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Statement by Mr. Eichel

Statement by Mr. Hans Eichel
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

Germany agrees with the Fund's outlook for the world economy and its balanced policy advice. Conditions for robust growth remain in place, and the global economic upswing is likely to become more broad-based but at the same time less buoyant. The overall balance of risks is now more tilted towards the downside. Major adverse risks are: high and volatile oil prices, overvalued house prices in a number of advanced countries, and global imbalances. Furthermore, many emerging market economies are challenged by fragile debt structures and excessive credit growth. In order to sustain the current global expansion at a high rate, a more balanced growth pattern is required. In countries, where the cycle is most advanced, monetary policy impulses should be removed in a measured way. The upswing should be used to reduce fiscal deficits and to strengthen fiscal sustainability. Structural reforms should aim at improving resilience to shocks and strengthening medium-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 - The recovery of the euro area is gaining momentum. The essential conditions for a sustained upswing are in place supporting fiscal consolidation within the framework of the Stability and Growth Pact. Domestic demand has to pick up as well, in particular in Germany. As this will require, among other things, improved employment prospects, the challenge is to create a virtuous cycle of rising employment and growing domestic demand. This will be facilitated by fully implementing recent structural reforms but needs to be supplemented with additional reforms over the medium term. 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 in order to increase both the growth potential and 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. In view of the generally strong rebound of economic activity and still fragile debt structures, we encourage Latin American countries to continue with broad-based structural reforms and prudent fiscal policies. Access to economic opportunities for all parts of society remains important to strengthen long-term economic growth. The development of domestic financial markets should become a strategic priority to reduce the dependency on borrowing in foreign currency.

Oil markets and energy policy - It is worrisome that little surplus capacity in oil production is left and that any supply-side disruption could lead to renewed price hikes. Capacities in oil-producing countries need to be expanded to reduce the high oil price and its excessive volatility. Volatility could be reduced by more market transparency, also with respect to the activities of hedge funds; here, there is a need for intensified surveillance. In the medium-term, use of oil and other non-renewable energy sources has to 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. Surveillance, crisis prevention and crisis resolution

Surveillance, the Fund's key instrument to promote macroeconomic and financial stability, should be further strengthened. Priority should be given to consistently implementing and applying the reforms that have already been agreed. Surveillance should focus more closely on the Fund's core mandate, macroeconomic performance and financial sector stability. Particular emphasis should be given to crisis prevention, sustainable fiscal and exchange rate policies, and global repercussions of national policies. Surveillance in program countries should be more candid and comprehensive. Debt sustainability analysis should be strengthened within the existing institutional framework, particularly through a centralized and regularly updated debt-sustainability data base and more realistic assumptions, especially in the fiscal area. Transparency needs to be further increased in line with the framework that became effective in July 2004.

Non-borrowing programs or policy monitoring arrangements could provide the Fund's seal of approval often sought by creditors and donors. They could also promote the graduation from the Fund's financial support. This type of arrangement should be further explored.

Clear access limits to official sector financing is fundamental in providing incentives for sound policies in borrowing countries and for prudent risk-taking by private creditors. Fund credits should make up only for a small part of a member's external debt. Access to Fund resources should be guided by regular access limits. Exceptionally high access should be restricted to truly exceptional capital account crises. The consistent and strict application of the exceptional access framework to new cases of exceptional capital account crises is essential to foster the Fund's credibility.

Financial position of the Fund - Although risks resulting from the concentration of large financial exposures to only a few member countries have increased, the financial position of the Fund is expected to remain strong. Vigilance is needed to preserve the Fund's financial position. In this regard, the following action is required: surveillance should be intensified focusing on debt sustainability analyses; the exceptional access framework needs to be consistently applied; the pricing of the Fund's lending should strengthen incentives for early repayment; and finally, the framework for setting up precautionary balances has to be fully implemented while an accelerated accumulation of precautionary balances could be considered.

Precautionary arrangements - To secure market confidence, precautionary arrangements within normal access limits can be a useful instrument. Germany does not support, however, a policy framework of precautionary exceptional access as this would thwart efforts to foster private sector involvement. Moral hazard would be exacerbated. The assessment of a potential balance-of-payments need would be difficult and highly arbitrary. The strain on Fund's resources could easily become overwhelming. Moreover, precautionary exceptional access would be incompatible with the Fund's systemic role as a provider of emergency assistance at "not-risk-adjusted" terms.

Crises resolution initiatives - Germany supports the ongoing efforts of borrowing countries and private sector organizations to develop common guiding principles for fair sovereign debt restructurings. Such voluntary principles could make debt restructurings more orderly, transparent and equitable. We hope that such principles can be presented soon. Germany welcomes the increased use of Collective Action Clauses in sovereign bonds issued under foreign law. The German government is working intensively on a comprehensive reform of the indenture law that will enable borrowers to use such clauses in sovereign bond contracts issued under German law. This law is expected to enter into effect by next year. The Fund should continue its conceptual work on issues raised in the discussion on Sovereign Debt Restructuring Mechanisms. We urge the Argentine authorities to complete a comprehensive and sustainable restructuring of its sovereign debt with its private creditors, supported by a sound medium-term fiscal framework. Furthermore, we call on the Argentine government to resume close cooperation with the Fund as soon as possible with the objective to reactivate and fully implement the agreed program.

