International Monetary and Financial Committee

Twenty-Fifth Meeting
April 21, 2012

Statement by Eveline Widmer-Schlumpf
Minister of Finance, Switzerland

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

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I. Immediate Priorities

While the global outlook for growth has improved, risks are high, and debt levels remain at unsustainable levels in many advanced countries. What I perceive to be critical and urgent at the current juncture for most major advanced economies is the adoption of credible fiscal consolidation plans to stabilize and then reduce the public debt-to-GDP-ratio. Such plans need not impinge on sustaining growth in the short run—quite the contrary: fiscal credibility reduces uncertainty and supports private investment and consumption. I believe five key lessons can be learned from past experience:

- Since sustainable consolidation of public finances takes time, credible measures must be adopted *today* to achieve a sustainable consolidation of public finances *tomorrow*.
- Not only the *size* of fiscal measures matters; a clearly spelled-out medium-term consolidation *path* is equally important. Specifying a clear policy path towards consolidation enhances predictability of government action, which in turn helps restore investor confidence.
- The outlays for *entitlements*—rather than discretionary spending—need to be addressed. This is politically difficult, yet the message is the same: we should act early because procrastination will only lead to more pain in the future. Widely publicized reports on the long-term sustainability of public finances can serve as important devices to foster public awareness and consensus on the necessity to adjust social and other entitlement programs.
- Appropriately tailored *fiscal rules* and other fiscal governance measures should be a key ingredient of the necessary reforms. They reduce government discretion and greatly simplify the political process underlying fiscal policy. Their objective should be to balance the budget over the economic cycle, which will stabilize debt in nominal terms. The commitment to fiscal rules in an increasing number of countries is thus welcome.

Monetary and liquidity policies should remain accommodative wherever needed and possible. They must remain compatible with the overarching mandate of price stability. Monetary policy may have to rely on unconventional instruments to ensure properly functioning financial intermediation, as long as financial market conditions have not returned to normal. However, monetary policy support should not become a permanent substitute for financial sector repair and structural reform. I also caution that the continued low-interest rate environment may give rise to excessive risk-taking and asset price bubbles.

Switzerland and Poland are ready to contribute to an increase in the Fund's lending capacity. A greater resource envelope for the IMF will clearly enhance global financial stability at the current juncture. These additional resources should be in the form of temporary bilateral credit lines to the Fund's General Resources Account, and they should be used only as a second line of defense. A fair burden sharing among the Fund's main shareholders is important. Given the size and correlation of potential risks, risk mitigation will be essential, meaning that conditionality should be strong and resources should not be tied up in precautionary arrangements. Last but not least, the bilateral contributions should be reflected in the outcome of the quota formula review.

II. Architecture for global cooperation

Enhancing surveillance

The long-term health of the international monetary system or, more broadly, the global financial system, is best ensured by effective surveillance. Surveillance is the single most important task of the Fund. I am pleased to note that the comprehensive Triennial Surveillance Review (TSR) recently undertaken by the Executive Board proposed concrete recommendations for strengthening the Fund's surveillance. The TSR appropriately emphasizes that surveillance should (i) take better into account the interconnectedness of the world economy and analyze more and better the spillovers across sectors and countries; (ii) focus more on the key risks, in both bilateral and multilateral surveillance; (iii) focus more, and more systematically, on financial sector issues; (iv) adopt a broader approach to assessing external stability; and (v) generate greater traction with policymakers. I also agree that surveillance needs a modernized legal framework.

Many important surveillance reforms are already under way. I particularly welcome the creation of a new external sector report, the increased use of financial sector experts in Article IV consultations of systemically important economies, as well as the new unified spillover report for the five largest systemic economies. I also welcome the Managing Director's Consolidated Multilateral Surveillance Report. It will help further condense the main findings of the IMF's surveillance into an easily accessible format. These reforms will be instrumental in increasing traction with policymakers.

Strengthening the IMFC is another, crucial means of enhancing the traction and effectiveness of Fund surveillance. To achieve this objective, the ministerial level should be more involved in setting the priorities of surveillance and in the subsequent surveillance of the core global issues. IMFC agenda setting should also be more formalized. IMFC Deputies should be more involved in preparing the meetings. And there should be a more a systematic follow-up on commitments taken during the meetings.

