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

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I. Introduction

Continued severe disruptions on financial markets have broadened into a deep global recession. Worldwide economic activity is falling for the first time in 60 years, financial flows to emerging markets have reversed, and trade is in sharp decline. Member governments now face the extraordinary challenge to mitigate the immediate impact of the downturn, while not undermining the economic fundamentals that will enable an eventual recovery. It is also important in this global environment that governments refrain from protectionist measures that would further hamper international trade and financial flows.

The international community has responded with high-profile initiatives to contain the crisis. I welcome the efforts of the various international bodies and fora. This process has provided an impetus for timely reforms to improve the functioning of the global financial system. Specifically, I am convinced that a pragmatic strengthening of regulation, an enlargement of its perimeter, and a stronger focus on systemic oversight will improve the resilience of financial sectors. Closer international cooperation in supervising the cross-border activities of financial institutions is also clearly warranted. At the same time, we must be mindful not to unduly stifle financial innovation and international capital mobility. The global reach of financial intermediation has allowed for large welfare gains in the past and – with proper oversight – should continue to do so.

The IMF is making a significant contribution, which is a testimony to its central role in the international financial architecture. I commend the Fund for providing leadership as a crisis manager, as evidenced by sharply increased lending to members in need, including to low-income countries. The Fund has also been at the forefront in identifying the causes of the crisis, drawing initial policy lessons, and promoting a consensus on the priorities for action. The reforms of the Fund's policy instruments are proceeding apace. We have supported the comprehensive reform of the lending framework that allows Fund programs to be better tailored to country circumstances, while maintaining the needed financial safeguards. Similar progress is being made to modernize the Fund's concessional lending facilities and increase credit availability for low-income countries. Ensuring candid and effective surveillance remains crucial. In this context, I welcome the first Early Warning Exercise conducted together with the Financial Stability Board. I support a significant increase in the Fund's lending resources, including the allocation of Special Drawing Rights.

II. Confronting the Global Recession

Economic and financial outlook

Since last October, the financial crisis has triggered a sharp contraction in international trade and real economic activity, spreading beyond the advanced economies. As a result, economic growth continues to decline worldwide, thereby imperiling the soundness of banking systems. The necessary, but likely protracted, deleveraging process in the financial sector continues to cloud the prospects of a recovery for this year and next. The overextension of credit and the mispricing of risks over the past boom years will need to be corrected to restore trust between market participants and public confidence in financial institutions.

I expect a sharp contraction in growth in advanced economies in 2009, and likely negative growth rates as well in 2010. The European economies will be strongly affected by the fall in global demand and trade, while automatic stabilizers supporting domestic demand will somewhat cushion the downturn in many countries. The severity of the correction in the financial and housing sectors is uneven within Europe, however. Switzerland is equally, and particularly so, exposed to weaker external demand and will experience a sharp contraction in 2009. Banks' liquidity in Switzerland remains ample and there is no evidence of a domestic credit crunch, although the deteriorating economic outlook will impair banks' loan books and likely slow credit extension. The two large banks have significantly reduced their balance sheet exposure to further asset markdowns.

The crisis is also testing extensively the policy frameworks and the economic resilience of emerging markets. A retrenchment of foreign capital and severely diminished export prospects are undermining trade-based growth strategies, while remittance inflows are also declining sharply. Emerging Europe and Central Asia are particularly affected. Also, many low-income countries have to contend with the effects of lower commodity prices and aid flows.

Policy Priorities

The policy response to the global downturn in advanced economies has been aggressive and wide-ranging. Liquidity shortages and insolvency concerns regarding financial institutions have been met with unprecedented support by central banks and governments. I welcome these decisive measures. Fiscal and monetary stimuli will help restore global demand, but will need to be consistent with medium-term fiscal sustainability and price stability.

