International Monetary and Financial Committee

Fourteenth Meeting
September 17, 2006

Statement by Hans-Rudolf Merz
Minister of Finance, Switzerland
On behalf of Azerbaijan, Kyrgyz Republic, Poland, Serbia, Switzerland, 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

IMFC Meeting, September 17, Singapore

1. Introduction

The environment for the global economy and for financial markets continues to be very favorable, supported by strong overall growth and low inflation. With the build-up of substantial reserves in many emerging market countries, the Fund's volume of credit outstanding has reached historic lows.

I consider this diminished need for lending as positive. I would argue that this is an appropriate moment to rethink and refocus the role of the Fund to better equip it for the future. In particular, we should ensure that the Fund (i) has the right instruments at hand to promote international monetary cooperation and to safeguard global financial stability, (ii) can appropriately respond to members' needs, and (iii) has sufficient reserves to remain a strong anchor for the global financial system. It is crucial that we take advantage of the opportunity for strengthening the Fund that the benign global economic situation offers us.

Advancing the implementation of the IMF's medium-term strategy is the focus of this year's Annual Meeting. One important component is the adaptation of the IMF's surveillance to today's globalized world and the increased importance of financial markets. The other key element is the Resolution on Quotas and Voice Reform, which strives to balance the concerns of the entire membership. Both these elements are important for the legitimacy and credibility of the Fund. I have supported the Resolution on Quotas and Voice Reform, and I am encouraged by the willingness of all involved to compromise in order to advance our joint interest.

2. The world economy and global financial markets

It is very welcome to see global economic growth exceeding expectations, with all regions contributing to the global expansion. Among the large industrialized countries, growth was particularly strong in the United States. The prospects for a smooth adjustment to a higher interest rate environment seem to be good. As for Europe, the euro area has recently surprised with strong GDP growth rates, and growth is also strong in Switzerland. It remains to be seen whether this European upswing will translate into a sustained expansion that, in turn, would provide further room to address structural problems. In Japan, monetary conditions are still very accommodative. Restoring fiscal sustainability remains the key medium-term policy challenge.

The favorable development of emerging market economies is particularly noteworthy. They have continued to take advantage of improved access to international capital markets, and have weathered financial market turbulences earlier this year. Growth in Asia is strong and vibrant. China's economic performance continues to impress. Nonetheless, domestic reforms seem ever more urgent, particularly with regard to the soundness of the financial sector. Economic activity has picked-up in Latin America and in the Middle East, reflecting to a large extent rising revenue from fuel and non-fuel commodity exports. I would caution, however, that these sources of income may not be stable. Current revenue windfalls should therefore be saved or invested to support future growth in non-commodity sectors. Emerging Europe has robust growth driven by domestic demand and a significant increase in productivity. The region's generally large current account deficits, however, give rise to external vulnerabilities which should be addressed by structural and fiscal policies. This and the positive impact of EU-membership on economic performance should encourage the new member states to strive for expeditious euro adoption. I am especially pleased to note the strong growth performance of the CIS countries. Important challenges remain, of course, both with regard to strengthening institutions as well as macroeconomic and structural policies. Growth in Sub-Saharan Africa is strengthening, though it is below expectations and still significantly below the rate needed to achieve the Millennium Development Goals.

Globally, increased inflationary pressure, tighter conditions in financial markets, higher energy prices and persistently large imbalances all point to increased risks to the favorable picture. While the most likely scenario remains a gradual adjustment, I am nonetheless concerned about the potential for a disorderly unwinding of global imbalances that could entail a sharp drop in the U.S. dollar and a significant increase in U.S. interest rates. Such a scenario would doubtlessly impact financial markets and overall financial stability. On the upside, it is encouraging to note that the international financial system is currently supported by strong corporate balance sheets and profitability, and healthy financial institutions. I am convinced that private capital flows are also a source of resilience for global financial markets. Overall, however, I see no reason for being complacent as we must remain aware of the uncertainties ahead.

3. Implementing the IMF's medium-term strategy

It is in this environment that the IMF is called on to preserve and strengthen international economic and financial openness and stability. Supporting a gradual adjustment of global imbalances is now the primary challenge for member countries' authorities. The IMF must present and discuss these policy challenges and divergent developments with the necessary candor. It should continue to provide its expertise for cross-country analysis, for fostering public awareness, and for proposing appropriate policy measures. Moreover, more intensive trade and financial linkages call for strong institutions that are capable of pursuing the common good while being responsive to its members' needs. The medium-term strategy for reforming the Fund aims at precisely this. It is a broad and ambitious agenda that will require further efforts to implement. I will comment on some of this elements.

Policy advice and cooperation

Regarding multilateral surveillance, given today's global economic linkages and the challenges they entail for policy, it is crucial to have fora for a frank exchange of views among country authorities. For this purpose, the newly established multilateral consultations can help to overcome collective action problems that may hamper globally optimal policy responses. I am looking forward to a progress report and hope for a tangible outcome of the current first round of this new type of consultations. However, the Executive Board must be an integral part of these consultations, including with regard to the choice of topics. These consultations should entail a regular, informed debate in the Executive Board. The confidentiality of these ongoing consultations should not crowd out a frank discussion of the respective issues in the World Economic Outlook and the IMFC. This will be important to ensure the necessary ownership at the political level.

