International Monetary and Financial Committee

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April 24, 2004

Statement by Jean-Pierre Roth
Chairman of the Governing Board of the Swiss National Bank
On behalf of Azerbaijan, Kyrgyz Republic, Poland, Serbia and Montenegro, Switzerland, Tajikistan, Turkmenistan, Uzbekistan

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1. Introduction

After several meetings characterized by downward revisions of global economic growth, I gladly take note of the significant improvement of the forecast in the current World Economic Outlook. More important, the global economic recovery not only seems to be strengthening but also broadening. At the same time, however, the risks to the global outlook we identified at our previous meetings have not disappeared. Global imbalances continue to pose a threat and despite the sizeable policy stimulus, the recovery remains surprisingly fragile. Furthermore, this has left fiscal and monetary policies in most economies with little room to respond to possible future shocks.

Looking forward, a historic event will fundamentally change the economic and political frameworks of the ten countries that are to join the European Union (EU) on May 1, 2004. This is of particular significance for the group of transition countries, as it bears testimony to the truly impressive economic transformation that these countries have undertaken in the relatively short time since the start of the transition process. I commend these countries for their remarkable achievements. The Fund has been closely involved in the transition process and should continue advising the new EU members as they design their policies and strategies for maximizing the economic benefits from EU integration and from their future participation in the euro area. I also hope that the experience gained by the Fund in its work with the EU accession countries will benefit the countries that are still less advanced in the transition process.

2. The Global Economy and Financial Markets

Since the 2003 Annual Meetings, the world economic environment has improved and financial vulnerabilities have subsided. Based on strong growth in the United States and in emerging Asia, the global recovery is gaining momentum. The recovery provides a good opportunity for all countries, including advanced economies, to make progress with much-needed structural and fiscal reforms. Such reforms are crucial for increasing growth potential and reducing vulnerabilities to external shocks. A successful conclusion of the Doha Round would support global economic growth, and it would be particularly beneficial to the further integration of developing countries into the world economy.

I am particularly glad to note that growth in the Commonwealth of Independent States (CIS) continues to be strong, which should help the CIS-7 countries to advance structural reforms and address their pressing poverty and debt problems.

With global recovery gaining momentum, the time is approaching when monetary policy in a number of countries will have to be tightened. Prolonged excess liquidity poses genuine risks, and so will the potential for abrupt changes in market expectations. Central banks will have to start preparing markets for the upcoming turn in the interest rate cycle, particularly since the reversal of the present benign financing conditions pose substantial risks for financial sectors in advanced countries and emerging markets with large external financing requirements. Timing and clear communication will be key and provide a challenging task for policy makers.

The global imbalances that have given rise to concerns at previous meetings have not abated. The continued dependency of the global recovery on the U.S. economy and the weak growth performance in continental Europe are not contributing to the correction of the existing imbalances. The large U.S. fiscal and external deficits and the associated external financing needs continue to give rise to concerns about the risk of a sharp fall in the value of the U.S. dollar and an increase in U.S. long-term interest rates. Both could have severe consequences, in particular for emerging market economies. Efforts in all countries to decisively address their home-grown imbalances would be the best contribution to an orderly correction of the global imbalances.

3. Crisis Prevention, Crisis Resolution, and the Use of Fund Resources

During recent years, a number of surveillance-related initiatives have been launched in order to strengthen the Fund's capacity for crisis prevention. Additional work is underway to enhance the focus of surveillance and improve the Fund's analytical tools. We have strongly supported these measures based on the importance we attribute to effective crisis prevention. To reap the full benefit of these initiatives, it is imperative to ensure their full and consistent implementation. The upcoming Biennial Surveillance Review will provide a good opportunity to take stock of the achievements to date and to identify areas where further improvements are needed. Among the latest initiatives, I would particularly like to note the framework for more rigorous assessments of public and external debt sustainability, and the related work on debt structure and currency mismatches. Fiscal and debt problems remain at the heart of most financial crises and belong to the Fund's core areas of expertise. Based on the experience with fiscal adjustment during times of crises, the Fund should also put a greater focus on public expenditure management in middle-income countries, as it is already being done in HIPC-countries.

Further progress with international standards and codes and, in particular, the achievements of the Fund's Data Standards Initiative are noteworthy. The increased participation in

Reports on the Observance of Standards and Codes (ROSCs) indicates the high level of acceptance and importance of this initiative. Empirical evidence suggesting that observance of standards and codes is associated with sounder policies and rewarded with higher credit ratings is encouraging. However, given that a main objective of this initiative is to provide a sounder information base for financial markets, the Fund should strive for a higher publication rate of ROSCs.

