



International Monetary and Financial Committee

Fourteenth Meeting
September 17, 2006

**Statement by Peer Steinbrück
Minister of Finance, Germany**
On behalf of Germany

**Statement by Mr. Peer Steinbrück,
Minister of Finance of The Federal Republic of Germany
to the International Monetary and Financial Committee
Washington, D.C., September 17th, 2006**

I. Global economy and financial markets

Global economy – The overall economic outlook remains positive, and the prospects for more balanced global growth have improved further. Growth in the euro area is significantly stronger and more balanced, as successful corporate restructuring and strong profit growth have spurred investment and labour markets are showing clear signs of recovery. The upswing in Japan remains solidly based on domestic demand and is likely to continue, albeit possibly at a somewhat slower pace as the cycle matures. Growth in emerging Asia and in particular China, while mainly export driven, remains buoyant. The US is likely to remain an important engine of global growth. Signs for stronger export growth and some slowdown in consumption caused by a cooling housing market are welcome from a global imbalances perspective, as an increase in private savings in the US together with stronger and more balanced growth in Europe and Japan, will help secure an orderly adjustment. Economic policy should continue to support this process, and we remain committed to our joint strategy, including a continuation of fiscal consolidation in the US as well as structural reforms in Europe and Japan, and increased exchange rate flexibility in Asia. We are deeply disappointed by the deadlock in the Doha round. In our view, trade liberalization on a non-discriminatory basis is an important instrument to open up new global growth opportunities and to fight poverty. All parties involved should step up their efforts to revive the process of multilateral trade liberalization. High and volatile oil prices remain a concern. Addressing this problem requires efforts from all countries. In particular, well-functioning markets with sound and reliable regulatory and tax frameworks will help bring forth the considerable investment in production and refinery capacity that is needed, while energy prices that properly reflect underlying costs are important to ensure that consumers have the right incentives to conserve energy. We have seen some increased volatility in asset prices since our last meeting, in particular in emerging markets. In our assessment, these price movements largely reflect corrections after prior price run-ups. Financial markets have increased their resilience in recent years, and we are confident that they can adapt to changes

in the global environment, including the inflationary outlook and risk reassessment, without major disruptions.

Germany –The recent positive economic developments confirm our economic policy strategy, namely to postpone the more substantial part of our fiscal consolidation package until the recovery has significantly strengthened. Now that growth has actually gathered strength, we are determined to fully implement the envisaged VAT increase, using it in part to lower the tax burden on labour and thus strengthen labour demand. While substantial consolidation is likely to dampen growth temporarily, this is the price we have to pay to improve our fiscal balance in the medium-term and enhance the long-term sustainability of public finances. We are convinced that our strategy will also pay off in the medium to longer run by supporting confidence, growth and employment.

Emerging market economies – During the period of larger moves in emerging markets asset prices, many emerging market countries have benefited from previous efforts to strengthen the resilience of their economies. We encourage those countries that still depend to a large extent on external financing or have high public debt to address the related vulnerabilities. We support China in further pursuing the modernization of its social security systems and its financial sector, and in continuing to move towards greater exchange rate flexibility, thereby making a necessary contribution to the adjustment of global imbalances. This will also help China to contain overheating in its economy. We encourage Middle Eastern countries to make use of their higher oil revenues for productive investment in the oil and non-oil sectors to raise potential growth and provide more employment opportunities for their growing working-age population.

II. Funds Medium Term Strategy

The Fund needs to adapt to challenges, such as growing global imbalances, unprecedented global capital mobility and a sharp fall in income from its lending operations. Therefore, we welcome the timely report of the Managing Director on Implementing the Fund's Medium-Term Strategy. We agree with many of his proposals, notably to focus the Fund more on its core mandate, to streamline activities and to improve the division of labour with the World Bank. In particular, the Fund should continue to advise and support its members in strengthening their economic resilience and in becoming more attractive for stable private capital inflows. This should increasingly enable members to overcome times of economic stress without Fund financial assistance.

Adapting surveillance to meet the demands of globalization. Surveillance is the most important task of the Fund and should be further strengthened. In this regard, we welcome the first round of multilateral consultations initiated by the Managing Director as they can be a means to strengthen surveillance and to address global imbalances. Given its crucial role as the IMF's central decision making body, the Executive Board must be involved actively and early in all surveillance activities, including the multilateral consultations. As long-standing advocates of effective Fund surveillance, we support the Fund's work on reviewing the foundations of surveillance, including the increased focus on cross-country spillovers and the review of the *1977 Surveillance Decision on Exchange Rate Policies* with a view to enhancing the quality and effectiveness of surveillance to meet the challenges of today's international monetary system. As exchange rate analysis is key for focussing surveillance on multilateral aspects, we appreciate the efforts by the Fund to strengthen the operational and analytical foundations of the surveillance of exchange rate policies. However, as long as important assumptions are not generally accepted, we doubt whether equilibrium exchange rate models can provide reliable yardsticks for policy advice. Subject to further work on the issues involved in setting a remit, we support the aim of a remit to clarify medium-term objectives and operational priorities of surveillance. We welcome the establishment of the new Monetary and Capital Markets department which marks a step towards integrating macroeconomic and financial market analysis in multilateral surveillance and towards focussing bilateral surveillance on financial sector issues. Given these important tasks, the new department should become a lead department in the Fund.