I agree that the first priority must be to stabilize the financial system and put the credit cycle in motion again. To this end, banks in many countries must be recapitalized and solutions need to be found to deal with impaired assets. There is a strong case in the current environment for government intervention in systemically important and viable banks. I am of the view that, provided a principled and transparent approach is taken, different ways to repair banks' balance sheets can be successful. Switzerland has chosen a "bad bank" approach for one of its large banks, with the necessary legal and financial prerequisites in place when it was publicly announced. The fact that these details were concretely spelled out arguably helped minimize market uncertainty and instability, and we have already completed the pricing and transfer of illiquid assets to the stabilization fund.

The case for a strengthening and refinement of regulation, including on cross-border arrangements, is compelling. I support this reform agenda, which should be informed by considerations on the economic costs and benefits and the scope for regulatory arbitrage. A strengthening of capital and liquidity cushions in banks is pertinent, particularly for those of systemic importance. The Swiss authorities have been at the forefront internationally in asking its large banks to substantially increase their risk-weighted capital adequacy ratios over the medium-term. The authorities will also use a leverage ratio as an additional indicator for containing excessive balance sheet exposure. A better scrutinized ratings process, more transparency in trading complex derivatives, and better-structured remuneration incentives constitute further important reform objectives.

Credible policy frameworks and exit

While determined public interventions are part of the solution for restoring confidence, we must be careful that the burden on public sector balance sheets does not undermine the confidence that such interventions are intended to support. I strongly believe that large-scale crisis-related public spending should not impede the necessary structural changes and, most importantly, be compatible with a sustainable medium-term fiscal policy framework. In my view, clarity, predictability, and credibility of macroeconomic policies are essential for reducing uncertainty, restoring trust, and bolstering much needed confidence by consumers and businesses alike.

Clearly, designing exit solutions that phase out government support, ownership, or guarantees is an important medium-term challenge. Making such considerations part of the crisis response strategy would provide much needed certainty on governments' role during and beyond the crisis. I would see a prominent role for the Fund in facilitating such exit efforts.

III. Reforming the IMF

An expanded resource envelope

The severity of the current crisis and the readiness to provide insurance-type credit lines has led to substantial additional demand for Fund credit. Against this background, I support a substantial expansion of the Fund's lending resources as a cushion to cover any further borrowing needs by members. However, the augmentation of lending capacity should clearly be seen as a backstop, not a target amount to be lent.

Bilateral borrowing agreements best meet the objective to rapidly increase the IMF's lending capacity. As a longer-term solution, I support an enlargement and augmentation of the New Arrangements to Borrow (NAB), recognizing that such amendments will be subject to participants' domestic approval procedures. The Fund should strive for a broad participation in the provision of additional Fund resources in order to achieve a fair burden sharing. The Swiss government has expressed its intention to contribute up to USD 10 billion to reinforce the Fund's lending resources.

Modernized lending

I have supported the comprehensive reform of the Fund's lending framework, which balances the diverse interests of the membership. The new framework allows for sufficient Fund financing on a precautionary basis or in times of crisis. At the same time, the Fund has to account for higher risks due to the expansion in lending resources, as well as an increase in the average size of Fund arrangements, and more focused conditionality. These risks call for adequate safeguards to protect the Fund's financial position.

The increase in access limits will help countries to address the extraordinary financing needs of this crisis. At the same time, it puts a substantial burden on the Fund's resources, and we have to ensure that the Fund remains financially sound. The Fund's reserves must be rapidly increased. A prudent reserves policy needs to be forward-looking and include a safety margin.

The Stand-By Arrangement should remain the mainstay of Fund lending. If a case for exceptional access on a precautionary basis can be made, the high access precautionary arrangement is a natural extension. We have also supported the establishment of the new Flexible Credit Line (FCL). As the Fund under the FCL will need to delineate between good and bad performance, this distinction must be based on well-defined and transparent qualification criteria. To the extent that the FCL invites large-scale precautionary lending, it may test the Fund's ability to lend to members with actual needs. Therefore, I expect that the application of ex-ante conditionality with the FCL will remain confined to the best-performing members. Also, I expect that in the future arrangements under the FCL will not be announced before they are fully endorsed by the Fund.

