International Monetary and Financial Committee

Twentieth Meeting
October 4, 2009

Statement by Hans-Rudolf Merz
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On behalf of Azerbaijan, Switzerland, Kyrgyz Republic, Poland, Serbia, Tajikistan, Turkmenistan, Uzbekistan

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I. Introduction

The global economic downturn seems to be bottoming out, and the outlook is markedly more encouraging than in the spring. Large-scale liquidity injections by central banks, substantial fiscal stimulus packages, as well as unprecedented government support for financial institutions over the past year have diminished systemic risks. However, the process of financial sector and household deleveraging has yet to run its full course. Any recovery from the current global recession will likely be protracted. Subdued consumer demand and trade, as well as limited credit availability, are holding back economic activity in many countries. While macroeconomic policies should remain supportive, the timing for the unwinding of public support measures will be crucial and delicate.

The Fund has responded flexibly and effectively to the challenges posed by the crisis. It has deployed the full range of its instruments, and has substantially adapted both the capacity and the framework for lending. The commitment by the international community to significantly increase the Fund's resources, including resources for the NAB and for low-income countries, and the agreement to allocate Special Drawing Rights to the membership is clearly a vote of confidence for the institution.

As the systemic threat is receding, the Fund must again look beyond its role in a crisis environment. It is well placed to draw lessons for policy, including where enhanced cooperation among members is needed. In order to enhance global financial stability, I consider close partnerships with other international fora with a stability mandate as equally essential. I believe that, in addition to the envisaged stronger integration of financial sector issues into surveillance, a clearer mandate for the IMF on financial flows and the capital account is needed. Also, the Fund should return rapidly to a significantly lower lending volume, once the circumstances allow. At the same time, I do not believe that the IMF lacks legitimacy. The Fund‘s institutional framework continues to serve the membership well, allowing for the broadest possible representation and legitimate decision-making.

II. Global Outlook and Policy Challenges

Supporting the nascent recovery

I am confident that after the sharp and concurrent downturn, the world economy is on its way to recovery. Global growth is supported by the strong performance of the Asian economies and the more modest expansions elsewhere. This reflects a rebound in manufacturing, a turn in the inventory cycle, and stabilizing consumer confidence. However, economic activity still remains far below pre-crisis levels. I also expect potential growth rates to remain lower than before the crisis for an extended period of time. I hope that the countries in our constituency rapidly overcome the adverse economic shocks that have affected them in various degrees. These stem from trade disruptions, lower remittances, volatile commodity prices, as well as more difficult bank refinancing and higher sovereign risk premia. With growth still depending on policy support, scaling back accommodative monetary and fiscal policies will need to proceed cautiously so as not to stall the fragile recovery. We should, however, also me mindful not to crowd out private activity. The global economy still seems vulnerable to a range of shocks.

There are nevertheless welcome signs that confidence might be returning faster than expected. I am encouraged by the upward adjustment of the Fund's growth projections, including for the countries in our constituency. At the same time, systemic risks in the financial sector have substantially declined in tandem with a more optimistic outlook for global financial markets. The threat of system-endangering adverse effects between the real and the financial sectors has clearly receded.

I welcome the progress made under the umbrella of the Financial Stability Board in pursuit of a comprehensive, yet pragmatic, reform agenda for strengthening oversight over global finance. The Fund's diagnosis and policy priorities in the World Economic Outlook (WEO) and the Global Financial Stability Report (GFSR) are consistent with the thrust of these regulatory initiatives. I emphasize that in striving for enhanced international coordination to mitigate economic downturns and systemic risks, effective supervision at the national level remains indispensable. Switzerland was at the forefront in developing and introducing improvements in the regulatory framework that are now being implemented internationally. It opted for the early implementation of measures in support of systemic stability, despite concerns over possible competitive disadvantages.

Unwinding public interventions

A well-timed exit from loose monetary conditions and unconventional monetary policies is important for containing the build-up of excessive inflationary pressure. High fiscal deficits and the increase in public debt levels in many advanced economies call for the formulation of credible strategies for safeguarding long-term fiscal sustainability. Strong fiscal policy frameworks, underpinned by binding fiscal rules, would be helpful in this respect. Long-term fiscal pressures from population ageing and health-related services need to be accounted for in a transparent way. These costs by far exceed the cost of current crisis-related outlays in many countries.

