Statement by Jean-Pierre Roth
Minister of Finance, Switzerland

On behalf of Azerbaijan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, Uzbekistan
I. Introductory Remarks

The global economy faces its most difficult period in decades as the turmoil engulfing financial markets and institutions has intensified. The deep crisis of confidence in financial markets, which has triggered large-scale public interventions, represents extraordinary challenges for macroeconomic and regulatory policies. An adequate and internationally well-coordinated response to these challenges is more important than ever, and I expect the IMF to be instrumental to such efforts. These should aim at mitigating the short-term impact of the current turmoil, while ensuring that the right lessons are learned for the global financial system to function more smoothly and consistently in the future. To this end, the Fund must work closely with other international fora and the Financial Stability Forum (FSF) in particular.

In order for the Fund to play its key role in enhancing the stability of the global monetary and financial system going forward, it needs to assess whether the instruments at its disposal remain appropriate and effective. I encourage the implementation of the Managing Director’s strategic initiatives. In particular, more clarity on the main thrust of Fund surveillance over the medium-term is welcome, and I endorse the new Statement of Surveillance Priorities. This will support the necessary stronger focus on the linkages between the financial sector and the real economy as well as on cross-border vulnerabilities in Fund surveillance. I also welcome the start of a comprehensive review of the Fund’s lending framework, which should result in a streamlined and more coherent set of credit arrangements available to members. I support the amendments to the Exogenous Shocks Facility to allow more rapid and up-front balance of payments support for low-income countries.

While the Fund has taken significant strides in enhancing voice and representation, important institutional reforms remain to be taken forward. I am looking forward to the further work on improving the Fund’s governance, based on the recommendations of the recent report by the Independent Evaluation Office (IEO). I am confident that this work will be conducive to pragmatic improvements and I welcome that the Executive Board has already responded to the IEO report with a comprehensive work plan. On the financing of the Fund, it is important that the new income model be finalized in due course. I thus call on members to ratify the Resolution allowing the broadening of the Fund’s investment authority and I trust that all members will formally consent to gold sales in the near future. While ongoing internal
Restructuring is necessary to modernize the Fund, it is essential that the institution remain an attractive employer for its highly-skilled and diverse body of staff.

II. Economic and Financial Market Developments

Financial sector deleveraging weighing on growth prospects

A cascade of adverse financial market developments since the beginning of this year has affected advanced and developing countries alike. Prospects for a further significant reduction of the size of financial institutions’ balance sheets foreshadow a painful restructuring in the financial sector. This process of deleveraging is likely to be protracted and to hold back global growth for longer than initially expected. There are large unknowns about the linkages between financial markets and the real economy and the persistence of the shocks. The dynamism of emerging markets will also slow, while inflation pressure in many of these countries will be particularly pronounced. For the remainder of 2008 and into 2009, I expect a few quarters with almost no growth in advanced economies. A weakening European economy will lead to a – possibly substantial – decline of exports from Switzerland, negatively affecting the growth outlook for the Swiss economy. At the same time, there is no evidence of credit supply constraints, despite the fact that the investment business of the two large Swiss banks has not escaped the global credit crisis. Other banks did not experience direct effects of the financial turmoil and the Swiss property market and the economy overall are in sound condition.

Policy responses and scope for cooperation

Unprecedented systemic challenges have prompted unprecedented government measures in the US as well as in Europe. Assessing recent government interventions, in terms of effectiveness, costs and longer-term implications will likely require some time. I generally believe that crisis containment measures that shift liabilities from the financial sector to the public balance sheet should be accompanied by a credible exit strategy, as well as by measures to prevent future disruptions. Care also needs to be taken that the incentive structures are adequate.

It must be a priority for the Fund, in close cooperation with the FSF and others, to assess the implications of the crisis beyond the short-term. Lessons can be drawn in order to be able to better detect and reduce systemic vulnerabilities early on, including on the design of regulatory and supervisory frameworks. These efforts should also address how distorted incentives and moral hazard can be mitigated and how accounting and disclosure can promote efficient market pricing. I favor a pragmatic strengthening of the regulatory framework for financial markets that builds on the joint work in progress on the international level. The comprehensive set of recommendations put forward by the FSF in its Report on Enhancing Market and Institutional Resilience provides the appropriate reference. I see a role for the Fund in monitoring the implementation of these recommendations in member countries. I expect the private sector to undertake commensurate efforts to strengthen the
financial system and I encourage the financial industry to implement the recommendations outlined in the report by the IIF Committee on Market Best Practices in a timely manner.

