International Monetary and Financial Committee

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Statement by Hans-Rudolf Merz, Minister of Finance, Federal Department of Finance, Switzerland

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

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Statement by the Honorable Hans-Rudolf Merz, Minister of Finance of Switzerland Speaking on behalf of Azerbaijan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

I. Global Outlook and Policy Challenges

The global recovery remains fragile, with downside risks continuing to prevail

The recovery in the global economy is continuing but remains fragile, with downside risks continuing to prevail. Financial stability suffered a major setback during the first half of this year. This added to existing worries about the sustainability of the recovery. In recent months, financial conditions have been easing again. Risks have been reduced by unprecedented policy initiatives and a frontloading of fiscal adjustment in response to market pressures. However, underlying sovereign and banking vulnerabilities remain a significant challenge amid lingering concerns about risks to the global recovery. The near-term prospects for the global economy remain precarious on account of persistent sovereign risks, weak confidence in the financial sector, and uncertainty about private sector demand being able to supplant public stimulus measures in advanced economies.

Policymakers need to engage in more proactive policies

Major fiscal consolidation will be needed over the years ahead. The increase in budget deficits played a key role in staving off an economic catastrophe. As economic conditions improve, the attention of policymakers should now turn to ensuring that doubts about fiscal solvency do not become the cause of a new loss of confidence—recent developments in Europe have clearly indicated that this risk cannot be ignored. Of utmost importance are firm commitments to ambitious and credible strategies to lower fiscal deficits over the medium-term. Advanced economy governments need to begin legislating on the consolidation measures they intend to implement in the future to achieve their medium-term fiscal objectives. Consolidation strategies should focus on policy measures that reform major, rapidly growing spending programs—such as pension and public health care entitlements—and make permanent reductions in non-entitlement spending. There is also large scope to improve tax structures. Well-designed spending and tax reforms can help rebuild confidence by reducing the future fiscal burden and boosting the economy’s supply potential.

Continued financial sector repair and reform are needed to keep the recovery on track. Insufficient progress on this front in many advanced countries is slowing the normalization of monetary and fiscal policies. I welcome the adoption of the new Basle III regulatory reform, which was indispensable. Banks should hold much larger buffers of higher quality capital and liquidity. Capital and liquidity requirements should be introduced gradually over the next decade to ensure that their implementation supports the economic recovery. More forceful action is also needed to address the "too-big-to-fail" problem of systemically important institutions, which continue to be a threat to sovereign solvency in many countries. They must fulfill more stringent conditions, going beyond the new capital requirements. International coordination will be important to prevent regulatory arbitrage and preserve a level playing field.

Monetary policy can remain accommodative in advanced economies for some time, but risks to inflation in the longer run stemming from the enormous amount of liquidity in the global economy must not be ignored. I note that Fund staff acknowledges that inflation has fallen less than what one would have expected from a crisis of such magnitude. In addition, in some cases, political pressure on central banks to monetize sovereign debt may constitute a further risk. Although inflation is projected to remain subdued in advanced economies in the short run, amid excess capacity and high unemployment, policy rates should rise once the recovery is well established.

II. IMF Reforms

Mandate Reform I: Modernizing Bilateral and Multilateral Surveillance

I welcome the progress on modernizing bilateral and multilateral surveillance. I am persuaded that effective and evenhanded surveillance is crucial for the fulfillment of the Fund's advisory and crisis prevention roles. Effective bilateral surveillance is a matter of the IMF delivering high-quality assessments and pertinent recommendations, and of its members fulfilling their obligations under Article IV of the Articles of Agreement. Enhanced multilateral surveillance hinges first and foremost on the Fund implementing its broad mandate in a way that adequately addresses today's global economic challenges.

I am of the view that the best way to strengthen bilateral surveillance is to enhance clarity, focus, and timeliness of Article IV consultations. I encourage the Fund to explore further avenues to improve the traction of surveillance, and I endorse the simplification and increased flexibility of rules for Article IV cycles.

Mandate Reform II: Integrating Financial Stability Assessments into Article IV Surveillance

I strongly welcome the decision to make financial stability assessments under the FSAP a regular and mandatory part of Article IV surveillance for countries with systemically important financial sectors. I see these regular assessments of key financial centers as an important step toward strengthening the Fund's financial sector surveillance, and as a key component of the overall strategy to modernize its surveillance mandate. To ensure the high quality of these assessments, I am supportive of commensurately prioritizing the Fund's work and resource allocation.

Mandate Reform III: Expanding the Lending Toolkit

I endorse the modification of the Flexible Credit Line (FCL) and—reluctantly—the establishment of the Precautionary Credit Line (PCL). The enhanced flexibility of the FCL has come with a strengthening of safeguards, in particular the assessment of the impact on Fund liquidity.

I would have preferred to review the new lending toolkit before amending and expanding it further. Only last year, a comprehensive overhaul of the Fund's lending framework introduced significantly more flexibility. The crisis response capacity was reinforced through a significant augmentation of the lending resources available, and the crisis prevention mechanism was strengthened through the establishment of the FCL. Experience gained in the course of a full lending cycle would have been valuable before making additional changes to the toolkit.