III. Low-income countries

The framework for our cooperative efforts in low-income countries remains the Millennium Development Declaration. Low-income member countries have the primary responsibility to put in place the policies and institutions needed to spur economic growth and to reduce poverty. The advanced countries should adopt a more liberal trade regime and continue to provide development assistance at an appropriate level. The Fund should complement these efforts by helping low-income countries to establish and maintain macroeconomic stability through surveillance, technical assistance and financial support. We agree with the staff report on Aid and Financing Modalities that the best way to step up development assistance would be for donor countries to increase their aid budgets, with a view towards reaching a level of official development assistance of 0.7 percent of gross national income. At the same time, we have to acknowledge that serious fiscal constraints in many donor countries are a major obstacle to this goal. Despite these constraints and as an intermediate step, Germany endeavors to increase its official development assistance to 0.33 percent of GNP until 2006.

PRGF arrangements remain the core instrument of the Fund to contribute to poverty alleviation and to strengthen growth, given the overall financing needs of low-income countries, frequent needs to structural adjustment and protracted balance-of-payments problems. Lending should be confined to countries willing to implement an ambitious reform agenda. Progressively lower access to PRGF resources would facilitate the graduation to surveillance-based relationships, keep debt sustainable and limit prolonged use of Fund resources. PRGF programs must be more closely linked to the country-owned Poverty Reduction Strategies (PRSPs). We are pleased to note that a total of 42 countries are now implementing PRSPs. It is primarily the task of the low-income countries themselves to further promote this process with a focus on mobilizing internal resources and setting up properly functioning institutions. In addition, coordination among donors needs to be considerably improved. Progress with respect to the Millennium Development Goals should be systematically assessed. The necessary decision of the Executive Board on financing and instruments for low-income members from 2006 onward should no longer be delayed. Germany supports a financially-augmented self-sustained PRGF. We are willing to make a financial contribution and encourage others to follow.

HIPC Initiative - We are pleased that since the last Annual Meetings, six more countries have reached the completion point under the HIPC Initiative but we had hoped for more. We call on all HIPCs in the interim period to step up their reform efforts. Macroeconomic stability, satisfactory implementation of a PRGF-supported program and good governance remain essential. We welcome the decision to extend the sunset clause by two more years. We await an analysis of its cost implications and urge the Fund to examine how this can be financed. 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 HIPC countries, provided that these claims originate from contracts concluded not later than the 1999 Cologne summit.

Debt Sustainability Framework - Good governance, sound institutions and solid policies are key prerequisites to achieve and preserve debt sustainability in low-income countries. A comprehensive analysis of debt sustainability should guide future lending decisions. We, therefore, strongly support the new debt sustainability framework jointly proposed by Fund and Bank staff, although some parameters of this framework still remain to be specified. Regarding debt thresholds, it will be important that the new framework strives to err on the side of caution to avoid new lend-and-forgive cycles. The best way to achieve debt sustainability is to stimulate economic growth, to attract investment, and to implement sound policies. We do not favor a predominant role of grants for countries eligible for debt relief under the HIPC initiative because this might endanger the catalytic roles of the International Financial Institutions in development finance.

IV. Other issues

Money laundering and the financing of terrorism threaten the integrity of the global financial system. Therefore, we welcome the fact that countering money laundering and combating the financing of terrorism has become a core responsibility of the Fund, that respective assessments are a regular part of all Financial Sector Assessment Programs and that the Fund and the Bank are fully accountable for comprehensive assessments of the corresponding standards. The cooperation between the Fund, the Bank and the FATF should be further intensified.

Budget issues – The Fund is an institution committed to sound public finances; it has rightly stressed the need to restrain public expenditure increases in most member states. We, therefore, support a constant administrative budget in real terms for the coming years. We welcome the recent proposal by the Committee on the Budget to introduce a multi-year budget. We expect staff and management to make appropriate suggestions on how to set clearer budgetary priorities, how to streamline other activities, and how to save additional costs. We look forward to the results of an independent review of staff compensation and benefits. We reiterate our proposal for establishing a sunset clause for new Fund activities.

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. Beyond that, voting rights and quotas should continue to reflect the relative economic position of member countries in the world economy. The quota formula could nevertheless be simplified. Administrative capacities of developing and transition countries could be further enhanced.

Independent Evaluation Office - Germany commends the Independent Evaluation Office (IEO) for its candid and frank assessment of difficult and sometimes delicate topics such as the role of the Fund in Argentina between 1991 and 2001. Lessons from evaluations, supported by the Executive Board, have to be consistently incorporated into regular Fund operations. We continue to support and look forward to the IEO's high quality and important work.