I strongly favor terminating public involvement in the financial sector as soon as market conditions permit. The decisive measures taken by the Swiss authorities in dealing with impaired assets and in recapitalizing one of its global banks have been successful. Public guarantees have been pledged widely during the crisis. Public financing capacities would come under severe stress if such contingent liabilities were to materialize. Strengthened regulatory frameworks that ensure adequate capital and liquidity buffers and foster the private recapitalization of banks should accelerate a phasing-out of such guarantees. Similarly, deposit insurance schemes should be redesigned to raise significant amounts upfront, while limiting insurance to levels commensurate with available funding.

International cooperation regarding the unwinding of public interventions in the financial sector should focus on areas where incentives to exit remain weak and the risk of protectionism is strong. It should ensure that no market disruptions are triggered by the withdrawal of public support, and that this does not give rise to competitive distortions. I call on the Fund to monitor the progress of its members in scaling back public support.

III. IMF Policies and Reforms in Response to the Crisis

Providing global liquidity

In the wake of the severe global recession, many countries had to deal with shortages in foreign exchange liquidity, which threatened to further hamper trade and international financial transactions. The general allocation of SDRs has provided such liquidity on a global scale. I also welcome the entry into force of the Fourth Amendment of the Articles of Agreement adopted in 1997, which resolves an issue of inequitable treatment by allocating USD 21.5 billion SDRs selectively to members that joined the Fund after 1981.

Given the unprecedented size of the SDR allocation, the Fund’s advice to members is essential in mitigating any related macroeconomic and stability risks. In my view, the SDR allocation should not substitute for the Fund’s program lending and it must respect the constraints many members face regarding debt sustainability. The use of SDRs will also have to be fully accounted for in debt sustainability analyses. The currently very low interest rates for servicing the use of SDRs will not persist over the medium-term.

Furthermore, adequate mechanisms for smoothly assimilating potentially sizable SDR transactions must be in place. I welcome the progress made in augmenting voluntary trading arrangements and expanding the group of participating countries. The bilateral trading agreement with Switzerland has already been adjusted accordingly. Although the designation mechanism appears to be robust even in the face of large additional SDR transactions volume, it should be augmented significantly and include more countries.

Mobilizing additional lending resources

The Fund has substantially increased its lending capacity and reformed the framework that guides its general resource lending. This is a central element in the response of the international community to the crisis, and has been instrumental in mitigating its effects on the broader membership. It should, however, also be emphasized that the expansion in lending resources, the increase in the average size of Fund arrangements, and more focused conditionality have increased financial risks for the Fund. It is imperative that these risks be accounted for by adequate safeguards, including a rapid accumulation of reserves. This is particularly relevant given the large-scale financing with ex-ante conditionality provided by the newly established FCL.

Bilateral borrowing is an interim solution for rapidly augmenting lending resources. Our constituency is contributing substantially, and Switzerland has committed to enter into a borrowing agreement for up to USD 10 billion. I agree that the sums pledged under bilateral agreements and note purchases, as temporary supplementary resources, may be transferred to a revised New Arrangement to Borrow (NAB). This arrangement should remain the primary backstop for extraordinary Fund lending in case of extreme events. Broad participation and an equitable burden sharing in an amended NAB will be critical.

I agree that the Fund's lending capacity under its concessional facilities for low-income countries should broadly keep pace with the augmentation in general resources, particularly in the current crisis. However, relying on internal Fund resources for financing increased concessional lending is inadequate. Bilateral contributions are clearly the most appropriate and transparent source of funding. The use of the proceeds of the sale of Fund gold reserves for this purpose weakens the balance sheet of the Fund, and in my view contradicts the objectives of strengthening the Fund's income base.