One of the central conclusions from the ongoing market disruptions is the need to increase capital and liquidity buffers for banks. Such a strengthening of buffers would need to be well-coordinated, especially among home regulators of internationally active banks. The Swiss supervisory authorities are considering an increase in the capital requirements under pillar two of the Basel II framework for the two global banks. There is also a discussion on the merits of the introduction of a leverage ratio as a supplementary measure to address procyclicality problems. Overall, it seems very reasonable to base banks’ solvency and liquidity regimes on a set of variables, not a single statistical measure. Switzerland has been at the forefront of cooperation on cross-border vulnerabilities and crisis response: the Swiss supervisory authorities have in place a tripartite arrangement for cooperation with their U.S. and UK counterparts; the Swiss National Bank has, with a number of other central banks, taken coordinated measures designed to address the pressures in U.S. dollar short-term funding markets and, more recently, to ease global monetary conditions.

Regarding the implications of sovereign wealth funds (SWF) for global financial stability, I take comfort from the fact that SWFs have to a large extent supported the recapitalization of global banks in the past year. They have thus proved to be a stabilizing rather than disruptive force for financial markets. I welcome the agreement to establish a voluntary code of principles and best practices. These “Santiago Principles” promise to enhance the predictability and accountability of SWF investments while fostering open cross-border investment regimes and the opportunities these provide.

III. Fund Policies

I commend the Managing Director for his initiative in implementing the Fund’s strategic directions outlined last spring. Good progress is being made in assessing the Fund’s role and the adequacy of its instruments in all main areas of activity: surveillance, lending, and technical assistance and training.

I consider the regular dialogue with members to be a cornerstone of the Fund’s activities and of its relevance. The just completed triennial review of surveillance has confirmed that Article IV consultations – and the analysis and advice they offer – are highly valued by country authorities and market participants. I support the objective to further adapt these consultations to the global challenges and enhance their focus on core areas. The Fund adds particular value by assessing the linkages between the financial sector and the real economy, and by analyzing cross-border vulnerabilities. The more prominent focus on external stability, prompted by the adoption of the 2007 Surveillance Decision, is very welcome. I support the newly agreed procedures, which clarify how this Decision will be implemented in cases where further fact-finding and dialogue is needed. This should strengthen an even-handed application of the Decision. Effective surveillance ultimately hinges on the superior quality of its output. This is why it is necessary for Article IV staff reports to retain sufficient
analytical depth. Informative, timely, and sufficiently candid reports send highly important signals to markets and donors. The Fund’s Statement of Surveillance Priorities is a valuable innovation that provides appropriate guidance, directing surveillance towards key issues of common concern. The Statement also sets the benchmark for assessing the achievements over the next three-year review cycle.

I welcome the upcoming discussions on reforming the Fund’s lending framework as an opportunity to streamline the set of instruments by reducing overlap and making the facilities more consistent. This broad reform should also be guided by the need to protect the Fund’s resources. Adequate safeguards must remain an integral part of the Fund’s lending policies. Conditionality is such an essential safeguard. It provides clear and objective criteria for access to Fund resources and it sets the standard for even-handed treatment. Changes to the framework will have to include the policies on access, charges, and maturities. I also support simplifying the Fund’s toolkit for low-income members and making it administratively more efficient and transparent. To this end, the concessional resources provided by members should be pooled. I support the road map proposed by the Managing Director to complete a comprehensive reform of the Fund’s lending framework by October 2010.

