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On behalf of Azerbaijan, Switzerland, Kyrgyz Republic, Poland, Serbia, Tajikistan, Turkmenistan, Uzbekistan

Statement by the Honorable Hans-Rudolf Merz, Minister of Finance of Switzerland Speaking on behalf of Azerbaijan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan
International Monetary Financial Committee (IMFC), April 24, 2010

I. Global Prospects and Policy Challenges

Recovery is proceeding faster than expected—but risks remain

I am very glad to note that the global recovery is proceeding better than expected, albeit at differing speeds.

As the recovery gains momentum, risks to economic and financial stability emanating from the financial system have eased somewhat, but a new source of concern is emerging: sovereign risk in some advanced economies, as well portrayed in the WEO, the GFSR, and the Early Warning Exercise. Fiscal stimulus measures, which provided major support in response to the deep downturn, and the slump in economic activity are pushing fiscal balances in advanced economies into deep deficit and sovereign debt ratios to historic highs. Vulnerabilities now increasingly emanate from concerns over the sustainability of sovereigns' balance sheets, at a time when economic activity is still dependent on highly expansionary macroeconomic policies. The key concerns in this context are that sovereign debt refinancing problems might become acute before private sector demand generates growth, and that room for policy manoeuvres to deal with new shocks might be largely exhausted in many advanced economies.

Some emerging economies are starting to face inflationary risks. Rapid growth in emerging economies, expectations of appreciating currencies, ample liquidity and historically low interest rates in the major advanced economies, as well as a returning appetite for risk have led to a strong rebound of cross-border capital flows from advanced to emerging economies, especially in Asia and Latin America. In some cases, these inflows have led to concerns about the potential for inflationary pressures and asset price bubbles, which could compromise monetary and financial stability. Current conditions warrant close monitoring an early policy action in order not to compromise macroeconomic stability.

Policies need to strengthen recovery by addressing longer term challenges

Many advanced economies need to assign top priority to exiting from fiscal stimulus measures. They need to urgently design and communicate credible medium-term fiscal consolidation strategies, including clear timeframes to bring down debt-to-GDP levels. Given the still fragile recovery, it is, however, in many cases too early to start withdrawing fiscal stimulus. If macroeconomic developments proceed as expected, most advanced economies should then embark on fiscal consolidation in 2011. Together with the announcement of credible medium-term strategies geared toward the reduction of debt levels, fiscal consolidation will improve confidence, thereby enhancing the recovery of economic activity. In this context, I would like to emphasize the importance of credible fiscal frameworks that can help deal both with cyclical events and longer-term pressure from population ageing.

Progress with financial sector reform is another key priority. The regulation of banks has to be fundamentally reviewed and recalibrated. Capital requirements and liquidity rules should be—and for the case of Switzerland: are being—tightened. Systemic vulnerabilities emanating from institutions perceived to be "too-big-to-fail" (TBTF) need to be reduced. The introduction of a financial sector levy would not normally lead to the desired results in terms of financial stability. I believe a reduction of systemic vulnerabilities can be more effectively achieved by the following measures. First, the size of systemically relevant institutions has to be addressed, for instance, by increasing capital requirements as the size of the institution rises, giving incentives to banks to limit their size. Second, banks should be organized in ways that will allow continuation of certain activities in case of a crisis without forcing the government to rescue the entire bank. Third, a well defined and internationally coordinated way to wind down global financial institutions should be found. Given the complexity of the task and different interests of the countries involved, I consider that the harmonization of national wind-down rules is a precondition for effective international coordination.

Monetary policy should be normalized gradually, focusing on ensuring price stability over the longer term. The combination of very low interest rates (and a large increase in the monetary base) and a nascent economic recovery may already be inconsistent with the longer-term objective of price stability, especially when potential output has decreased as a result of the crisis. It is crucial to ensure that monetary policy does not fall behind the curve, lest inflation expectations could increase rapidly and endanger the fragile recovery.

II. IMF Reforms in Response to the Crisis

Updating the Mandate

I am persuaded that the Fund's core mandate should be focused on effective crisis prevention in normal times; crisis-lending should only complement this role. Changes in the Fund's policies and procedures must build on its particular institutional strengths, expertise, and comparative advantages, while also affirming a sensible division of labor and cooperation with other international bodies. Further policy refinements should thus focus on strengthening bilateral, multilateral, and financial sector surveillance, rather than on expanding the Fund's lending toolkit.

