International Monetary and Financial Committee

Eleventh Meeting
April 16, 2005

Statement by Mr. Hans Eichel
Minister of Finance of the Federal Republic of Germany
On behalf of Germany

Statement by Mr. Hans Eichel
Minister of Finance of the Federal Republic of Germany
to the International Monetary and Financial Committee
Washington, D.C.
April 16, 2005

I. Global economy and financial markets

Germany broadly agrees with the Fund's assessment of the world economic outlook and its well-balanced policy advice. Conditions for robust growth remain in place, although the pace of economic expansion is likely to be more moderate compared to last year. The overall balance of risks is somewhat tilted towards the downside. Major downside risks for the global economy include continuing high and volatile oil prices and the possibility of abrupt adjustments of global economic imbalances, including through further depreciation of the US-dollar. Improved fundamentals, but also the prolonged accommodative stance of monetary policy in some countries, have caused exceptionally benign financial market conditions, as reflected in low long-term interest rates and spreads close to historical lows. There is a risk that financial market conditions could tighten sharply in the event of shocks or sudden changes in expectations, including surprises in inflation. On the upside, the resilience and systemic stability of financial markets have further improved during the past year. In countries, where the cycle is most advanced, monetary policy impulses should be reduced in a measured way. The ongoing upswing should be used to reduce fiscal deficits and to strengthen fiscal sustainability. To avoid increasing global imbalances, a more balanced global growth pattern is required. Structural reforms should aim at improving resilience to shocks and strengthening longer-term growth prospects. Given the important role of international trade for growth and prosperity in all countries, we reaffirm our strong commitment to a global reduction of trade barriers within the Doha Round.

Advanced economies – We fully endorse the Fund's view that global imbalances need to be reduced in a co-operative manner, including a shift to higher savings in the United States through credible, medium-term fiscal consolidation, and continued structural reforms in Japan to increase both the growth potential and internal demand. In Europe, as well, we remain committed to structural reform to boost our growth potential and to fiscal consolidation within the strengthened framework of the Stability and Growth Pact. In the euro area, a pick up of domestic demand is needed to ensure a continued expansion. This is especially important as the export growth has been slower lately, as a result of the weaker US-dollar and a slower expansion of global demand. Stronger domestic demand will require, among other things, improved employment prospects. In Germany, far reaching reforms of the social security systems and the labor market will likely show their full impact only with some delay. Yet, we expect the employment situation to improve later this year. We believe that in the medium term these reforms will create a virtuous cycle of improved employment prospects, rising confidence and stronger domestic demand.

Emerging market economies – Germany welcomes rapid growth and improved resilience to external shocks in many emerging market economies. In view of large current account surpluses and competitive exchange rates, a higher degree of exchange rate flexibility, combined with further measures to strengthen financial systems, is desirable. We encourage emerging Asia to strengthen market-oriented reforms, including the banking sector and state-owned enterprises. Germany welcomes the improvement in fiscal positions and debt structures in many Latin American countries. In view of still high, albeit declining, public debt levels and the generally strong rebound of economic activity, we encourage Latin American countries to continue with broad-based structural reforms and prudent fiscal policies. In order to reduce the dependency on borrowing in foreign currency, the development of domestic financial markets should become a strategic priority. Access to economic opportunities for all parts of society remains important to strengthen long-term economic growth.

Oil markets and energy policy – Oil prices are to remain high and volatile because excess capacity is low and growth in demand continues to be strong. Therefore, oil extraction and refinery capacity needs to be expanded, although this will take time. Furthermore, enhanced market transparency, particularly through higher quality and timeliness of market data, could help reduce volatility. In particular, we encourage all major oil producers to provide more timely data on oil production and stocks. In the medium-term, demand management can also play a role in reducing the tightness of the market. The use of oil and other non-renewable energy sources could be restrained by a mix of measures including abolishing subsidies, imposing adequate and uniform tax rates on energy consumption, setting strong price and regulatory incentives to adopt energy saving technologies, improving the regulatory framework in the energy sector, and setting incentives for the use of renewable energies.