Adjusting the lending framework for low-income countries

The Fund continues to offer concessional financing to low-income members in accordance with its mandate. Such balance of payments support should catalyze donor support and must not substitute or compete with lending from development banks. I have supported the reform of the concessional lending framework that streamlines existing instruments, program design, and financing modalities.

I have agreed to the suspension of all interest payments on concessional lending through end-2011. It reflects the need to avoid additional fiscal retrenchment due to the crisis. However, I consider it important to maintain the link between the level of interest charged for low-income facilities with the SDR interest rate. It provides for an appropriate eventual upward adjustment of these charges while keeping the level of concessionality stable.

Switzerland consents to the comprehensive reforms of the lending framework for low-income countries and continues to provide substantial subsidy and loan resources. I note, however, that the criteria for eligibility for concessional financing remain to be clarified. I strongly believe that the Fund's finite subsidy resources should go to those members most in need. The Executive Board should thus regularly review eligibility in order to better target these resources. Also, we should keep in mind the final goal of a the Poverty Reduction and Growth Trust that finances credit to low-income members on a self-sustained – albeit lower – level.

Improving the surveillance process

I urge all members to commit to regular policy reviews, which I view as an essential responsibility of membership. I realize that enhancing the effectiveness and "traction" of Fund surveillance remains challenging, but I am convinced that high-quality assessments and persuasive argumentation are a necessary condition to achieve this. In this respect, the Executive Board remains the appropriate forum for peer review.

The Fund, together with the FSB, has made substantial progress in assessing systemic vulnerabilities. I welcome the development of the EWE as an integral part of IMF multilateral surveillance. I expect that this process will harness the strengths of both institutions in flagging risks that, while being somewhat remote, would put extreme stress on the global financial system. The good collaboration with the FSB that takes advantage of complementarities and avoids duplication of work is essential.

A clear understanding about roles, responsibilities, and the use of instruments between the Fund and the FSB is also essential with regard to assessments of financial stability and international standards. I see merit in introducing a risk-oriented approach in conducting updates for all main standards. I welcome the envisaged more flexible framework for the Financial Sector Assessment Program (FSAP). This should serve the important goal to better integrate financial sector and macroeconomic surveillance. Ideally, a core financial stability component should be integral part of Article IV consultations

Revisiting Fund governance

An essential characteristic of the Fund is its framework for effective decision-making within a clearly defined setup of constituencies. Its response to the global crisis has been rapid and flexible. While other venues usefully support political consensus building, especially in a crisis situation, they cannot substitute for the assurances that the Fund's institutional arrangements and mandate confer, in particular for smaller members. I consider that the Executive Board in it is current form ensures a good trade-off between inclusiveness and effective functioning, as would even be a moderately larger Board. Legitimacy commands adequate representation of a membership that has increased significantly over the years. In order to preserve and build on these strengths, I clearly favor pragmatic reforms rather than fundamental modifications of the institutional framework.

As part of such reforms, the IMFC should be strengthened. This would allow it to give clearer guidance to the Fund. An enhanced Deputies process will be critical to this end. Deputies should be more involved in the preparation of the IMFC's agenda, meet more frequently, and determine the main elements of the communiqué. Also, I agree to improve the oversight functions of the Executive Board. I also support a selection process for Fund Management that is open, transparent, and merit-based. With respect to the selection of the Managing Director, the progress achieved in 2007 should be formalized. I consider the workplan by the Executive Board Working Group on IMF Corporate Governance as a suitable roadmap for follow-up on many of these issues.

The Fund remains a quota-based institution, which is to be reflected in the upcoming Fourteenth General Review of Quotas. The size of a quota increase must be based on the assessment of the long-term need for Fund liquidity. I can agree to the overall distribution objective to bring the quota-based representation at the Fund better in line with members' calculated quotas. Such adjustments in favor of the most underrepresented members should be rules-based and transparent. In addition, I consider it necessary for the Fund's effectiveness that a member's ability and willingness to finance the Fund's activities is adequately reflected its voice and representation. Members' quotas should also reflect the openness and systemic importance of their financial sectors. The swift ratification of the 2008 quota reform is essential for credibly pursuing additional quota and voice reforms.

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