I am decidedly of the view that the decline in Fund lending was foremost a reflection of positive global developments in the recent past, supported by country-specific improvements. More recent developments have reminded us that these hard-won achievements can be easily put to risk. However, Fund lending should in any case not be an end in itself. We should examine the set of existing instruments rather than engineering new ones and new venues for lending. For example, I see scope to broaden access to the Policy Support Instrument (PSI) to countries with a higher income level. This reflects the fact that the signaling role of Fund arrangements to financial markets and donors has become more important relative to the financing rationale. With such an arrangement in place, the Fund could act very rapidly if a need for Fund resources arose. It could thus be a workable alternative to a new instrument where members prequalify for significant potential access up-front. Conversely, I remain to be convinced of the need for a new crisis prevention instrument like the proposed Rapid Access Instrument (RAL) or the Financial Stability Line (FSL).

I support the recent amendment to the Exogenous Shocks Facility (ESF) which will allow the Fund to more rapidly support low-income members with a balance of payments need primarily caused by external developments. However, I would have preferred more explicit conditionality to induce targeted adjustment efforts and guarantee that countries will be able to repay the Fund. I also emphasize that Fund programs should catalyze, not substitute for, development financing. The introduction of the rapid access component in the ESF must not alter this critical characteristic of Fund lending.

Switzerland has traditionally been one of the largest contributors to externally financed Fund technical assistance. I thus welcome that the Fund’s policies on technical assistance and training have been successfully reformed, concentrating these activities on fewer areas of comparative advantage. I also welcome the progress in establishing an accurate and
transparent costing that reflects international best practices. The new policy for country contributions, although limited in scope, will enhance ownership by recipients and encourage the careful use of limited resources. Regional Technical Assistance Centers effectively deliver capacity-building in a cost-efficient way and close to recipients. I very much welcome the intention to open such a regional center in Central Asia. Switzerland is ready to support the newly envisaged topical trust funds, for example in the area of anti-money laundering.

IV. Governance Reforms

I welcome the IEO’s report on “Aspects of Fund Governance – Including the Role of the Board” issued in May. It analyzes pertinent governance issues that may warrant improvement, while building on the existing strengths of the institution. It is a useful stocktaking of the relevant questions that will be the basis for further work by others. I welcome the active role by the Board and the consensus on a work plan for addressing the recommendations in a comprehensive way. I have also taken note that the group of eminent persons established by the Managing Director will provide its own assessment next year.

I am of the view that the Fund’s structures and practices have generally served it well. The Fund has proved to be adaptive in its activities over time, responding to the needs of the membership. Its governance mechanisms have proved robust and allowed to maintain a consensus-based, and thus inclusive, decision making. In particular, the Board composition based largely on multi-country constituencies has proved to be effective for conducting business among a universal membership. I am a strong supporter of this model of representation, which is also appropriate for the IMFC.

I concur with one of the main conclusions of the IEO that the roles of the different governance bodies, and in particular between the Board and Management, should be clarified. While I see a case for strengthening the Board’s supervisory role, its executive functions remain important. There are crucial synergies in exerting effective oversight and fulfilling regulatory and fiduciary responsibilities in individual cases. The Board also has to ensure the even-handed implementation of policies. While supporting a clearer strategic role of the IMFC, I would see less merit in seeking to establish the Council contemplated in the Articles. It is unclear how the present well-functioning arrangement could in practice be improved upon. An additional decision-making layer would hardly be conducive to enhancing efficiency, decision-making, or legitimacy. I look forward to further addressing these issues jointly with Management and the Board in the coming months.

V. Looking Ahead

While I believe that the outlook for the global economy is worrisome, it would be wrong to succumb to pessimism. The same dynamic forces that weigh on the global economy today will eventually allow countries and their financial sectors to recover. This is not the first and will not be that last difficult period of economic disruption with global repercussions. I am
firmly of the view that we must not underestimate, and should be confident in, the fundamental strength of market forces to improve economic welfare. One of the lessons to be drawn, however, is that more cooperative solutions must be found to strengthen oversight over global markets. The Fund with its universal membership and financial stability mandate is called to closely monitor developments through its bilateral and multilateral surveillance. It should also contribute to the formulation of effective immediate policy responses and contribute to a robust global financial system, in close cooperation with other international bodies and in consultation with the private sector. The Fund should be determined to detect external and financial sector vulnerabilities early on and to engage in a candid dialogue with its members large and small.