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Statement by Wolfgang Schäuble
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On behalf of Germany

Statement by Mr. Wolfgang Schäuble

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to the International Monetary and Financial Committee

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I. Global Economy and Financial Markets

The global economy has entered a decisive phase. The strong output expansion in 2010 close to or above pre-crisis levels has mainly been a rebound from the trough of the crisis. At the current juncture, nearly all regions experience a slowdown in growth. Uncertainty about medium-term growth prospects has increased. Yet, the baseline scenario for the world economy is still one of moderate growth, not of recession. Going forward, we are well advised to be cautious on whether pre-crisis growth trends can be sustained. Projections on potential output may have to be adjusted downwards if the current rise in unemployment levels in some advanced economies weighs more permanently on the economy. Therefore, we should expect a period of more moderate growth.

The current phase of "balance sheet" adjustment in advanced economies is necessary in view of the unsustainable accumulation of debt in the public and private sector. Reducing the debt overhang is a fundamental prerequisite for growth going forward. Therefore, we must concentrate on firmly implementing agreed policy strategies, in particular the implementation of medium-term fiscal consolidation, the strengthening of our financial sectors and structural reforms to enhance the growth potential of our economies. On the fiscal side, our strong commitment to stick to the fiscal targets agreed by the G20 in Toronto is important. Where necessary we can strengthen the growth orientation of our budgets, without leaving the path of fiscal consolidation.

Germany

The upswing in Germany is still intact although the progress of the upturn in early summer 2011 was lower than expected after the surprisingly strong start of economic activity at the start of this year.

While the leading confidence indicators have been on a downward trend for some months now, albeit from exceptionally high levels, most recent data show that the industrial sector has made a favourable start in the third quarter despite. For the time being, industrial production is likely to benefit from the still overall robust inflow of orders.

The German labour market has clearly benefited from the noticeable increase in macroeconomic activity. More recently, however, the decrease in unemployment and the increase in employment have tended to somewhat level off. Both in 2011 and 2012 unemployment is expected to remain below the three-million mark on average. Forward looking indicators suggest that employment will continue to expand.

Meanwhile, the risk profile has significantly shifted to the downside. In particular, the recent loss of momentum in global trade might put a strain on the German economy. At the same time, the importance of domestic demand as a pillar of growth is likely to further increase.

In the year 2011, Germany's budget deficit is expected to reach 1 ½ percent of GDP. The deficit will be back below the deficit ceiling stipulated by the European Stability and Growth Pact two years earlier than required under the excessive deficit procedure. With consolidation progressing, a balanced budget could be reached 2014 and the debt ratio could decrease to 72 percent of GDP in 2015.

Financial Markets

Global financial stability risks have increased severely over the past months. Regaining confidence will require resolute and reliable endeavors to fiscal consolidation thus ensuring fiscal sustainability as well as further strengthening of bank balance sheets.

The continuing financial crisis underscores the necessity to further strengthen regulatory and supervisory policies in order to make financial systems more resilient and prevent future crises. The focus will be on implementing the G20 Washington Action Plan and the decisions made at the G20 summits in London, Pittsburgh and Seoul on a timely and coordinated basis. At the upcoming Summit in Cannes, the G20 will need to take crucial decisions to assure that further progress is made. IMF members should support this process by bringing in the necessary legislation to ensure that the new global standards and policies are implemented, in particular with regard to strengthening the capital and liquidity regime. These new standards and policies will strengthen the resilience of banks, contribute to the stability of the entire financial system by submitting all financial products, institutions and markets to effective oversight and regulation, and improve incentives for better risk management. It will also be important to strengthen the framework and the data base for macro-prudential supervision. In this context, Germany welcomes the IMF's and FSB's recent biannual Early Warning Exercise.

On the regulatory side, one of the most pressing challenges ahead is the finalization and implementation of an appropriate framework to deal with systemically important financial institutions in order to both bolster their resilience and reduce the moral hazard. Germany welcomes the recent progress by the FSB and Basel Committee towards the determination and regulatory treatment of global systemically important firms, especially banks. Germany supports the introduction of a capital surcharge tiered according to the systemic importance of a bank. The experience of the crisis has also demonstrated the importance of a well-designed legal framework for effective bank resolution. The German government has already implemented a comprehensive framework allowing to restructure and ultimately resolve failing banks, complemented by a systemic levy in the shape of a "banking fee". The fee will flow into a stability fund to finance the restructuring and resolution of systemically relevant banks in the future. The levy charged will reflect the systemic risk a financial institution poses, thus helping to internalize some of the negative externalities embedded in its activities.

