International Monetary and Financial Committee

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Statement by H. E. Hans-Rudolf Merz
Minister of Finance of Switzerland

Speaking on behalf of Azerbaijan, Kyrgyz Republic, Poland, Serbia and Montenegro, Switzerland, Tajikistan, Turkmenistan, Uzbekistan

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1. Introduction

Global economic and financial developments since we last met have been fairly positive. Of course, we cannot forget the terrible human toll caused by the tsunami in many south-east Asian countries. I thank the Fund for doing its part in the difficult aftermath of this natural disaster.

Shortly before the last IMFC Meeting, the Fund took the opportunity of a period of relative global economic calm to start a discussion on its strategic directions. This is an important debate, and I am pleased that we can discuss the progress made so far. One aspect of the Fund's future strategy is particularly relevant today, namely its role in supporting low-income countries' efforts to reduce poverty and enhance growth. In the context of the Millennium Development Goals and various initiatives to increase resources for low-income countries, it is all the more important that the Fund remain focused on its core competences. To ensure that the Fund can continue to assist its low-income members, we must strive toward better defining this role and avoiding overlaps with other international organizations. In particular, under no circumstances should the financial integrity of the Fund be compromised.

2. The Global Economy and Financial Markets

I am pleased to note that the global economy remains on its expansionary path. The current benign outlook, however, is clouded by growing global imbalances. In particular, the higher world output forecast compared to the last World Economic Outlook owes much to higher U.S. and Chinese growth, whereas the euro area and Japan continue to disappoint. This increasingly unbalanced growth constellation decreases the resiliency of the world business cycle.

Global imbalances have been a concern for some time and have now even further increased, thereby additionally compounding the risk of a disorderly adjustment. This adds urgency to the well known mantra: For an orderly resolution of the imbalances we need a credible medium-term fiscal consolidation effort in the United States, an acceleration of structural reform in the euro area, and more exchange rate flexibility in Asia. The fact that this is not a new message in no way diminishes its importance. Indeed, I note that we are not seeing enough efforts to correct global imbalances. While globalization allows global imbalances to persist longer than in the past and smoothes the adjustment process, ultimately corrections still have to take place. It is better to prepare for these corrections sooner than later.

So far the impact of high oil prices on economic output has been relatively moderate. However, a further increase cannot be ruled out. This could trigger a rapid fall in consumer and business confidence and thereby have a very strong negative impact on economic activity. Looking into the medium and long term, I note that oil prices are likely to remain at relatively high levels, due to the strength of demand and to the lack of spare capacity. This has two significant consequences: First, second-round effects of oil price increases, which have so far remained limited, would then have to be watched with even more vigilance. Second, to address the structural origin of high oil prices, more needs to be done in the area of energy conservation. Measures such as energy taxes, efficiency standards and promotion of alternative technologies do not only help to reduce the dependency on oil, but importantly contribute to the fight against global warming and environmental pollution caused by fossil fuels.

Global financial stability has further improved in the last six months. It is reassuring that the situation in the financial and corporate sectors throughout the major markets is at its best in years. The favorable prospects for the world economy further lower the major risks to financial stability. So the biggest danger now is possibly complacency, especially since it is not easy to see what single event might trigger a reversal of the positive short and medium-term outlook. However, a key risk today is—possibly in conjunction with a disorderly correction of global imbalances—an abrupt rise in interest rates. It is difficult to tell what such a rise and the possible parallel decompression of risk spreads would mean for global financial stability.

3. Shaping the IMF’s Strategic Direction

The Fund has evolved significantly over the past years, in order to remain relevant for the membership in an increasingly integrated global economic and financial system. Many reform initiatives have come to fruition, while others are still being debated. The benign global environment and relative calm in financial markets are an excellent time to take a step back and perform a strategic review. Such a review would help define the Fund's role in the international financial system as a whole, as well as in its member countries. It would also guide us in our decisions on how to allocate limited resources in the context of our new medium-term budget framework.

Devising a strategy requires both stocktaking and setting priorities for the future. Looking at the discussion so far, the focus appears to have been on the former element. To be truly forward-looking, it is important not to get bogged down in short and medium-term issues. A strategic review must not shy away from the difficult long-term challenges. I encourage management and the Executive Board to concentrate on specific proposals to deal with these issues in a visionary manner.

At the basis of setting priorities is the Fund's central role as preserver and promoter of global macroeconomic and financial stability. The Fund should continue to foster sound macroeconomic policies based on its three pillars of activity: surveillance, use of fund resources and technical assistance. But the Fund has recently dispersed its strength by venturing into activities for which its comparative advantage is questionable. Today, the Fund needs to refocus on its core responsibilities. In doing so, hard decisions will have to be made about the allocation of scarce resources both among and within the three pillars.

There has been intensive discussion, including within the Fund, on the importance of institutions for economic growth and thereby for financial stability. The Fund has long recognized the value of well-functioning "specific" economic institutions, such as central banks and treasuries. Capacity building activities have increased accordingly. There is no doubt in my mind that beyond these specific institutions, the existence of basic or "broad" institutions, such as the guarantee and protection of property rights for broad sections of society, are very important for any economy. However, building these institutions are not in the purview of the Fund and should be left to those institutions that have the relevant comparative advantage.

The provision of temporary financial assistance will continue to be a key element of Fund activity. In order to be able to respond quickly and effectively in cases of crises, the Fund must be financially sound and rely on a rules-based approach. The idea of leveraging the Fund's catalytic role must remain at the heart of all lending activities. Providing large amounts of Fund resources should be exceptional. Furthermore, incentives to exit from dependency on Fund resources should be strengthened. In my view, this includes discussing maturities and charges. Financial soundness also requires that the Fund develop ways to better analyze and control its financial risks. Furthermore, strengthening internal control systems, including the establishment of a Board audit committee, is crucial.

