International Monetary and Financial Committee

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Statement by H.E. Hans-Rudolf Merz
Minister of Finance, Switzerland
On behalf of Azerbaijan, Kyrgyz Republic, Poland, Serbia and Montenegro, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

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1. Introduction

The global economy continues to expand at a solid rate, exceeding last fall's expectations. What is more, the economic expansion appears to be more broadly based than half a year ago and the global financial system has gained further strength and increased its resilience to shocks. However, the risks emanating from global imbalances have further increased. I think that the Fund plays a key role in highlighting these risks and promoting the orderly unwinding of these imbalances through specific recommendations to its members.

To remain effective and relevant for all of its members, the Fund must ensure that it provides high-quality services. To this end, the review of the Fund's medium-term strategy is crucial. While I welcome the progress since our last meeting, the review needs to further sharpen the focus on activities that the Fund is best placed to perform and pare down others. We also need to ensure the Fund's long-term financial viability.

In my view, the most important progress has been achieved in rethinking surveillance. The proposals to strengthen multilateral surveillance and to devote more attention to financial sector issues are key to maintaining the Fund's effectiveness. Conversely, further work is needed to give the Fund a more effective framework for its cooperation with emerging market members and low-income countries. Regarding emerging market members, the focus should be on safeguarding financial stability through enhanced financial sector coverage and consistent lending policies. Regarding low-income countries, we need to focus more on areas within the core mandate of the Fund. In this context, I welcome the recently announced external review of Bank-Fund collaboration.

2. The Global Economy and Financial Markets

I am pleased to note that the global economic outlook remains solid, supported by favorable financial market conditions and accommodative macroeconomic policies. The higher oil prices have not had any major real effects and only limited impact on inflation. Importantly, global growth appears to be more balanced now as Japan and Europe are set to deliver thrust to economic activity, as are most emerging economies. The global economy is now less dependent on US growth.

At the same time, the global financial system has gained further strength and increased its resilience to shocks, thanks both to cyclical and structural factors. Over the last few years, the corporate and household balance sheets have strengthened considerably. In particular, I welcome that many emerging markets have lowered their vulnerabilities to shocks by taking advantage of the benign environment. Many have improved their debt profiles by partly substituting foreign by local currency denominated debt.

On the risks to this generally benign outlook, my principal concern is an abrupt unwinding of global imbalances. It is true that in a globalized world such imbalances may be sustained over a longer time. However, with globalized markets, an unwinding may also spread more quickly and more widely. What I said during the last few IMFC meetings is still valid: We need more serious fiscal consolidation in the US, higher exchange rate flexibility in Asia and more structural reform in current account surplus countries to enhance growth. This institution, with its global membership, is ideally placed to promote the orderly adjustment of global disequilibria with a more specific action plan for members on both sides of the imbalance.

High and volatile oil prices are a further concern. The impact of higher oil prices may turn out stronger than expected, particularly if producers and consumers treat higher oil prices as a more permanent price change. An abrupt increase in interest rates is a further concern. Yet if interest rate increases are well-communicated and anticipated, a higher level should not pose a major risk. An avian flu pandemic is a low-probability, but high cost-event, which justifies the current concern among national authorities.

3. Implementing the IMF’s Medium-Term Strategy

The review of the Fund’s medium-term strategy has made progress. The Managing Director’s most recent report addresses the right issues and provides useful proposals in some areas, notably in surveillance. In many areas, however, the way forward is less clear and more deliberations will be necessary. Generally, I feel that our medium-term strategy needs to further sharpen the focus on activities that the Fund is best placed to perform, while paring down others. This exercise must be driven by both strategic and resource considerations, given the pressure on the Fund’s income. In this context, it is imperative that the Fund rapidly considers measures to ensure its long-term financial viability.

Surveillance for Members and Surveillance for the Membership

The medium-term strategy offers good proposals on how to progress in surveillance. In particular, I welcome the more global perspective and the importance given to the financial sector. Regarding the former, the Fund’s universal membership provides it with an unmatched comparative advantage for the analysis of regionally and globally interconnected economic developments. As to the latter, thorough macroeconomic surveillance has become impossible without keeping a close look at the financial sector.

Introducing multilateral consultations in addition to the existing bilateral surveillance procedures makes good sense. This will allow the Fund to promote the debate on systemically important issues. But the procedure for multilateral consultations remains to be defined. In any case, the Executive Board and the IMFC need to be able to play their pivotal roles in these consultations.

I agree that the treatment of exchange rate issues must have a central place in surveillance. We have often argued for more depth, more candor, and more even-handedness in dealing with such issues. In this context, I would like to stress that assessing the right exchange rate levels is associated with well-known uncertainties. These must be taken into account, when expanding the Fund's role in exchange rate surveillance. We do thus not support the Fund publishing equilibrium exchange rates.