II. Strategic Review, surveillance, crisis prevention, and crisis resolution

Strategic Review – The Fund should primarily promote monetary and financial stability, thereby contributing to sustained economic growth. This can be best achieved by support of sound policies and robust institutions that strengthen the market mechanism. The Fund's primary instruments should remain surveillance and policy advice, supplemented by well-targeted technical assistance. In particular, the Fund should continue to advice and support its members to strengthen their economic resilience and to become more attractive for long-term private investors. This should increasingly allow members to overcome times of economic stress without drawing on Fund resources. We would like the Fund to remain a lean, efficient and effective institution that operates under a tight budget constraint and plays a clear role in the division of labor among international economic institutions.

Surveillance remains the Fund's key instrument for promoting macroeconomic and financial stability by increasing transparency in the capital market and improving the functioning of the market mechanism. Now it is important to consistently implement and apply the reforms generally agreed. Against the backdrop of budget constraints and the relevant expertise of the Fund, surveillance should concentrate on areas within the Fund's core mandate, mainly on financial sector issues, sustainable fiscal and monetary policies, and regional and global spillovers of national policies. In particular, the Fund should continue to advise governments on the appropriate sequencing of capital account liberalization and the development of financial markets, related institutions and supervisory capacity. This will require a further build up of capital markets expertise within the Fund. It is also important to strengthen debt sustainability analyses within the existing institutional framework, particularly through better information of the Executive Board by establishing a centralized and regularly updated "debt-sustainability data base", and through more realistic stress tests that identify additional fiscal adjustments necessary to reach the program targets in case of exogenous shocks.

Policy monitoring arrangements could promote the graduation from the Fund's financial support and, more generally, provide the Fund's "seal of approval" often sought by creditors and donors. They should resemble regular Fund programs with upper credit tranche conditionality and regular Board reviews, but without access to Fund financial support. Thus, the Fund could become more selective in providing financial support only to those countries that actually do have a balance-of-payments need.

Clear access limits to official sector financing are fundamental in providing incentives for sound policies in borrowing countries and for prudent risk-taking by private creditors. A predictable and consistent application of regular access limits and the exceptional access framework is key in this respect and indispensable to safeguard the Fund's credibility. Fund programs under exceptional access should provide adequate safeguards against extended use of Fund resources above access limits. Germany does not support a policy framework of precautionary exceptional access as this would make the Fund a general risk insurer. This would not be compatible with its systemic role as a provider of emergency assistance at deliberately "not-risk-adjusted" terms. It could also overstrain the Fund's financial resources. Moreover, efforts to foster private sector involvement would be undermined and moral hazard would be exacerbated.

Financial position of the Fund – We welcome the further improvement of the financial position of the Fund, in particular Russia's early repayment of obligations to the Fund and Brazil's graduation from Fund support. Nevertheless, risks remain as the Fund continues to have a large exposure to a few members, and the Fund's share of some member countries' total indebtedness remains high. To protect the Fund's financial integrity and its preferred creditor status, it is important to strictly adhere to the agreed access limits including the exceptional access framework, take into account debt sustainability analyses in lending decisions, and strengthen price incentives for early repayment of Fund credit. An accelerated accumulation of precautionary balances should be considered.

Crisis resolution initiatives – Germany welcomes the agreement on voluntary "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets" that private sector organizations and emerging market countries have reached in October last year. At their meeting in Berlin the Group of Twenty expressed its general support. The "Principles" provide a useful guideline for a cooperative approach to crisis prevention and crisis resolution. They can help to enhance the predictability of debt restructurings in cases where they are inevitable. The Fund should lend its support to the "Principles".