The bilateral surveillance process with members should be preserved and its regular character maintained and clarified. Bilateral surveillance enables the Fund to assess each country's policy implementation and to be a valuable advisor to member authorities. It is also through regular consultations with each member that the Fund has the biggest impact on members' policies and sets itself apart from other international financial institutions. Proposals to strengthen the legal framework of Article IV consultations are thus welcome. It is a general concern that surveillance has not enough traction in member countries. To rectify this problem, countries should clearly commit to fulfilling their membership obligations.

I welcome the IMF staff's intention to buttress multilateral surveillance, including by initiating ad-hoc multilateral consultations on special topics and through spillover reports, which should be of particular interest to the membership. In my view, greater Board involvement than in similar past exercises will be crucial for making ad-hoc multilateral consultations successful. Board involvement would bestow the broadest possible legitimacy on the process, while allowing the selected participants in the consultations to present their views. A multilateral surveillance decision could be helpful to implement the envisaged improvements.

I strongly endorse strengthening financial sector surveillance. I am ready to support the adjustments in resources, organization, and operations that will enhance the coverage of financial sector issues throughout the Fund. In particular, I support making FSAP stability modules a mandatory part of surveillance.

I see no need to fundamentally alter the Fund's lending toolkit. The Fund fulfills a crucial role in the international financial safety net by facilitating members' adjustment to shocks through the agreement on sound macroeconomic frameworks, supported by temporary financing. It is this particular role that serves the authorities best, and that provides other international financial institutions, financial market participants, and donors with clear indications when making their own decisions on engaging with a country. I do not believe that the Fund should depart from this traditional role.

Increasing Quotas

I acknowledge that an increase in IMF quotas is warranted. The volume of quotas should be determined in relation to the level of likely future demand for Fund resources under "normal" circumstances. A reasonably good and straightforward indicator of such demand is global GDP. Global GDP has roughly doubled since 1998 when the last quota increase occurred. In exceptional crisis situations like the one recently experienced, the Fund can resort to borrowed resources, be they bilateral or preferably multilateral through the expanded and enlarged NAB. I am of the view that even in case of a significant quota increase, the NAB will still be needed; it should remain a backstop for times of exceptional need.

Governance Reforms I: Realigning Quota Shares

I am committed to the January 2011 deadline for completion of the 14th General Review of Quotas. In particular, I support the redistribution of quota share from over-represented to under-represented countries, based on the calculated quota share, using the 2008 formula. This objective can be best achieved with a selective allocation of a quota increase in combination with ad-hoc increases for the poorest members, to protect their voting shares. The poorest members I understand to be those eligible for IDA financing.

I consider it very important that the discussion on realigning quota shares takes account of the member's contributions to those Fund activities that are financed bilaterally and voluntarily. Such voluntary contributions to the Fund's activities—as a trustee or provider of technical assistance, and in underwriting the Fund's financial safety net—are politically difficult to obtain, justify, and maintain. As such, they are a tangible expression of the ability and willingness to provide support to the benefit of all members, supporting the Fund in fulfilling its mandate.

I urge all members that have not already done so to ratify the 2008 quota reforms without delay.

Governance Reforms II: Strengthening the IMFC

I support a prudent and adaptive approach to governance reforms. This constituency has consistently advocated pragmatic improvements in the Fund's governance arrangements, improvements that preserve the particular strengths of the institution. Among these strengths, the well-established formal decision making framework stands out. These strengths have allowed the Fund to be extraordinarily adaptive in its policies over the past years and they have been conducive to an effective crisis response by the Fund. They should be preserved.

I welcome the proposals to reinforce the IMFC process. These proposals aim at enhancing the clout of the IMFC in providing strategic guidance to the Board. These goals can be achieved if all stages in the process are strengthened and made more transparent. The IMFC Deputies should play a more prominent role in preparing the agenda. While I support the idea for more outreach in setting the IMFC agenda, such outreach seems to be more inclusive if conducted through the Deputies rather than through a "troika" leadership model. The Deputies should discuss the IMFC communiqué at an early stage and approve it, with controversial points left bracketed for decision by the IMFC. More formalized procedures would also be desirable with regard to the appointment and (fixed) term of the IMFC Chairman. Finally, a dedicated IMFC Secretariat—for instance, within the IMF's Secretary's Department—should be charged with preparing meetings and coordinating inputs. This Secretariat should manage the agenda setting process, in consultation with the Executive Board.

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