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Statement by H.E. Peer Steinbrück
Minister of Finance, Germany

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The Federal Republic of Germany
to the International Monetary and Financial Committee
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I. Global economy and financial markets

Global economy – The overall economic outlook remains bright, and the prospects for more balanced global growth have improved. While the US and China are likely to remain important engines of global growth, the upswing in Japan has continued to gain breadth and depth. Likewise, there are more and more signs that the recovery in Europe is also starting to extend to domestic demand. However, this global economic outlook is not without risks. These include a delayed impact of high energy prices on output and inflation, a stronger than expected correction of housing prices in countries where they have been increasing, and either a disorderly unwinding of global imbalances or, were these to continue to widen, rising protectionist sentiment. We reiterate our commitment both to cooperative policy action to foster a gradual adjustment of global imbalances and to the goals of the Doha Round. More generally, the favourable macroeconomic environment should be used to improve fiscal balances and to strengthen fiscal sustainability. Structural reforms should be continued in order to increase resilience to shocks and longer-term growth prospects. We welcome the high degree of global financial stability at the current juncture. Against this backdrop, we are confident that current financing conditions, which remain exceptionally benign, stand a good chance of continuing to return to normal in a gradual and smooth manner.

Germany – External competitiveness remains strong and there are signs that the dynamic performance of the export sector is starting to spill over to domestic demand. We are firmly committed to improving the fiscal balance in the medium-term and enhancing the long-term sustainability of public finances. As a further measure closely linked to these policy goals, we are working towards increasing the quality of public finances with a view to strengthening economic growth and employment.

Emerging market economies – We welcome the continued strong growth and the steadily improving resilience in many emerging market economies. We support China in further pursuing its course of modernising its social security systems and financial sector, and in moving towards a more flexible exchange rate. Chinese leadership in striving for a much-needed increase in exchange rate flexibility in the region could provide a valuable

contribution towards adjusting global imbalances. Latin American countries have now the opportunity to use strong external positions to continue their laudable efforts to strengthen their fiscal positions and to reduce public debt. We encourage Middle Eastern countries to channel a good part of their higher oil export earnings into productive investment in the oil and the non-oil sectors to raise potential growth and provide more employment opportunities for the growing working-age population.

Oil markets and energy policy – Against the backdrop of relatively low reserve capacities, bottlenecks in oil processing and strong growth in demand, oil prices are likely to remain at their historically high levels for the foreseeable future. While this poses macroeconomic risks, it also provides opportunities: High energy prices can spur investment in energy infrastructure, in energy-efficient technologies, and in alternative sources of energy. Policy-makers can contribute to this by ensuring that the price signal remains undistorted, by removing barriers to investment and by working further towards improving the quality of oil market data.

II. The Fund's 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 allow members to overcome times of economic stress without Fund financial assistance.

Surveillance is the most important task of the Fund and needs to be further strengthened. In particular, the Fund should monitor more closely the global monetary and financial system and advise its members to undertake the necessary adjustments in order to maximize positive spill-overs. Bilateral surveillance should assess more frankly the consistency of domestic policies with exchange rate policies and their international repercussions, while respecting the member's free choice of its exchange rate regime. As long as technical assumptions are not generally accepted, we doubt, however, whether equilibrium exchange rate models can provide reliable yardsticks for policy advice. We welcome the proposals to integrate more closely macroeconomic and financial market analysis in multilateral surveillance, and to focus bilateral surveillance more on financial sector issues. Since the current debate on strengthening the surveillance role of the Fund is closely related to the evolution of global financial markets, this should be reflected in the Fund's institutional work structure. The new department evolving from the merger of the International Capital Markets and the Monetary and

Financial Systems Departments should therefore become a lead department – not a mere support department for area departments – and be responsible for providing comprehensive, cross-country and global analysis of financial markets. Reorganizing the new department in line with the work practices of the Fiscal Affairs Department, which takes a national perspective, would bypass the Fund’s comparative advantage of having a truly global perspective. While the Fund should continue to advise members on financial sector reforms, it should avoid becoming involved in specifics of national banking supervision. In addition, a better integration of bilateral, regional and multilateral surveillance is essential in making Fund surveillance more effective.

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 financial assistance in acute balance of payment difficulties. In order to strengthen responsible risk assessment by global investors and to alleviate debtor moral hazard, the Fund should consistently apply the agreed Exceptional Access Framework in future crisis cases. In addition, the programme design should be sufficiently ambitious as to allow emancipation from Fund assistance after regular programme expiration to be expected ex ante. We regard the Fund’s strengthened toolbox as being adequate enough to allow it to respond flexibly to member needs. In any case, new financing instruments would have to be checked against their consistency with the Fund’s mandate, its financing mechanism and other existing instruments, as well as the universally accepted principles of conditionality and uniformity of treatment.

