International Monetary and Financial Committee

Eighteenth Meeting
October 11, 2008

Statement by Wayne Swan
Treasurer of the Commonwealth of Australia

On behalf of Australia, Kiribati, Republic of Korea, Marshall Islands, Federated States of Micronesia, Mongolia, New Zealand, Palau, Papua New Guinea, Philippines, Samoa, Seychelles, Solomon Islands, Vanuatu

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Statement by the Hon. Wayne Swan,
Treasurer of the Commonwealth of Australia
to the International Monetary and Financial Committee
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On behalf of the constituency comprising Australia, Kiribati, Korea (Republic of), Marshall Islands (Republic of the), Micronesia (Federated States of), Mongolia, New Zealand, Palau (Republic of), Papua New Guinea, Philippines, Samoa, Seychelles, Solomon Islands and Vanuatu

This year's Annual Meetings are taking place in the midst of a very challenging environment. The financial market turmoil that erupted around the middle of 2007 has deepened, with systemic implications across the global financial system. Governments and central banks in the major advanced economies have responded strongly to stabilize markets and support critical financial institutions, but the situation remains highly uncertain. While emerging and developing economies have so far been relatively resilient to the financial turmoil, there are signs that they are also being affected. Commodity prices have also remained high and volatile. While assisting commodity exporters, high commodity prices have contributed to both a pick-up in global inflation and pressure on the balance of payments positions of many commodity importing countries. Taken together, these developments are weighing heavily on economic activity, with global growth slowing markedly through 2008 and expected to gain pace only gradually in 2009.

Against the background of the Fund's refocusing exercise, which is transforming the Fund into a leaner and more focused institution, the Fund's priorities must now be to strengthen financial sector surveillance and related policy advice, support members hit by high food and fuel prices, and assist policy makers in striking the right balance between supporting growth and restraining inflation.

Drawing Lessons from Ongoing Financial Market Turmoil

The immediate task to ease the financial strains is to rebuild confidence in the financial system. Key to this will be improving standards of disclosure and transparency, increasing the level of capital and reducing leverage within the global financial system. Central banks have a crucial supportive role to play in ensuring the smooth functioning of money markets by providing necessary liquidity. Governments must also be prepared to take decisive actions to manage risks to financial stability and restore market confidence.

Beyond the short-term responses, however, the challenge is to reform financial markets and regulatory systems to address existing vulnerabilities and reduce the risk of future crises. In this context, there is scope for the Fund to enhance its effectiveness in three areas:

- **The Fund must strengthen its early warning capabilities in relation to identifying and reporting on risks to global financial stability.** This will involve monitoring and analysing risks and vulnerabilities arising from the financial sector at the country, regional and global levels and ensuring that any risks are effectively communicated.

- **The Fund must play a key facilitation, analytical and assessment role in helping build a more robust and coherent financial policy framework and advise members on policies to address the weaknesses revealed by the current financial turmoil.** As part of a strengthened global financial architecture, we see the need for: a more conservative and consistent set of prudential and disclosure standards to be applied to all financial institutions of systemic significance, with licensing dependent on proper disclosure; counter-cyclical capital requirements; accounting standards that take a medium-term perspective; improved incentive structures in financial firms; and a clearer financial stability mandate for central banks.

- **The Fund must play a broadened watchdog role in overseeing the implementation of policy reforms.** With its wide membership and mandate, the Fund is uniquely placed to tailor, monitor and evaluate the implementation of policy recommendations through its bilateral and multilateral surveillance activities.

To perform these roles effectively, the Fund must collaborate with the other multilateral organisations, in particular the Financial Stability Forum (FSF), to exploit complementarities and build international consensus. We also see a central role for the G-20, in collaboration with the Fund and FSF, in facilitating implementation of the reform agenda, and want to see financial stability at the centre of its work program. While the policy response to the financial turmoil is appropriately focused on the major advanced economies, systemically important emerging economies must also be partners in strengthening the global financial system. To facilitate this, the Fund in partnership with the FSF and G-20 should undertake further outreach activities that deepen the engagement of these economies.

Progress has been made prioritizing financial sector issues in the Fund's work. However, in terms of the Fund's mandate for prudential analysis, strengthening financial sector surveillance still stands out as the Fund's highest operational priority. To do this effectively, the Fund must ensure that it has the right mix of people, with both financial markets and policy-making experience, recalibrating its skill mix to keep pace with financial innovation. While we recognize budgetary constraints, now is not the time to be reducing the size of the Monetary and Capital Markets Department. The Fund must continue to develop and refine its financial surveillance toolkit, focusing in particular on improving the understanding of macro-financial linkages and extending the vulnerability exercise to advanced countries. Strengthened risk identification and scenario analysis, developed in consultation with the FSF, should be included in an enhanced *Global Financial Stability Report*. The Financial Stability Assessment Programs need to be updated more frequently, targeting systemically important countries.

The Fund's communication of its analysis and advice needs to become more assertive, more persistent and better targeted. This will mean spelling out with greater clarity the nature of risks that have been identified, assessing potential impact and likelihood, formulating and effectively advocating appropriate policy responses, and monitoring their implementation. It also means finding the right balance between a strong public voice and the Fund's confidential advisor role.

