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

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Statement by Ms. Eveline Widmer-Schlumpf, Minister of Finance of Switzerland
Speaking on behalf of Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, and Turkmenistan

I. Immediate Threats to Global Stability

Financial stability risks are severe and rising, while global growth is flagging. Collective action is indeed called for to address the negative interplay between financial sector weaknesses, fiscal imbalances, and demand. In the euro area, the most immediate priority is for policymakers to find agreement on a comprehensive solution that is able to dispel the severe doubts about the viability of the euro area. Without this, their "commitment to the euro and to do whatever is needed to ensure the financial stability of the euro area as a whole and its member states", spelled out in the July 21 agreement, will not enjoy the required credibility with financial market participants. In the US and Japan, credible measures for medium-term fiscal consolidation are required.

The priority for major advanced economies is to pursue fiscal consolidation without undercutting the recovery. How can both desirables be achieved? The key lies in adopting *today* a credible consolidation plan that will deliver savings *in the future*. This, in turn, will help support growth *today*.

What I perceive to be critical at the current juncture for most major advanced economies is the adoption of a credible fiscal consolidation plan to stabilize and then reduce the public debt-to-GDP-ratio. I believe five key lessons can be learned from past experience:

- Since sustainable consolidation of public finances takes time, credible measures must be adopted *today* to achieve a sustainable consolidation of public finances *tomorrow*.
- Not only the *size* of fiscal measures matters; a clearly spelled-out medium-term consolidation *path* is equally important. Specifying a clear policy path towards consolidation enhances predictability of government action, which in turn helps restore investor confidence.
- Consolidation has to focus on *expenditure-side* measures. Relying too heavily on revenue enhancement will harm competitiveness and choke growth. If implemented correctly, budget restraint will not trade off against growth in the short term—quite the contrary: a credible and effective consolidation will reduce uncertainty and will be conducive to both private investment and consumption.

- The outlays for *entitlements*—rather than discretionary spending—need to be addressed. This is politically difficult, yet the message is the same: we should act early because procrastination will only lead to more pain in the future. Widely publicized reports on the long-term sustainability of public finances can serve as important devices to foster public awareness and consensus on the necessity to adjust social and other entitlement programs.
- *Fiscal rules* can indeed be golden: they reduce government discretion and simplify the political process underlying fiscal policy. Their objective should be to balance the budget over the economic cycle, which will stabilize debt in nominal terms. But two pre-conditions have to be fulfilled to make them work: first, a binding rule requires broad public consensus; and second, a rule requiring a balanced budget over the economic cycle can only work effectively once the structural deficit has been addressed.

Further, advanced economies should make their financial systems more resilient and, more specifically, European policy makers need to strengthen banks' capital bases. Regulators should strive to introduce the higher capital and liquidity standards of Basel III in a timely manner. In addition, higher capital requirements are needed for the global systemically important financial institutions. Also, national authorities must ensure effective financial sector supervision and pursue cooperation to establish a workable cross-border resolution framework. As the global financial system remains vulnerable, financial sector repair and reform should be accelerated where needed and promptly implemented. A consistent and coordinated implementation of these reforms is essential to prevent regulatory arbitrage and negative cross-border spillovers.

Accommodative monetary policy is required wherever needed and possible. It must remain compatible with the overarching mandate of price stability. Monetary policy may have to rely on unconventional instruments to ensure properly functioning markets, as long as financial market conditions have not returned to normal. However, monetary policy support should not become a permanent substitute for financial repair. I also caution that the continued low-interest rate environment may give rise to excessive risk-taking and asset price bubbles.

I consider the financial assistance toolkit of the Fund to be adequate. The priority is to ensure that this toolkit is implemented as intended and does not breed moral hazard. Particular caution is required not to overestimate the Fund's ability to take on an insurance role and to offer ever larger rescue packages, which would require substantial additional transfers of resources to the Fund. This is neither realistic nor desirable. I see central bank swap lines as very important complements to—and not substitutes for—Fund credit lines. Central bank swap lines are traditionally part of monetary operations and therefore of a very different nature. That said, I see scope for enhanced collaboration with regional financing arrangements with regard to liquidity provision.

