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

Statement by Ms. Eveline Widmer-Schlumpf, Minister of Finance of Switzerland
to the International Monetary and Financial Committee
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I. Global Outlook and Policy Challenges

I am pleased to note that the prospects for a global recovery have solidified. While the recovery is gaining strength, the pace of activity remains geographically uneven. Growth remains below potential in most advanced economies, whereas emerging and developing economies are growing much faster—and some are about to overheat. In advanced economies, the hand-off from public to private demand is advancing, reducing concerns that diminishing fiscal policy support might cause a double dip recession. Financial conditions have continued to improve, although they remain unusually fragile. In emerging and developing economies, activity is being boosted by accommodative macroeconomic policies and easy financial conditions, including capital inflows.

Downside risks to growth that could derail the global recovery continue to prevail, however. I consider further instability in the euro area periphery as the key risk. Markets remain worried about the sustainability of public debt levels in some economies. Risks are exacerbated by weak sovereign balance sheets and continuing weakness among many financial institutions. Another key downside risk relates to the possible impact of a further rise in oil prices on inflation as well as economic growth. In emerging markets overheating asset markets have emerged as medium-term risks. That said, there is also potential for upside surprises to growth in the short-term, owing to strong corporate balance sheets in advanced economies and buoyant demand in emerging and developing economies.

I see a strong need for many advanced countries to pursue credible fiscal consolidation strategies. High and rising public debt in several advanced economies undermines their macro-economic stability and long-term growth potential. With such levels of debt and the prospect of rising interest rates, simply returning to pre-crisis fiscal positions and eliminating structural deficits will not be enough. More is needed to secure fiscal sustainability.

Broad public support, a strong fiscal framework, and an effective fiscal authority are essential ingredients for effective fiscal consolidation. Broad public support can be built by clear communication about the rationale for consolidation. A strong fiscal rule, embedded in a medium-term fiscal framework, ensures that fiscal policy is constant throughout the entire cycle, thereby helping to build fiscal buffers. And an effective fiscal authority helps safeguard the credibility and transparency of fiscal policy. I welcome that many countries are already moving in this direction, and encourage others to do likewise.

Progress with financial sector reform is urgently needed. Increasing capital requirements must be at the forefront of the agenda to make the international financial system more robust and resilient. In particular, the resilience of systemically important financial institutions (SIFIs) needs to be strengthened to reduce the threat to financial stability and sovereign solvency. Additional capital requirements for globally active SIFIs, as they are currently discussed in the Financial Stability Board, are thus to be welcomed. Mitigating systemic liquidity risks is another important policy objective, ideally tackled in parallel with increasing capital buffers. In addition, we also need to establish effective resolution regimes for SIFIs.

II. Reforming the International Monetary System

I am not one of those who think the current international monetary system (IMS) is in need of fundamental repair. In my view, the IMS has proved quite resilient in the recent global crisis. It is rather the macroeconomic policies of a limited number of systemic countries, together with inadequate financial supervision in many advanced economies, which bear much of the responsibility for the pressures that ultimately triggered the crisis. Most solutions to build a more stable IMS are thus at the national level. Reform efforts should focus on providing national authorities with the incentive to implement sound economic and financial policies. Such policies are a necessary condition for orderly international adjustment and stability. The IMS cannot be more stable than its constituent parts.

That said, I do share the view of those who think improvements to the IMS can and should be pursued. These improvements include the need to strengthen policy coordination, to further improve surveillance by the IMF, and to develop a framework for managing capital flows.

Strengthening Policy Coordination

I can see a good case for further strengthening macroeconomic policy coordination. Assessment guidelines should prove useful, as long as they take due account of the specific structure of countries. Fund-provided support to the G-20 mutual assessment program (MAP) should be better integrated into the Fund’s regular multilateral surveillance. Priority should be given to further emphasizing financial sector issues in Fund surveillance and to effectively integrating them into macroeconomic analysis. Also, experience needs to be gained with the pilot spillover reports.

Improving Surveillance

After having spent considerable efforts to revamp its lending framework and reform its governance, it is high time for the Fund to similarly crystallize its energies to enhance its surveillance function. The Triennial Surveillance Review (TSR) should propose concrete recommendations for operational improvements that are feasible to implement. It should assess the effectiveness of surveillance, in particular whether, and to what extent, policy recommendations were implemented by members. Further insight should be gained on the low traction of surveillance in large countries, both developed and emerging. The TSR should cover all the various surveillance products. And since the Fund needs to constantly find a balance between upholding the candor of surveillance and disclosing its findings to the public, I also expect a critical review of the consistency of the Fund's messages across its numerous communication outlets.

Monitoring and Managing Capital Flows

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. Ultimately, it 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 market distortions of CFMs are important and should not be underestimated or even neglected.

Enhancing the global financial safety net

I consider the financial assistance toolkit of the Fund to be adequate. The priority now is to ensure that this toolkit is implemented as intended and does not breed moral hazard. Particular caution is required so as 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 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 than Fund arrangements. However, there is scope for enhanced collaboration between the Fund and regional financing arrangements with regard to liquidity provision.

Assessing Reserve Adequacy

I welcome the innovative groundwork on reserve adequacy. The new metrics proposed promise to improve the ability of the Fund and its members to determine what constitutes an adequate level of international reserves for precautionary—or self-insurance—purposes. The Fund should test these new metrics by applying them broadly and referring to them in country discussions. However, any reserve adequacy assessment should also take into account additional country specificities. In particular, due consideration should be given to macroeconomic and prudential frameworks and policies, alternative forms of contingent financing, the overall international investment position, and the costs of holding reserves. In addition, peer comparisons remain a useful complementary tool to assess reserve adequacy.

The Role of the SDR

I remain skeptical on expanding the role of the special drawing right (SDR). I agree in principle that the SDR could contribute to the stability of the IMS, if it was given a sufficiently important role. Enhancing this role is, however, compounded with a number of practical difficulties that overshadow its conceptual appeal. First, expanding the supply of official SDRs seems implementable, but potential misuse is a source of concern. Second, issuance by the Fund of SDR-denominated bonds raises fundamental issues that would need to be clarified.

That said, I remain open to further work: first, on the costs and benefits of allocations of SDRs on an irregular basis, coupled with a reconstitution requirement; second, on the concrete steps that could be taken to encourage the private sector to use the SDR without financially involving the Fund; and third, on the feasibility of expanding the SDR basket, based on transparent criteria applicable to all currencies.