With regard to bilateral surveillance, it is clear that exchange rates must have their place in surveillance. The world has changed since 1977. Accordingly, I agree that it is opportune to review the 1977 Surveillance Decision on exchange rates. However, while discussions of exchange rates policy are integral to surveillance, assessments should make clear that the Fund is not all-knowing about the levels of exchange rates. I also fully endorse a strong focus on the financial sector and its related systemic risks, which namely includes the FSAP-process. Switzerland was an early participant in this initiative and will complete an FSAP-update in the current Article IV-cycle. More generally, I welcome putting the Fund at the forefront of financial sector coverage in macroeconomic analysis. In this light, the establishment of the new Monetary and Capital Markets Department as a center of excellence is the right approach. It is my hope that this will allow to better integrate financial market issues into Fund advice.

For crisis prevention, the IMF should have a clear focus on financial and capital market issues in the surveillance of emerging economies. Although I remain skeptical about the benefits of high access financing, I am ready to further examine a new liquidity instrument that could give countries with strong policies assurances against vulnerabilities related to international financial market linkages. In this respect, strong safeguards in terms of access criteria – namely debt sustainability – and an overall ceiling as well as monitoring procedures would need to be in place to safeguard the Fund's resources.

In its poorest member countries, the IMF is advancing the initiatives for Heavily Indebted Poor Countries and Multilateral Debt Relief. It should now be the Fund's primary objective to ensure that the beneficiaries of debt relief do not again accumulate excessive debt. These countries must have a macroeconomic framework in place that is consistent with aid flows. They should pursue economic policies that support growth and poverty reduction. This will be critical to achieving the Millennium Development Goals. Cooperation with the World Bank and with other development partners will also be important to this end. I also hope that the external review of Fund-Bank collaboration currently under way will lead to a clearer division of labor that better reflects the key mandate of the two institutions.

Legitimacy and governance

A well balanced participation in the decision-making of the Fund is important for the legitimacy and the effective functioning of the institution. It is in this spirit that I support the two-stage approach as set out in the Resolution on Quotas and Voice Reform. Allowing for an immediate ad hoc quota increase for China, Korea, Mexico, and Turkey – which are currently most underrepresented – is a significant first step.

Reaching agreement on a new quota formula will be central to the second phase of the reform package. This new formula should reflect the Fund's mandate and the role of its members in the international economic and financial system. It would thus reflect their ability to contribute resources in case of a financial crisis with global repercussions. Specifically, a new quota formula should account for the spectacular increase in capital flows and financial globalization over the last three decades. Consequently, it will have to include a country's relative importance in global capital markets. The formula discussion should thus give renewed consideration to financial openness and, more specifically, the inclusion of the international investment position of member countries.

I reiterate my support for an increase in basic votes as part of a well-balanced agreement to be reached within the next two years. The concrete size of the envisaged increase and the suggested mechanism to preserve the shares of basic votes in the future will need to be determined in light of the new quota formula. Also, a second ad-hoc increase in quotas would need to address misalignments that are significant as determined by a new formula. Beyond the second stage of reforms, general quota increases should continue to be guided by the Fund's liquidity needs. This fundamental requirement should be met when further realignments are envisaged.

There is no legitimacy without accountability. While I recognize the need for confidentiality in certain circumstances, the Fund should continue to be as transparent as possible about its policies and its activities. In this regard, continued thought should be given to strengthening the Executive Board and the IMFC, as well as the selection process for the Fund's management.

The Independent Evaluation Office (IEO) contributes significantly to the good governance of the IMF. It supports the Fund as a learning institution that is able to reflect on the outcome of its work. The IEO's evaluations to date have rightly been outspoken about the strength and weakness of Fund policies and procedures and have put forward valuable recommendations. I welcome the fact that this year the IEO itself has been subjected to an external assessment and look forward to the implementation of the review proposals. This will further enhance the credibility, relevance, and voice of the IEO.

Fund Finances

Adequate reserves and liquidity, as well as policies that safeguard the financial integrity of the IMF as an institution, are indispensable. This is the basis needed for the IMF to fulfill its stabilizing role at the center of the international monetary system. I therefore support the reform steps that strengthen the IMF's financial soundness. These will ultimately also raise its clout and effectiveness. In this sense, the introduction of a medium-term budgetary framework is an important contribution, as it better allows a strategic evaluation of options. I also welcome the fact that the medium-term strategy is to be implemented in a budget-neutral way. While I agree that any streamlining of operations should be driven by strategic choices, the current pressure on the income side is a stark reminder that a sustainable financial position cannot be achieved without measures on the expenditure side.

Looking further ahead, there is a pressing need to put the Fund's finances on a sounder footing. The establishment of an investment account is welcome, but it will not be sufficient to make up shortfalls in the absence of members drawing on the Fund. I am looking forward to proposals of the Committee of Eminent Persons on the options for the Fund's long-term financing.

4. In Conclusion

In fulfilling its broad mandate for promoting growth and maintaining international financial stability, the Fund has neither lost its relevance nor its attractiveness for its near universal membership. In this context, I would like to call on the members of the IMF to give the formal application of Montenegro their approval and to support a rapid accession of this new sovereign state.