I see no compelling case for a general allocation of Special Drawing Rights (SDRs) in the period ahead. I supported the SDR allocation in 2009 as a measure to boost confidence in the global economy in an extreme crisis period. But even then, we had doubts about the implications of providing unconditional and open-ended liquidity to all members. Before considering a new allocation, I would like to see a thorough review of the experience with the 2009 allocation.

II. Long-Term Health of the International Monetary System

The long-term health of the international monetary system is best ensured by effective surveillance. Surveillance is the single most important task of the Fund, and strong and effective surveillance is a matter of good governance. I am pleased to note that the comprehensive review of surveillance recently undertaken by the Executive Board proposes concrete recommendations for strengthening the Fund's surveillance. The review appropriately emphasizes that surveillance should better identify financial sector vulnerabilities, be more risk-oriented, and devote more attention to multilateral aspects.

In my view, strengthening the IMFC process will be crucial to enhancing the traction and effectiveness of Fund surveillance. To achieve this objective, the ministerial level should be engaged as consistently as possible in the surveillance of core global issues. IMFC meetings should focus on the key topical policy challenges, allowing us to spell out—and follow up on—clear action plans, both for our own policies, as well as for the IMF.

I see much merit in developing a comprehensive and balanced policy framework to monitor and manage capital flows. Such a framework will need to be carefully designed, be based on experiences, and be sufficiently flexible to take into account the various structural characteristics of countries. Capital account liberalization should remain the ultimate goal. The framework should foster cross-border flows. The latter are beneficial to all, as they permit a better allocation of savings and investments across countries.

Within this framework, priority should be given to prudential and structural policies that strengthen the resilience of the financial system and enhance the capacity of the economy to productively absorb capital inflows. Such policies would reduce the need for capital flow management measures (CFMs) in the first place. If CFMs are considered, they should only be used as a last resort, that is, once the macroeconomic policy space has been exhausted. And if the latter stage has been reached, CFMs that do not discriminate on the basis of residency should be preferred over residency-based CFMs, and they should only be used temporarily. In addition, implementation costs and distortions of CFMs are important and should not be underestimated or even neglected.

While I am open to considering changes to the composition of the SDR basket, I am skeptical that a revision of the basket alone would be sufficient to enhance the attractiveness of the SDR as a reserve asset. In my view, a broadening of the SDR basket should fulfill two necessary requirements: first, the value of each currency included in the basket should continue to be market determined and not linked to the value of any other currency in the basket, so as not to increase the weight of this other currency; and second, any change in the SDR basket should not imply increases in costs and complexity for SDR users, or affect the stability of the SDR basket value.

The nature of the global crisis has accentuated the weaknesses of the 2008 quota formula, one of the most fundamental among them being the negligence of financial linkages and cross-border financial flows. The central role of quotas for the Fund's financing, its decision-making, and its lending makes it imperative that these weaknesses be addressed and remedied.

I have three concrete suggestions for further work on the quota formula that I would want to see addressed:

- The openness variable in the formula should be replaced by a new "interconnectedness" variable that captures both trade and financial openness. This adjustment would accommodate the financial globalization experienced during the past two decades. An interconnectedness variable would better capture the relative importance of member countries for, and their stake in, global financial stability—their "financial stability footprint" so to speak. It would be indicative of a member's importance as a source and recipient of shocks and spillovers. And it would also mirror the thrust of the recent reforms of Fund surveillance that have stressed the crucial importance of interconnectedness and macro-financial linkages.
- I would also like to reiterate a point that I—and others—have made strongly during the 2010 quota review: Voluntary bilateral contributions should be taken into account, in a transparent way, in determining members' quotas. A number of countries provide such bilateral contributions—in multiples of their quota share—to finance activities that are considered part of the Fund's core mandate. This readiness to spend domestic political capital on multilateralism should find an expression in these members' representation in the Fund.
- The purchasing power parity (PPP) component of the GDP variable remains unwarranted and should be removed. The formula should reflect the relative importance of countries in relation to the Fund's broad international financial stability mandate and functions. PPP-GDP is not an appropriate measure of the Fund's activities.