III. Low-income countries

Achieving the MDGs – The framework for our cooperative efforts in low-income countries (LICs) remains the Millennium Development Declaration. Germany endeavors to increase its official development assistance to 0.33 percent of gross national income until 2006. There is also a case for innovative financing. That is why Germany proposes a two pronged approach: the finalization and launching of a pilot IFF for immunization and the setting up of a solidarity tax on international air travel to refinance the pilot IFF. Possible options include an air fuel tax and charges on air tickets. The Fund's role is reflected in its commitment under the Monterrey Consensus. What is necessary now is greater clarity about the future evolution of the Fund's activities and instruments. A clear division of responsibilities between the various players is key. The Fund especially needs to focus on how to handle exogenous shocks, with a reasonable combination of non-concessional and concessional lending.

PRGF – In addition to surveillance and well-targeted technical assistance, PRGF arrangements remain the Fund's core instrument for assisting LICs to overcome protracted balance of payments problems, to strengthen growth, and to contribute to structural adjustment and poverty alleviation. Nevertheless, the goal of any PRGF arrangement should be for the country to eventually graduate to a surveillance based relationship; prolonged use of Fund resources should be avoided. PRGF programs must be more closely linked to PRSPs; lending should be strictly confined to countries willing to implement an ambitious reform agenda, with focus on mobilizing internal resources and setting up properly functioning institutions. In addition, coordination among donors needs to be improved considerably. Poverty and Social Impact Analyses (PSIA) are an important instrument and should be undertaken on a systematic basis. The necessary decision of the Executive Board on financing and instruments for LICs from 2006 onward should no longer be delayed. Germany supports a financially augmented self-sustained PRGF. We encourage others to follow.

Debt Sustainability – Considerable progress has been made under the HIPC Initiative to reduce the debt burden of LICs; we now need to avoid the re-emergence of unsustainable debt based on the new debt sustainability framework. In addition, policy monitoring arrangements could sharpen the Fund's signaling vis-à-vis other donors, where appropriate. Germany also supports higher multilateral debt cancellation - based on a case-by-case analysis for Post Completion Point HIPCs only and subject to the availability of additional financial resources for that purpose - where debt sustainability is strongly threatened as measured by the new country specific debt sustainability thresholds and where strict criteria of good governance are applied. Financing sources should be defined once a broad-based consensus on the necessity, desirability and operational feasibility of further debt relief is reached. Existing instruments and the financial integrity of the International Financial Institutions must be preserved under all financing options of a higher multilateral debt relief.

No debt relief package can possibly guarantee the attainment of the MDGs and long-term debt sustainability unless debt relief is accompanied by structural change in developing countries. The best way to achieve debt sustainability is to stimulate economic growth, to attract investment, and to implement sound policies and good governance. Therefore, we call on all HIPCs, particularly those in the interim period, to step up their reform efforts. Germany will continue to forgive the bilateral debt of the eligible countries, in total worth over € 6 ½ billion, and to raise the debt relief adopted by the Paris Club for these countries to 100 percent. In order to achieve full debt reduction, Germany would support a Paris Club consensus to cancel further commercial claims against HIPCs, provided that these claims originate from contracts concluded not later than the 1999 Cologne summit.

IV. Other Issues

Budget – Germany supports the initiative to maintain the Fund’s administrative budget at its current size in real terms for the next years. To achieve real zero growth, the Fund has to concentrate on core activities and improve the division of labour with other international economic institutions. Furthermore, we encourage Management to identify lower priority activities.

Staff Compensation Review – Germany welcomes the ongoing review of the Fund’s system of employment, compensation and benefits. We favor a transparent and rules-based system for salary adjustment that maintains the Fund’s competitiveness, ensures a truly multinational staff, and, at the same time, takes into account budgetary constraints.

Quotas, governance, voice and representation – Germany supports efforts to strengthen voice and representation of developing countries. An increase in basic votes might be an option. However, voting rights and quotas should continue to reflect the relative economic position of member countries in the world economy. At the same time, the quota formula could be simplified. Administrative capacities of developing and transition countries could be further enhanced.

Independent Evaluation Office – Germany commends the IEO for its candid and frank assessment of difficult and sometimes sensitive topics. Lessons from evaluations, supported by the Executive Board, have to be consistently incorporated into regular Fund operations. However, the IEO and the staff should avoid duplications.