Concessional financing

The crisis is increasingly affecting low-income countries. The Fund needs to stand ready to support these members and facilitate adjustment in this difficult global environment. However, in reviewing the Fund's concessional financing for low-income countries (LICs), we will need to ensure that the Fund's role remains in line with its mandate. In particular, I continue to see the IMF's financing role as providing temporary balance of payments support on the path towards sustainable external positions. In this sense, Fund concessional financing should be complementary to donor financing, the Fund's main function being to lend credibility to the authorities' economic policies. In doing so, fostering debt management capacity and ensuring debt sustainability must remain a core concern. Since the Fund's concessional financing capacity is limited, it should be targeted to benefit the poorest countries of the membership. I thus call for a regular review of eligibility for concessional financing, based on transparent criteria.

Also, I call for caution in stepping up the volume of concessional lending by the Fund. Any use of a part of the revenue of the planned gold sales to this end should be made in careful consideration of the Fund's long-standing principles on gold holdings, and on the implications for the IMF's new income model. The Fund's concessional lending should ultimately be made self-sustained, with additional resources provided only in well substantiated exceptional circumstances.

I agree that there is room to optimize the structure of the Fund's financing instruments for LICs. Specifically, I am in favor of setting up a short-term concessional lending facility that would aim at meeting actual and potential, rather than protracted, balance of payments need. Also, I agree to consolidate the emergency facilities. Care should be taken, however, not to cover domestic policy slippages or aid shocks as part of concessional emergency financing. I welcome that the Policy Support Instrument (PSI) continues to be seen as an important instrument for signaling graduation from Fund financing. I have much sympathy for making the PSI available more broadly beyond LICs considered as mature stabilizers.

Greater "traction" in surveillance

Surveillance remains the IMF's key crisis prevention tool. But progress remains to be made in its implementation. To this end, I consider it essential that the Fund's bilateral and multilateral instruments result in candid and evenhanded assessments and that shortcomings in the scope and coverage of surveillance be remedied. I underscore in particular the value of better financial sector coverage in Article IV consultations, and of financial sector assessments (FSAPs). Also, I would like to underscore that Fund surveillance can only be effective to the extent that members are open to policy dialog and Fund advice.

The membership's alertness to systemic vulnerabilities will be enhanced by the Early Warning Exercise (EWE) conducted jointly by the IMF and the Financial Stability Board. This regular monitoring process is very welcome, as it allows to pool crucial expertise within both bodies. Looking ahead, it will be important that the gist of this exercise can be conveyed to the public through the IMF's flagship publications.

Effective capacity building

I welcome the progress in implementing the policy reforms with regard to capacity building. Switzerland, as a long-standing supporter of the Fund's technical assistance, is a lead donor of the recently established Topical Trust Fund to support projects in the area of anti-money laundering and the combating of terrorism financing. Also, I look forward to the establishment of a regional technical assistance center in Central Asia.

Broadening the income base

Although income risk for the Fund has receded as lending activity has intensified, I consider the new income model an important part of modernizing the institution. I hope for an accelerated ratification of the relevant decisions by all members, and in particular for their consent to the sale of gold.

IV. Looking Beyond the Crisis

The present crisis is an opportunity to examine the role of the Fund, and how it should adapt. However, we need to deal carefully with this opportunity for change. A redefined role for the Fund must preserve those instruments and practices on which the institution's credibility has been built, and that remain crucial to fulfill its mandate. Institutional reforms will have to stand the test of time, as calmer times in the global economy will eventually return. From this perspective, I particularly welcome the emphasis on strengthening surveillance and crisis prevention. Lastly, I stress that prudent policies and well-tailored regulation and prudential supervision on the national level continue to be key in mitigating systemic vulnerabilities. The Fund is uniquely placed to monitor and advise on sound domestic policy frameworks.