While the Fund has made some notable progress in the work on crisis prevention, much less has been achieved in the area of strengthening the framework for crisis resolution. Fortunately, however, important progress has been made by our member countries. I very much welcome the growing use of collective action clauses (CACs) in sovereign bonds issued under New York law. And I particularly welcome that the 75 percent voting threshold for majority restructuring clauses is becoming the industry standard, as recommended by the G10 working group. The fact that also sub-investment grade countries were able to issue bonds with such clauses without any evidence of higher premia will hopefully encourage other issuers to follow the example.

Work by some sovereign debtors and private creditors in developing a voluntary Code of Conduct for crisis resolution [Principles for Emerging Market Finance] seems to be progressing, although much slower and on a more limited scale than originally hoped for. We are also concerned about recent developments indicating an increase in sovereign debt litigation. The Fund should closely monitor these developments.

No further progress has been made at the Fund with the intended work on issues of general relevance to an orderly debt restructuring, such as aggregation and inter-creditor equity. However, the problems that the Sovereign Debt Restructuring Mechanism (SDRM) was meant to address have not disappeared. This lack of progress is disappointing, because I remain convinced that the contractual framework does not provide a sufficiently robust basis for an effective crisis resolution mechanism. The Fund should keep all options on the table and continue its work in this area.

The limited progress on an effective crisis resolution mechanism has direct implications for our efforts to strengthen access policy. A strict application of the Fund's new framework for exceptional access is therefore more important than ever. It is a crucial instrument for preserving the credibility and predictability of the Fund's policies and safeguarding Fund resources. Moreover, exceptional access must be priced appropriately. This has clearly not been the case recently. The large financing packages of recent years have significantly increased the Fund's financial risks.

Credit outstanding to the largest three borrowers has reached an unprecedented share of total Fund credit. An equivalent increase has occurred in the Fund's share of the large borrowers external debt. Moreover, this increased concentration in Fund exposure has been associated with a prolonged use of Fund resources by middle-income countries with access to international capital markets. These developments are very worrisome and need to be reversed. The Fund's access policy should remain based on the presumption that exceptional access is truly exceptional. Large financing needs may well arise, particularly in today's environment of large-scale capital flows, but they do not necessarily have to be fully covered by Fund financing. Fund programs should always seek an appropriate balance between adjustment, official lending, and private financing.

4. Fund Support for Low-Income Countries

The Fund has an important role to play in low-income countries. Sound macroeconomic policies are critical for long-term growth and can thus make an important contribution to helping countries achieve the Millennium Development Goals (MDGs). The Poverty Reduction Strategy Paper (PRSP) approach and the Poverty Reduction and Growth Facility (PRGF) continue to provide the appropriate framework for the Fund's engagement in low-income countries. The fact that a number of low-income countries have already made significant gains toward achieving macroeconomic stability and stronger growth seems to provide evidence for the appropriateness of this approach. The Fund's efforts should concentrate on strengthening the PRSP approach, including through a better collaboration with other multilateral and bilateral partners, and the World Bank in particular. In this context, I look forward to the results of the Independent Evaluation Office's evaluation of the Fund's instruments to support low-income members.

The Fund's primary contribution to addressing the needs of low-income countries should be through policy advice and technical assistance. Temporary financial support to help address macroeconomic imbalances can be an important complement to these efforts. However, the Fund has neither the mandate nor the capacity to provide the long-term development financing needed by its low-income members to meet the MDGs. The Fund has the important role of ensuring that the conditions are in place for an optimal utilization of long-term development assistance provided by multilateral and bilateral partners. Eventually, the final objective of the Fund's engagement must be to help countries graduate from concessional financing and to promote the transition to domestic and private sources of financing. To facilitate this transition, I encourage the Fund to work on possible frameworks of enhanced surveillance.

It will be important, however, to ensure that low-income countries' external debt remains sustainable as they pursue the MDGs. High external indebtedness would constrain their ability to provide social services and limit growth and development, and thereby undermine the very objectives of the MDGs. The HIPC Initiative is designed to help countries reach a sound foundation for accessing new resources for development finance, and efforts towards its full and consistent implementation should be maintained. Some post-HIPC countries, however, have already experienced a significant rise in the debt burden within only one year of having reached the completion point, mainly as a result of new borrowing from multilateral development banks. Concessional lenders have a clear responsibility for better coordination, and there is an urgent need for guidance on how much debt these countries can afford to accumulate. I therefore very much welcome the ongoing work on a debt sustainability framework for low-income countries.

The kind of structural adjustments that are necessary in most low-income countries require time-consuming institutional changes. This is where the Fund's technical assistance (TA) has an important role to play. The PRSP serves as a useful long-term framework for defining TA needs. But TA provided by the Fund should be properly prioritized and well in its core areas of expertise. This requires closer collaboration with other providers and a better dissemination of TA reports. In addition, there seems also scope for a better integration of TA into program design. However, as in the case of Fund-supported programs, greater selectivity in extending TA is also needed where there is insufficient evidence of commitment and implementation. The forthcoming IEO review of TA will provide a welcome opportunity to look for further ways to improve the Fund's activities in this important area.