have so far taken advantage of the programme, now that the PSI Fact Sheet is published on the IMF website.

Furthermore, the Fund needs to change its approach to surveillance and, accordingly, some important structures of the Fund, such as the IMFC, have suggested that surveillance needs to become more advisory than prescriptive. It is felt that such an approach would encourage country ownership of decisions resulting from IMF advice, and facilitate more timely publication of surveillance Reports, instead of the current protracted exchanges, in some cases, on the findings of Fund surveillance missions. This is not to suggest that there should be no scope for a more constructive dialogue, especially in areas where the difference between fact and perception is negligible. As it should be, the Managing Director espouses the view that the Fund must be trusted to give even-handed advice and fair representation to all its members. I need not emphasise that the role of the Executive Board is to ensure that this trust is earned and then maintained.

Governance

As I come to the end of my remarks, I would like to devote a few minutes to the related and equally important topical issue of governance, which is one of the principal themes of your Retreat.

You may be interested to note that, earlier this year, the Bank of Botswana hosted a two-day workshop for SADC Central Banks on Trends in Central Bank Governance, with technical input and assistance from the Central Bank of Sweden, Bank for International Settlements and the Fund. Unsurprisingly, it was found that there is diversity in the internal governance structures and procedures required to ensure good governance of an autonomous central bank, and it was further noted that consensus is yet to emerge regarding best practice in the conduct of a central bank in its relations with various stakeholders. Diversity was due to several factors, among which are historical and socio-political characteristics of a country. Nevertheless, there were common pillars that are a basis of good governance, namely, accountability, transparency and avoidance of conflict of interests by Boards and management.

Evidently, governance issues in the Fund are similar and equally challenging. It follows, therefore, that despite the diversity of the 185 member countries, the governance of the Fund must, of necessity, be based on these principles. You will agree that unless the Fund is seen to be managed according to the highest standards of good governance, which enshrine widely accepted notions of fairness and accountability in its operations and decision-making, including in staff appointments, then its relevance and objectivity will continue to be questioned.

The Executive Directors themselves do, of course, strive to be above reproach on this matter, and it is important to stress that, from the member countries' point of view, the buck of accountability stops with you, as you are effectively the guardians of this institution.

Unfortunately, recent events at the World Bank are not encouraging. While almost every independent commentator saw an excellent opportunity to reform the outdated system of choosing the leadership of the two Bretton Woods institutions, it was disheartening to note that the need for the reform of this practice was apparently not even on the agenda of those entrusted with such responsibility. This suggests that the United States of America has little inclination, if at all, of giving up its "traditional right" of appointing the President of the World Bank. Similarly, Europe appears disinclined to change with respect to its historical "entitlement" to appointing its national to the leadership of the Fund. Needless to add, such "traditions" or "rights" have no place in the governance of modern institutions. The selection process must, of necessity, be based on merit, certainly not on the current primary criterion of nationality. Even the British seem to have seen the light on this important matter with respect to appointments to the House of Lords, which used to be based more on heredity.

It is my sincere hope, therefore, that as you continue your deliberations tomorrow, this Retreat will explore new and innovative ways for the Board to effect appropriate changes to its governance practices, in the interest of all stakeholders. One of those changes, as many member countries have submitted, should be the policy or practice of selecting and appointing the leadership of both the World Bank and the Fund. In addition, there is implementation of the main elements of the Medium Term Strategy, with emphasis on quota and voice as well as surveillance reform.

We all look forward to reaching the goal of an increasingly assertive International Monetary Fund based on its relevance. Such relevance to developing and developed countries alike must be earned through good governance in all its manifestations.

Distinguished members of the high echelons of the Fund, with these words, it only remains for me to wish you success in your collective endeavours to advance the course of this great institution. I wish you fruitful deliberations in your Retreat.

Thank you for your attention.