International Monetary and Financial Committee

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

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Minister of Finance of The Federal Republic of Germany
to the International Monetary and Financial Committee
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I. Global Economy and Financial Markets

Global Economy – Global growth continued to be strong in the first half of 2007 and is expected to be close to 5 percent in 2008, led by emerging markets. However, risks are on the downside following recent financial market turbulences. The recent events on financial markets have caused a re-pricing of credit risk and a retrenchment from risky assets that, combined with increased complexity and illiquidity, have led to disruptions in core funding markets. This has prompted extraordinary liquidity injections by central banks. The adjustment process will probably take time. In particular, the money market is still affected by the lack of trust between major market players. Despite all of these developments, the effects of these turbulences on the real economy appear limited up to now. Growth in the euro area is stronger and more balanced as successful corporate restructuring and strong profit growth have spurred investment and labor markets are showing clear signs of recovery. In Japan, the economic situation remains generally sound and average 2007 growth is expected to be above potential. While the full impact of financial market turbulences on the US economy remains to be seen, US growth for 2007 is expected to be below potential. From a global imbalances perspective, signs for stronger export growth and some slowdown in consumption are welcome 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 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 ensuring that consumers have the right incentives to conserve energy.

Germany – In 2006, the German economy expanded at its fastest rate for six years and the dynamics this year will be only a little weaker. In view of high capacity utilization, investment activity has been further strengthened in the course of this year. The labor market situation improved markedly with employment rising to the highest level since reunification. Together with higher income this should stimulate private consumption. The positive economic development goes hand in hand with a stronger fiscal position. For 2007, we expect the budget deficit to come down to 0.1 percent of GDP. Moreover we are on track to reach our medium-term fiscal goals. Most likely, the overall nominal budget will be balanced next year, while a structurally balanced budget is envisaged for 2010 at the latest. We will continue our successful strategy of structural consolidation and, simultaneously, strengthening the conditions for growth and employment. Viable and sustainable public finances continue to be the prime objective of fiscal policy. An important initiative to further improve the fiscal framework is the reform of business taxation coming into force in 2008. In addition, we are planning a fundamental reform of national fiscal rules laid down in our constitution.

Emerging Market Economies – Growth momentum in emerging markets remains strong. Today, most emerging market economies are far less susceptible to crisis situations than was the case ten years ago due in large to sound policies. In many emerging market economies, foreign exchange reserves, which have increased substantially in recent years, build a buffer against developments in international financial markets. At the same time, strong foreign exchange inflows can also complicate policymaking, especially in countries with fixed exchange rates. 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 in order to raise potential growth and provide more employment opportunities for their growing working-age population.

II. Implementation of the IMF's Medium-Term Strategy: Priorities Ahead

Quota and Voice Reform – Germany advocates a fair representation of all members of the Fund according to their relative weight in the global economy. We remain committed to reaching an agreement on the reform within the timeframe provided by the Singapore Resolution. The reform should set appropriate incentives to pursue policies consistent with IMF principles, promote openness and global integration, and take into account the contribution to global financial stability as well as to growth and development. We recognize that the outcome of the reform should be a sound and balanced package resulting in a shift of actual quota shares from advanced economies to dynamic emerging market economies while the voting power of low-income countries should at least be preserved. All parties need to show flexibility and act in a spirit of compromise.

We continue to support a principle-based formula with a clear and strong economic rationale. While we agree that the weight given to GDP could be increased significantly, a sufficiently high weight for openness is critical too. There is no principled case for the calculation of GDP in the formula using anything other than market exchange rates. Once a new quota formula has been agreed, a second round of limited ad hoc quota increases should take place to adjust the quota share of under-represented countries, based on an equal treatment of all countries concerned. Taking into account the IMF liquidity situation, we consider that a limited increase would be adequate to allow for the envisaged quota adjustments. We strongly support the objective of enhancing the voice and participation of low-income countries 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 Committee of Eminent Persons' analysis of the financial challenges that the Fund is facing.

While expenditure was outside of the remit of the Committee, we believe that new revenue measures cannot be considered in isolation from what is viewed as the Fund's mission, and the costs implied by that mission. Considering the Fund's financing gap, both its income and expenditure need to be addressed; and in order to maintain the credibility and sustainability of the Fund, it is imperative that decisions on continuous expenditure restraint be made at the same time as decisions on the revenue side. Furthermore, the IMF should establish an integrated and consistent income and expenditure framework.

In light of the Fund's changing role in the global system and the expectation of a structural shift to less country work on lending, we feel that a more ambitious saving target is essential and a more thorough review of expenditures is merited. In light of projected widening deficits, scenarios with higher expenditure restraints should receive careful consideration. Therefore, we would ask staff to provide us with illustrative scenarios, prioritizing the activities and core competencies of the IMF, building upon those set out in the Medium-Term Strategy. Such scenarios should include cost estimates as well as further significant expenditure restraints in real terms over a three year period. As part of any effort to restrain spending, we recognize that the Board must contribute its fair share.

Nevertheless, we consider finding a new income mechanism for the IMF a matter of the highest priority. We share the view of the Committee of Eminent Persons that an important feature of a new income model is that it relies on diverse sources of revenue which should be regarded as a comprehensive package to be discussed together. In particular, two elements for generating income should be looked into: the investment of a part of quota resources and the creation of an endowment, both accompanied by a cautious investment policy.