Income Position and Budget

We welcome the Fund's efforts to develop more stable and predictable sources of income against the background of the sharp fall in its earnings from lending operations and the shift in focus toward surveillance and crisis prevention. We support the Board's two-pronged strategy to adapt the Fund's financing to its changing needs, including the agreed measures for FY 2007, i.e. the activation of the Investment Account, the use of the Fund's existing reserves to meet remaining income shortfalls, and continued budgetary restraint. We also take note that the Managing Director has formed a Committee of Eminent Persons who will study longer-term options for financing the Fund's running costs. We look forward to making recommendations that can command support of the membership for a new income model. We feel that a lasting solution for the Fund's income problem must soon be found in order to limit further income shortfalls and a running down of reserves. We are ready to discuss a

variety of possible measures, including further cuts in real spending over the medium-term. The new medium-term budget already sets a zero growth budget in real terms for FY 2007, while reductions in real terms are planned in both FY 2008 and FY 2009, which are important steps in the right direction. We should also examine the introduction of user fees for special services of the Fund, depending on the per capita income of the recipient countries.

The Fund's role in emerging market economies should be guided by its core mandate, which includes candid surveillance, technical assistance and provision of temporary financial assistance in acute balance of payment difficulties. We appreciate the Fund's proposal of the Reserve Augmentation Line as a first effort to operationalise a possible new instrument to provide high-access contingent financing. The proposed new financing instrument has to be thoroughly checked against its consistency with the Fund's mandate, its financing mechanism and other existing Fund instruments, as well as the universally accepted principles of conditionality, uniformity of treatment and the revolving nature of Fund resources.

Role of the Fund in Low-Income Countries The Fund plays an important role in low-income countries through surveillance, technical assistance and concessional lending. The Fund's lending should be strictly confined to those countries with balance of payment problems that are willing to implement ambitious adjustment measures, the focus of which is on mobilizing internal resources and setting up sound institutions. Although we expect less need for PRGF lending, we reiterate our call on oil-exporting countries to contribute to the funding of the PRGF-ESF-Trust. Germany already contributed to the financing of the Fund's share of the MDRI. Our first instalment of grant contribution is equivalent to roughly 10 Mio SDR. Given the recent improvement of the Fund's toolbox and the aim of clarity and transparency in its operations, we see no need to create further lending instruments for low-income countries. We support efforts to further improve the division of labour with the World Bank and we are looking forward to the results of the External Review Committee on Bank-Fund Collaboration. In our view, the Fund should focus on macro-critical issues tailored to country-specific circumstances, including institutions relevant to financial stability and economic growth. In order to help them cope better with rising revenues from extractive industries and higher aid flows the Fund, in close cooperation with the World Bank and other agencies, should intensify its advice to low-income countries on public expenditure management, on consistency of projected flows with macroeconomic stability including real

exchange rate effects, and on estimated costs of achieving the respective countries' development goals.

III. Quota Reform

Germany advocates a fair representation of all members of the Fund according to their relative weight in the global economy. At present, many IMF members are under-represented in the Fund relative to the current quota formula – including both emerging market economies and some members of the EU, including Germany. We therefore support partial compensation via the use of limited ad hoc quota increases to address most significant cases of under-representation, namely China, Korea, Mexico and Turkey. We will work constructively to reach an agreement on a new quota formula as part of the second stage. A simpler and more transparent new formula, based on verifiable and clear economic criteria, should be the outcome of the quota formula review after Singapore. Considerations should be given to increasing the weight of GDP and openness. Once a new quota formula has been agreed, a second round of limited ad hoc quota increases should take place to adjust the situation of under-represented countries, including under-represented EU members. The extent and the pace according to which the new quota formula will be used to adjust quota shares should be guided by the Fund's liquidity situation. A demonstrated need for additional Fund liquidity is an essential precondition for any general increase in quotas. With a view to enhancing the voice and representation of low-income countries, Germany supports an increase in basic votes in the context of a global agreement. A mechanism for safeguarding the share of basic votes might also help to enhance IMF legitimacy and relevance.

IV. Development finance, debt sustainability and the role of the Fund

Development Finance – The Millennium Development Declaration remains the framework for our cooperative efforts contributing to poverty reduction and sustainable development. Last year, substantial commitments were made with a view to achieving the Millennium Development Goals (MDGs). Implementation issues are now coming to the fore. While increasing Official Development Assistance and delivering it in a more effective manner is important, developing countries themselves bear primary responsibility for their development. There is broad consensus on what the key prerequisites in this respect are: sound policies that support private sector activity, good governance, strong institutions and

the rule of law. The importance of mobilising domestic resources and attracting private capital flows to increase investment is also widely recognised, as is the importance of further trade liberalisation.

Multilateral Debt Relief Initiative (MDRI) and debt sustainability – Following the decision by the respective Boards of the Fund, the World Bank and the African Development Bank, we welcome that in the meanwhile full implementation of the MDRI has begun in all participating institutions. Countries benefiting from debt relief need to increase their efforts to combat poverty, to adopt or maintain sound policies, and to improve governance. Germany is committed, on the basis of fair burden sharing and according to established criteria, Germany is committed to contribute to the costs arising from the extension of the list of eligible heavily indebted poor countries (HIPC) agreed in the respective Boards in April this year. As regards countries with huge arrears vis-à-vis the International Finance Institutions we must closely cooperate with these institutions to find sustainable solutions. We welcome the recent Board decisions to let the sunset clause on the HIPC initiative take effect, while grandfathering all countries that are assessed to have met the income and indebtedness criteria at end-2004 which will permit these countries to qualify for HIPC initiative debt relief at their own pace. Strong efforts will be needed to ensure that the beneficiaries of debt relief do not accumulate excessive debt once more. We look forward to working with the IMF and the World Bank in the coming months on the review of the present Debt Sustainability Framework (DSF) that should incorporate more appropriate reporting obligations for debtors and address both borrower and creditor sanctions. This could help to avoid inappropriate lending that free rides on debt relief. Although the primary responsibility for responsible borrowing rests with the borrowing country itself, all creditor countries are called upon to use and respect the DSF and thus to lend responsibly.