I am a strong supporter of modernizing the legal framework for surveillance. My preferred solution would have been to amend the Articles of Agreement. However, given that there seems to be insufficient backing within the membership to amend the Articles of Agreement, I view the adoption of an Integrated Surveillance Decision (ISD) as a second-best solution. The ISD—although it would not establish new obligations—should clarify that surveillance should focus on global economic and financial stability, in addition to also addressing the stability of individual economies. The ISD should also make Article IV consultations a vehicle not only for bilateral surveillance but also for multilateral surveillance, allowing the Fund to discuss with a member the full range of spillovers from its policies on global stability. Finally, the ISD should alleviate the excessive emphasis on exchange rate policies characterizing the current framework by adding guidance on domestic policies.

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. Capital account liberalization should remain the ultimate goal. The framework should foster cross-border flows. The latter are beneficial to all, as they permit a better allocation of savings and investments across countries.

Governance

I agree that to make the Fund more effective, its legitimacy must be enhanced. I see three important steps to achieve this: (i) we must strengthen the IMFC, a priority I have elaborated on in the previous section; (ii) we must implement the 2010 quota and governance reform as soon as possible; and (iii) we must ensure that the upcoming quota formula review leads to a formula which better reflects members' relative positions in the global financial system.

I am glad to inform that the implementation of the 2010 quota and governance reform is making good progress in the countries of my constituency. Poland has ratified both the quota increase and the amendment to the Fund's Articles of Agreement on the reform of the Executive Board. Switzerland is on track to ratify both in June. Other constituency members will follow. In addition, and conditional on the full implementation of the reform, my constituency is ready to contribute its share to the process of realigning members' representation in the Executive Board, as agreed by the Board of Governors in December 2010.

There are several issues I regard as critical for the upcoming quota formula review. First of all, we must ensure that the revised quota formula continues to capture all three fundamental roles of quotas: quotas determine (i) the Fund's financial resources, (ii) members' access to these resources, and (iii) members' voting rights. To capture these three roles, the quota formula must reflect (i) members' financial strength and ability to contribute usable resources; (ii) their potential needs to borrow from the Fund, and (iii) their relative positions in the global financial system. In addition, the quota formula should better emulate the Fund's global financial stability mandate.

These considerations make it clear that members' quotas should be calculated based on a set of relevant variables rather than on a single one. A multi-dimensional quota formula is indispensable to capture the multiple roles of quotas as well as the range of Fund activities, as mandated by the membership. As to the variables that enter this multi-dimensional formula, I can summarize our view as follows:

- *Openness* is the most relevant variable in our view, as it is an indicator for all three roles of the quota formula. Its weight should thus be increased. It is the open economies that care most about global financial stability and its guardian, the Fund. In addition, the weight of the *financial openness* component within this variable (i.e. investment income) should be increased to make it equal to the weight of the *trade openness* component. The current formula's largest deficiency—especially highlighted in the global financial crisis—is its under-weighting of members' financial interconnectedness and cross-border financial flows and, thus, also of the relative importance of members from a systemic stability perspective.
- *Financial contributions to the Fund* should become an explicit component in the quota formula. As highlighted by the global crisis and the current efforts to augment IMF resources, the Fund depends on members' voluntary financial contributions in various areas to be able to fulfill its mandate and serve its membership. These contributions over a longer time period need to be accounted for in quotas and, thus, the formula. If this provides members who are able and willing to contribute an incentive to do so, the Fund membership at large will benefit.
- *GDP blend*, which reflects members' relative weight in the global economy, is already by far the most important variable in the formula. Its weight should thus not be increased any further. In addition, the PPP-GDP component of this variable should be reduced. In this context, the *compression factor* should be left unchanged. It is an important corrective that helps protect the voice of smaller members, given the importance attributed to GDP which favors large economies over smaller ones.

Finally, the discussions and decisions related to the quota formula review must take place within the decision-making structures of the Fund, not elsewhere. I welcome the initiative by the IMFC Chairman to set up a workstream to that effect.