Responding to the Challenges Posed by Higher Food and Fuel Prices

Soaring food and energy prices have placed a considerable strain on many low and middle income countries. The Fund's policy advice, technical assistance and balance of payments support are integral to safeguarding macroeconomic stability in countries adversely affected. The global food crisis has brought to the fore the impediments to the effectiveness of the Exogenous Shocks Facility (ESF) and therefore we support the Fund's recent decisions enabling faster disbursement, policy commitments and increased access.

The Fund's role also extends to examining the causes of current high food and fuel prices and advising on policy changes that could help to alleviate market pressures. Therefore, we encourage the Fund to continue building its expertise to ensure that it is well placed to make a strong analytical contribution to global discussions on commodity market issues.

Advancing the IMF's Surveillance Agenda

The recently concluded Triennial Surveillance Review (TSR) highlighted improvements in the conduct of bilateral surveillance, with a tighter focus on domestic and external stability, exchange rate analysis and financial sector assessments, while maintaining the standard of analysis in the Fund's traditional areas of strength (including monetary and fiscal policies). However, the TSR also highlighted that the Fund is not meeting the expectations of key stakeholders in several important areas, where strengthened risk analysis, understanding macro-financial linkages, bringing a multilateral perspective to bilateral surveillance and promoting external stability have correctly been identified as key operational priorities.

We support the first Statement of Surveillance Priorities (SSP) and the importance that it places on the Fund providing clear warning of risks to the global economy and assisting members to take mitigating actions. The four economic priorities – resolve financial market distress, strengthen the global financial system, adjust to sharp changes in commodity prices; and promote the orderly reduction of global imbalances – align with our views on where the Fund should be focusing its surveillance activities in the period ahead.

The 2007 Decision on Bilateral Surveillance reaffirmed the central importance of exchange rate analysis to bilateral surveillance. The Fund is now at the forefront of exchange rate analysis, with the technology improving substantially over a relatively short period of time. However, the 2007 Decision's emphasis on external stability has not translated into a greater focus on exchange rate policies and the implications for associated domestic policy frameworks. This needs to change. To be relevant for policy makers, exchange rate surveillance needs to go beyond assessments of the exchange rate level to consider questions such as: the consistency of the overall policy framework with the exchange rate regime and economic fundamentals; the proximate cause of any exchange rate misalignment; and appropriate policy response to correct identified internal and external imbalances. We also recognise that the requirement to arrive at explicit judgments on the exchange rate has complicated Article IV processes enormously and therefore we support the Managing Directors proposal to use ad hoc consultations as a pragmatic step towards ensuring the effective and timely conduct of bilateral surveillance in accordance with the 2007 Decision.

Reviewing the Fund's Lending Role

The IMF must ensure that it is in a position to provide quick and effective balance of payments support to all members, particularly in the present fragile environment. The decline in demand for Fund credit over the last decade can be attributed, at least in part, to a sustained period of relatively benign global economic conditions. At the same time, however, it is evident that the Fund's toolkit has failed to keep pace with developments in the global economy. Therefore, we welcome the decision to embark on a fundamental review of the Fund's lending instruments. Immediate priorities in this regard include finalising a new crisis prevention liquidity instrument, re-examining lending facilities for low income countries and reviewing access limits and financing terms for using Fund resources.

The Fund's Role in Low Income Countries

The Fund's work in low-income countries (LICs) is very important to our constituency and therefore we welcome the Executive Board's recent statement on the role of the Fund in LICs. By supporting macroeconomic policies and institutions conducive to economic stability and strong, sustained growth, the Fund plays a vital part in ensuring the preconditions for effective poverty reduction. The reforms to the ESF mentioned above establish a more effective shocks instrument for LICs, while the broader review of the Fund's financing instruments will provide an opportunity to assess the effectiveness of the Poverty Reduction and Growth Facility and the Policy Support Instrument and the extent to which these instruments are meeting the needs of the Fund's LIC membership.

Strengthening the IMF's Governance Framework

The Governors resolution on quota and voice reforms marked an historic step forward in improving the legitimacy of IMF governance, by establishing a dynamic process for realigning voting shares with weights in the world economy. However, the task of enhancing the Fund's legitimacy and effectiveness must also consider the suitability of the institutional framework through which members' voting power is exercised. We thank the Independent Evaluation Office (IEO) for their *Report on the Evaluation of Aspects of IMF Corporate Governance – Including the Role of the Executive Board* and look forward to engaging over the next twelve months on proposals to strengthen the roles and accountabilities of Management, the Executive Board and the IMFC.

Generally Accepted Principles and Practices for Sovereign Wealth Funds

As a constituency that both hosts sovereign wealth funds (SWFs) and benefits from their investment, we welcome the efforts of the International Working Group to develop generally accepted principles and practices (GAPP) for SWFs, recognizing the stabilizing role that these large long-term investors can play in the international financial system. If widely adopted, the GAPP will build transparency and enhance confidence in the independence and commerciality of SWFs, helping to prevent new barriers to SWF investment.