I warmly welcome a better integration of macroeconomic and financial issues in surveillance. Given the implications of financial sector stability for macroeconomic stability, the World Economic Outlook is the publication of choice to also analyze the impact on macroeconomic developments of financial sector issues discussed in the Global Financial Stability Report. Also, both the World Economic Outlook and the Global Financial Stability Report would benefit from a more systematic presentation and discussion of alternative scenarios together with clear statements about desirable policy responses.

With respect to bilateral surveillance, more focus and streamlining is necessary. It seems to me, however, that the principles determining the consultation cycle need to be further discussed. On the communication strategy, Switzerland's experience with Article IV press conferences has been very positive. I believe such conferences increase transparency and promote public involvement in policy discussions. As to the strengthening of regional outreach, the resource implications of the proposed new activities should be assessed before adopting a new strategy.

In Emerging Markets, Focus on Financial Stability and Effective Lending Policies

Enhanced focus on financial sector issues is especially relevant for emerging market members, given the remaining vulnerabilities. I agree with the recommendations to strengthen the emphasis on financial and capital market issues and to give priority to emerging market countries in the Financial Sector Assessment Program and the Standards and Codes work program.

On Fund lending, access to adequate financing remains crucial for members facing exceptional balance of payments needs. In order to avoid frequently resorting to exceptional circumstances, we might consider ways to improve and strengthen the framework for exceptional access financing. Members and markets need clarity as to when and how the Fund will provide exceptional levels of financing. However, we have to be aware that this can change incentives and create moral hazard. Therefore, an adequate balance needs to be struck between rules and discretion. We also need to ensure that the incentives are consistent across different Fund lending instruments by harmonizing charges.

Contingent financing may have a certain appeal. However, the well-known problems of such an instrument must be dealt with beforehand. First, solutions would have to be found for the general signaling problems associated with entering and exiting such an arrangement. Second, ways would have to be found to dissipate the fundamental tension between giving automatic access to Fund resources and ensuring adequate adjustments of macroeconomic policies. As a minimum, strong conditionality would continue to be necessary to provide the necessary incentives to the debtor and safeguards to the Fund, as well as to provide the positive signaling effect. In my view, reconciling the different demands on such an instrument seems very difficult if not impossible.

In Low-Income Countries, Focus on What the Fund Does Best

I welcome the Fund's headway in implementing the Multilateral Debt Relief Initiative. With debt burdens reduced, Fund advice becomes more important than Fund financing. However, the Multilateral Debt Relief Initiative will only have lasting effects if Multilateral Debt Relief Initiative relief is used effectively and a renewed build-up of unsustainable debt is avoided. This will be the major challenge for countries, multilateral institutions, and the donor community.

There is a clear rationale for engagement of the Fund in low-income countries. The challenge is to focus this work more clearly on what the Fund does best. I therefore expected to be able to discuss first elements of a comprehensive strategy toward a more targeted and selective engagement in low-income countries. However, instead of focusing on core competencies, the Managing Director in his medium-term strategy proposes an increase of the overall engagement of the Fund in low-income countries, asking for more staff resources for this purpose. I think these proposals should be better aligned with previous IMFC guidance and with the Fund's current resource constraints. Also, we hope that the recently established External Committee for the review of collaboration between the Fund and the World Bank will provide clear guidance on how current overlaps can be addressed.

Striving to meet the Millennium Development Goals calls for closer cooperation between the Fund, development banks, and donors. The Fund's contribution should be limited to providing guidance on sound macroeconomic policy frameworks, including preserving debt sustainability. Accordingly, regarding the expected scaling up of aid flows, the Fund has a role in assessing the impact of aid flows on macroeconomic stability, but it should not act as a gatekeeper or fundraiser. Further, the Fund should not get involved in cost calculations for reaching the Millennium Development Goals.

I noted the proposal in the medium-term strategy to introduce another new facility for low-income countries, offering more flexibility and weaker conditionality to countries with capacity constraints. I am not convinced that such an instrument is needed and think that the current tool-kit is sufficient to accommodate our low-income country members' needs.

Effectiveness Through Legitimacy

I believe that a well-balanced participation in the decision making of the Fund is important for its legitimacy. Legitimacy, in turn, is indispensable for the effective functioning of this institution. Ad hoc quota increases for the most underrepresented members among the emerging markets would serve to ensure an adequate representation across the Fund's membership. The precise modalities of these increases will be important to ensure broad support from the membership. As a general point, we should should focus on a realistic solution in the run-up to the Annual Meeting. Representation in the Fund must in any case continue to reflect the position of countries in the international financial system, and their contribution to financial stability.

Finally, any quota adjustment, if implemented as an isolated measure, will miss the objective of enhancing the governance and legitimacy of the Fund. In addition to adequate representation, legitimacy requires strong and independent self-assessment. The Fund's Independent Evaluation Office's work is essential in this respect, and great care must be taken to keep providing an environment conducive for the Office to be able to perform its work. It is also indispensable that the role of the Executive Board and the IMFC be strengthened.