The Fund’s role in low-income countries – The Fund should continue to play an important role in low-income countries through surveillance, technical assistance and concessional financial resources. We support efforts to further improve the division of labour with the World Bank by clearly assigning the respective tasks and responsibilities, and by cooperating closely. In our view, the Fund should focus on macro-critical issues tailored to individual country circumstances, including institutions relevant to financial stability and economic growth. Given the recent improvement of the Fund’s toolbox with regard to low-income countries and the aim of clarity and transparency in its operations, we see no need to establish further lending instruments for low-income countries. User charges for technical assistance, determined in accordance with members’ ability to pay, could help to allocate scarce Fund resources more efficiently.

Quotas, voice and governance – Germany supports the fair representation of all members in the Fund. Many fast-growing economies are no longer adequately represented. This is particularly true for, but not limited to, Asia. Many European members, including Germany, are also under-represented, as measured by the existing quota formulae. In order to correct for some of the largest imbalances, we support a limited ad hoc increase of quotas for under-represented members, to be agreed upon at the annual meetings in Singapore. To ensure its acceptance by all members, equal treatment, based on objective eligibility criteria and a fair

burden sharing, is crucial. In the spirit of fair burden-sharing, over-represented countries should bear a larger part of the burden of quota adjustment. It is our aim to have achieved concrete progress – as ambitious in nature as possible – by the annual meetings in Singapore. We recognize that there are longer term governance issues which may need to be addressed in due course. We favour a further strengthening of the Board as the central decision-making body; it should be involved more actively and as early as possible in core policy and country issues.

Income position and the budget – Given the sharp fall of its income from lending operations, we recognize the need to put Fund financing on a more stable, predictable and transparent footing, with less reliance on margins from lending. Running down reserves is not an option. We support the proposals currently being discussed by Management and staff for closing the financing gap in FY 2007, and we are ready to discuss further measures for broadening income with a view to finding a sustainable longer-term solution. We support the proposal to activate the Investment Account. We are ready to discuss further measures, such as cuts in real spending over the medium-term. We would not, however, be able to support proposals for using the hidden reserves in the Fund's gold holdings, because these reserves are essential to protect the Fund's financial integrity. Strong budget discipline must contribute to closing the financing gap. The Managing Director's report on the medium-term strategy is a first, valuable step in this direction. The new medium-term budgetary framework should be consistently implemented to ensure that the annual budgets adequately reflect the IMF's strategic objectives and provide transparent costing for each of the Fund's activities.

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

Development finance – The Millennium Development Declaration remains the framework for our cooperative efforts. 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 of 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 and the World Bank, we are confident of a timely begin to the full implementation of the MDRI. We hope that this will include the African Development Fund on the basis of decisions expected to be made very soon.

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, to contribute to the costs arising from the extension of the list of eligible highly indebted poor countries (HIPC) recently agreed in the respective Boards . We agree in principle to closing the list of ring-fenced countries, but the option of enlarging the list should be left open where countries, such as Afghanistan, can present verified data up to the end of 2004. The Fund should develop options to deal with countries which may be potentially HIPC, but which may not be able to establish a policy track record before the expiration of the sunset clause. Strong efforts will be needed to ensure that the beneficiaries of debt relief do not accumulate excessive debt once more. Debt management should continue to rely on the joint Bank-Fund Debt Sustainability Framework (DSF) that has enhanced the quality and comparability of assessments in low-income countries, including HIPC. Although the MDRI has strengthened the financial position for countries after debt relief, the current debt thresholds should be maintained. For countries well below the DSF thresholds, a case-by-case approach for new borrowing appears preferable. It is the responsibility of both the IMF and the World Bank to assess such borrowing and – to the extent that non-concessional borrowing is concerned – to decide whether such credits are appropriate or not. Another challenge is to take domestic debt more systematically into account.

The Fund's role – In order to cope better with rising aid, including debt relief, the Fund, in close cooperation with the World Bank and other agencies, should intensify its advice to recipient countries on public expenditure management, increasing absorptive capacity, and on how to respond to real exchange rate effects. The Fund should – within its area of competence – assess whether projected aid flows are consistent with macroeconomic stability and the estimated costs of achieving the respective countries' development goals. Strengthened technical assistance encompassing a more focused and integrated approach for capacity building is needed. Technical assistance should be closely linked to the Fund's surveillance or programme relationship with a country and set within an explicit medium-term perspective. In this respect, we welcome the establishment of the third African Technical Assistance Centre (AFRITAC), and we are currently considering contributing to this activity. Beside surveillance and technical assistance, the PRGF remains the main tool for assisting low-income countries facing protracted balance of payments problems. As a result of the increasing use of low-access PRGF arrangements, the new Policy Support Instrument (PSI) and higher multilateral debt relief, we expect less need for PRGF lending. Nevertheless, we reiterate our call on oil-exporting countries to contribute to the funding of the PRGF-ESF-Trust. The Fund's lending should be strictly confined to those countries with balance of payment problems which are willing to implement ambitious adjustment measures, the focus of which is on mobilizing internal resources and setting up sound institutions.