I remain skeptical of the need for a Global Stabilization Mechanism (GSM) to resolve systemic crises. The Fund has demonstrated its ability to act quickly and decisively to help its members, which testifies to a functioning decision-making process in the Executive Board. If a GSM were nevertheless to be created, I emphasize that it should be based on the existing lending instruments and conditionality standards; it should be a Board-centric process; and there must not be any automaticity in the creation, change, or use of Fund instruments and policies.

Mandate Reform IV: Strengthening the International Monetary System

I would welcome work by the Fund on desirable ranges of precautionary reserves. I see "excessive" reserve accumulation best and most effectively addressed in the regular dialogue with members in the context of the Fund's bilateral surveillance. Further, I see merit in a multilateral framework for managing capital flows, which could provide members with best practices on how to dampen excessive capital flow volatility.

Increasing Quotas

I consider that an increase in IMF quotas up to a doubling seems warranted. The volume of quotas should be determined in relation to the level of likely future demand for Fund resources under "normal" circumstances. A reasonably good and straightforward indicator of such demand is global GDP. The latter has almost doubled since the last quota increase in 1998. In exceptional crisis situations like the one recently experienced, the Fund can resort to borrowed resources, be they bilateral or preferably multilateral, through the expanded and enlarged NAB. I am of the view that even in case of a significant quota increase, the NAB will still be needed; it should remain a backstop for times of exceptional need.

Governance Reform I: Realigning Quota Shares

I remain committed to completing the 14th General Review of Quotas within the timeline and the parameters set by the IMFC a year ago. In particular, I support the redistribution of 5 percentage points in quota share from over-represented to under-represented dynamic emerging market and developing countries, using the 2008 quota formula for the double purpose of determining over- and under-representation as well as allocating the quota increase. I also support protecting the voting share of the poorest members, which I understand to be those eligible for IDA financing. I can accept a realignment that achieves these objectives, provided that three conditions are met: first, all over-represented countries must contribute to the adjustment in quota shares; second, over-represented countries must not end-up under-represented after the quota reform; and third, voluntary bilateral financial contributions must be taken into account in the final outcome—let me elaborate a bit on this latter point.

I consider it crucial that a member's quota share takes due account of its financial contributions to those Fund activities that are financed bilaterally and voluntarily. Concretely, I am thinking of a member's bilateral contributions, first, to the Poverty Reduction and Growth Trust, which finances the Fund's concessional lending to low income countries; second, to externally financed technical assistance, which supports capacity building across the membership; and third, to the NAB, which provides supplementary refinancing of the Fund's core business—its non-concessional lending—in exceptional crisis periods. These voluntary bilateral contributions are made by members in addition to the contributions to the General Resources Account and—as budget items—are difficult to obtain, justify, and uphold from a political perspective. As such, they are a tangible expression of the ability and willingness to provide support to the benefit of all members, supporting the Fund in fulfilling its mandate.

Governance Reform II: Strengthening Ministerial Involvement

I support strengthening ministerial guidance of the Fund. The IMFC plenary discussions should be more interactive. The IMFC Deputies should play a more prominent role in the preparation of IMFC meetings. They should also discuss the IMFC communiqué at an early stage and approve it, with controversial points left bracketed for decision by the IMFC. More formalized procedures would also be desirable with regard to the appointment of the IMFC Chair, and his/her term should be limited. Also, a dedicated IMFC Secretariat should be charged with preparing meetings and coordinating inputs. This Secretariat should manage the agenda setting process, in consultation with the Executive Board.

I am open to formalizing ministerial decision making, as envisaged under the suggested International Monetary and Financial Board (IMFB). The IMFB could decide on the appointment and dismissal of the Managing Director and on the general principles for surveillance. Also, I could well imagine the IMFB approving the Fund's administrative and capital budgets, thus backing strategic decisions with the appropriate budget allocations. These powers would allow for a more frequent involvement of ministers and governors in the business of the institution.

Governance Reform III: Adapting Size and Composition of the Executive Board

I do not see any objective argument in favor of reducing the size of the Board from the current 24 chairs, given the substantial increase in the membership since the 1970s. The current Board size reflects an appropriate and sustainable balance between the objectives of effectiveness and representation.

I am open to ending the privilege of the largest members to appoint an Executive Director, that is, to moving to an all-elected Board. An all-elected Board would facilitate a meaningful consolidation of European Union representation.

Governance Reform IV: Enhancing Management Selection and Staff Diversity

The process for selecting Fund management should be made open, transparent, and without regard to nationality. I acknowledge the difficulties in agreeing on similarly transparent processes across the different international financial institutions but would hope that these can be overcome.

Finally, I support the efforts to encourage greater staff diversity. I would like to emphasize, however, that greater diversity must under no circumstances compromise the quality of Fund staff and output.