Progress on Other Elements of the Medium-Term Strategy

Surveillance is the most important task of the Fund and we agree with the Managing Director that renewing the foundations of bilateral surveillance and strengthening its implementation is a key objective of the Fund. As long-standing advocates of effective Fund surveillance, we welcome the adoption of the 2007 Decision on Bilateral Surveillance over Members' Policies. The new Decision will contribute to the revalidation of the fundamental purpose and objectives of surveillance and can impart greater clarity, coherence, and focus to the surveillance framework. We are pleased that the new Decision appropriately reflects the three related principles endorsed by the IMFC in April (no new obligations, evenhandedness, and flexibility). As regards the scope of bilateral surveillance, we support the proposed concept of external stability which is closely related to domestic stability. We agree that as far as domestic policies are geared to domestic stability, domestic policies are contributing to the promotion of external stability. We welcome the fact that the new Decision also applies to currency unions and – most importantly – to the European Monetary Union as a whole. In this regard, it is important that the Fund consistently applies the Decision and in particular ensures that "the principles for the guidance of members' exchange rate policies and the associated indicators … only apply at the level of the currency union" as a whole. As exchange rate analysis is key for focusing surveillance on multilateral aspects, we appreciate the efforts undertaken by the Fund to strengthen the operational and analytical foundations of the surveillance of exchange rate policies. While we note that fundamental exchange rate misalignment can be an indicator of external instability, we draw attention to the considerable uncertainties and the judgmental nature of misalignment estimates which should be taken duly into account.

We welcome the agreement reached in the Executive Board to set a statement of surveillance priorities and responsibilities in the context of the 2008 Triennial Surveillance Review that will define economic and operational priorities for surveillance, clarify responsibilities and strengthen accountability. Given its crucial role as the IMF's central decision-making body, the Executive Board must be involved actively and at an early stage in all surveillance activities, including the multilateral consultations. We also welcome the first round of multilateral consultations initiated by the Managing Director as they proved to be a helpful tool in strengthening multilateral surveillance and addressing global imbalances. Regarding the recent turmoil in global financial markets, we feel that these developments can be best analyzed within the Fund's regular activities at present, supporting the work the Financial Stability Forum has been asked to do in this area. Moreover we call on the IMF to continue to analyze the possible implications of Sovereign Wealth Funds for global financial stability in close cooperation with other international institutions, and to develop a set of best practices.

We appreciate that **emerging market economies** have shown unprecedented resilience in the face of the recent financial market turbulence. The Fund's role in emerging market economies should be guided by its core mandate, which includes candid surveillance, technical assistance and the provision of temporary conditional financial assistance in acute balance of payment difficulties. Any new financing instrument proposal 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 IMF should give priority to enhancing the effectiveness and efficiency of its work in low income countries by focusing on macroeconomic stability and sustainable growth that support the achievement of the MDGs. We welcome the IMF's ongoing role to support the implementation of the HIPC and MDR initiatives. To foster the effectiveness and efficiency of public financial management in low-income countries, we ask the Fund to actively support the implementation of the "G8 Action Plan for Good Financial Governance in Africa".

Recognizing Liberia's fragile economic situation, widespread poverty and capacity constraints, a global effort is needed that will allow the country to clear its arrears and achieve debt reduction. Germany pledges to support Liberia in financing the clearance of its arrears towards the Fund. We call on all IMF members to follow suit along the lines of the package agreed in August 2007. We also urge commercial creditors to play their full part in providing debt relief under the HIPC initiative. We look forward to the Fund's expeditious work on all the issues concerning Liberia's arrears clearance.

IEO – We welcome the latest IEO report on "The IMF's Advice on Exchange Rate Policy", the subsequent implementation plan prepared by staff, and the Executive Board deliberations on this subject. The report, implementation plan, and Board discussion have offered many useful thoughts and suggestions. It is now important to consequently carry out the Board-endorsed recommendations. On the IEO's future work program, we look forward, in particular, to the report on IMF Corporate Governance. This report can make valuable contributions to the discussions on how to streamline the institution and adjust it to an altered environment.

III. Development Finance and Debt Sustainability

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 mobilizing domestic resources and attracting private capital flows to increase investment is also widely recognized, as is the importance of further trade liberalization.

Debt Sustainability – We welcome the fact that implementation of the MDRI has begun in all participating institutions and we call on all donors to continue honoring their commitments to the full extent and in a timely fashion. Countries benefiting from debt relief need to increase their efforts to combat poverty, to adopt or maintain sound policies, and to improve governance. As regards countries with huge arrears vis-à-vis the international financial institutions, we must closely cooperate with these institutions to find sustainable solutions. Strong efforts will be needed to ensure that the beneficiaries of debt relief do not accumulate excessive debt once more. We will support the IMF and the World Bank in their work on the Debt Sustainability Framework (DSF) to make debt sustainability analyses a widely-accepted means of guidance for lending decisions. Although the primary responsibility for responsible borrowing rests with the borrowing country itself, all creditor countries are called upon to take debt sustainability aspects into consideration in their lending policies. In this regard, the IMF should also encourage responsible borrowing and lending and actively support the use of the DSF by all borrowers and creditors.

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We would like to thank Rodrigo De Rato for his dedication and initiatives as Managing Director of the IMF. We welcome Dominique Strauss-Kahn as new Managing Director and look forward to working closely with him.