4. Effective IMF Surveillance and Crisis Prevention

Preventing macroeconomic imbalances and possible financial crises is the single most important activity of the Fund. Our goal is to have strong and effective surveillance and to ensure that the Fund gives the best and most useful advice it can to its members. Given limited resources, the Fund must set priorities. Thus the Fund should concentrate on further sharpening its analysis of exchange rate issues and on assessing country vulnerabilities both in the short and long term. A more systematic use of quantitative vulnerability analysis can provide valuable advice to members on how to increase their resilience against potential crises. Furthermore, the Fund, given its near-global membership, is in a unique position to analyze global and regional spill-over effects of individual country policies.

It is more and more common knowledge that a sound financial system is crucial for macroeconomic stability. That is why I think that the coverage of the financial sector needs to be further improved in the Fund's mandated surveillance under Article IV of its Articles of Agreement. Improving the link of the Financial Sector Assessment Program (FSAP) with the Fund's regular surveillance under Article IV should therefore be a priority. Regular and continuous surveillance of the financial sector is important to identify and to react to critical developments. FSAP updates can not take place frequently enough to substitute for regular financial sector surveillance in Article IV consultations. I thus appreciate that the Fund is conducting work in this direction.

5. Conditionality of IMF Programs

Conditionality remains a key element of the Fund's lending policy. I am encouraged by the recent review of the Fund's conditionality, which indicates that efforts to focus structural conditionality on areas in the Fund's core mandate are showing results. The stronger focus on the main areas of the Fund's expertise in this critical area will help to better define the role of the institution more generally.

At the same time, there is room for further improvement. For one, the IMF's staff needs to do a better job in setting and explaining the objectives of programs, as well as developing strategies to achieve these objectives. That way, it will be easier to single out the structural conditions that are critical for reaching the final objectives of a program. Also, some trends observed in the review need to be closely monitored in the time ahead. These include the persistently high incidence of structural measures that suffer delay or are not implemented. Another is the continued tendency to offset a lack of ownership with stronger conditionality. While it is inherently difficult to determine whether genuine ownership is given, the Fund should refrain from financial engagement when there are clear reasons for doubt. In this sense, streamlining the Fund's conditionality should entail increased selectivity in its lending.

6. Fund Technical Assistance

The importance of capacity building has rightly been recognized by the Fund and is reflected in the strong increase in resources devoted to Technical Assistance. In this context, I found the Independent Evaluation Office's report on this function very timely.

I particularly support the recommendation to provide technical assistance more systematically by setting up medium-term country based policy frameworks. In the case of low income countries the Poverty Reduction Strategy is the obvious instrument to develop technical assistance priorities. Under this umbrella the frameworks can be developed in close consultation with the country authorities and other stakeholders.

Furthermore, the Fund should develop more systematic approaches to track progress on major technical assistance activities in collaboration with technical assistance recipients. Tracking progress at different stages would identify shortcomings at an early stage and would help both the Fund and the member to focus on their respective responsibilities. It will also enable the Fund to be more selective, providing technical assistance with priority to countries with strong implementation records.

Finally, I fully agree with the report that the Fund should improve coordination with other technical assistance providers working in similar areas and should proactively seek a meaningful division of labor. This does not necessarily mean that the Fund should provide leadership in coordination.

7. IMF Support for Low-Income Countries

The IMF has a key role in low-income countries. I welcome the ongoing work to further clarify this role, and to improve the instruments at the disposal of the Fund. With international efforts increasingly focused on attaining the Millennium Development Goals (MDGs), the Fund's activities in low-income countries are of particular relevance. At the same time, a clear delineation of responsibilities between the various multilateral institutions and donors is called for. This way, all actors involved can focus on what they do best. For its part, the Fund should focus on its main competencies, i.e., macroeconomic policy advice and capacity building in its specific areas of expertise. We believe the Fund can best contribute towards the MDGs by focusing on these core competences. On the other hand, the mobilization of aid should best be left to other institutions.

The forthcoming work on PRGF program design will be important for the clarification of the Fund's role, as will the discussion on signaling and donor coordination in the context of the poverty reduction strategy process. This work should also serve to further tailor the Fund's activities to countries' individual needs. A welcome step recently taken to this end was the decision to subsidize emergency assistance for natural disasters. As with the subsidization of emergency assistance for post-conflict countries, Switzerland will participate in the financing of this new account. I urge other creditor countries to contribute, so the necessary subsidization resources can be mobilized.

In the context of MDG financing, a number of proposals have been made for the further reduction of multilateral debt owed by low-income countries. While debt relief in the past aimed at ensuring debt sustainability has been very effective, I believe that further debt relief would not be the most effective way to assist countries in their efforts to reach their development objectives. We should not provide aid that is based on past lending decisions and tends to reward countries with poor policies.

Assistance under the HIPC initiative has reduced the debt burden for the qualifying countries considerably, and has laid the basis for future external viability. The recently completed debt sustainability framework for low-income countries will be instrumental in carrying the achievements of the HIPC initiative forward. If we apply the existing instruments consistently, we can end the lend-and-forgive cycles of the past.

On the financing modalities of any further debt relief, we would have a clear preference for new bilateral grant contributions. In any case, the five principles of the Fund's policy on its gold holdings remain valid. We believe there is a strong case both against new off-market gold transactions, and against gold sales by the Fund by other means.