Another important issue of international financial sector reform is the development and implementation of an effective monitoring framework as well as balanced and targeted regulatory measures with regard to the shadow banking system. In order to effectively detect and reduce systemic risks stemming from the shadow banking system and address the problem of regulatory arbitrage, it is necessary to comprehensively cover all entities and activities directly or indirectly involved in credit intermediation outside the regular banking system, including hedge funds.

II. IMF Policies

With the approval of the 14th General Review of Quotas and Reform of the Executive Board by the Board of Governors, the IMF is but one step away from achieving a fair and balanced representation of membership in terms of quota and voice. In Germany, the necessary legislative processes are underway and ratification will be completed well before the envisaged target date of fall 2012. Germany supports the view that the IMF should remain a quota-based institution.

IMF surveillance

The IMF is the key institution to support and monitor macroeconomic and financial stability at the global, regional, and country level. Germany supports the ongoing efforts to strengthen the tools and effectiveness of surveillance, which is and will remain the primary crisis prevention tool at the IMF's disposal. Reform efforts are appropriately concentrated both on enhancing surveillance of the financial sector and putting greater emphasis on the multilateral dimension of surveillance. In this regard, we appreciate the recent completion of the first round of spillover reports for systemically important countries and regions. Furthermore, Germany welcomes the new Consolidated Multilateral Surveillance Report discussed by the IMFC which brings together the main conclusions and policy recommendation of the IMF's various multilateral surveillance products. Notwithstanding the welcome efforts to strengthen the multilateral dimension of surveillance, bilateral surveillance should remain the key pillar of the Fund's surveillance framework as preserving domestic stability is an indispensable precondition for safeguarding global stability.

Germany broadly supports the operational surveillance priorities for the period 2011-14 identified in this year's Triennial Surveillance Review. The intention to pursue a more holistic approach to surveillance is commendable. Better integrating macroeconomic and financial sector surveillance, fully taking into account the interconnections among countries, and enhanced risk assessments are particularly important going forward. Preconditions for increased traction include high quality analysis, candor, evenhandedness, and policy advice tailored to country specific circumstances while at the same time preserving the cooperative character of the Fund. Whether there is a need for adjustments to the legal framework needs to be thoroughly discussed. In our view, the Fund can analyze and assess all relevant issues on the basis of its surveillance mandate under the current Articles of Agreement and has demonstrated in the past its flexibility to adjust its surveillance policies to changing challenges within this frame. This said, Germany is open to further discuss possible options of an integrated surveillance decision which would cover both bilateral and multilateral surveillance. However, this must not lead to any subordination of bilateral surveillance or blur its main focus on domestic stability. Furthermore, efforts to develop an integrated surveillance decision should not distract the Fund from its ongoing endeavor to strengthen the effectiveness and traction of surveillance under the current surveillance framework.

Reform of the International Monetary System

- Capital Flows

Free movement of capital should remain the ultimate objective and countries, through individual and cooperative efforts, should work to put in place the preconditions for successful capital account liberalization. The main objective of capital flow management is to enhance national and global financial stability. In order to deal with high and volatile capital flows, countries need room for manoeuvre to formulate their policy mix against the background of country specific circumstances in order to enhance financial stability. Capital flow management measures may complement a broader macro-prudential approach, but should never be used to buttress unsustainable or distortionary policies and thus delay necessary adjustments in the economy. In particular, they are not a substitute to sound monetary, fiscal, exchange rate or other regulatory policies, which bear the prime responsibility for ensuring overall economic health and financial stability. If capital flow management measures are applied they should be predictable, temporary, reversible, targeted and transparent. To strengthen transparency, early detection of financial stability risks, and spillover analysis, the IMF should play an enhanced role in global monitoring of capital flows and capital flow management measures applied by members. In close cooperation with other relevant financial institutions it should strive to close data gaps on global capital flows.

- Global liquidity and reserves

Germany welcomes the progress achieved in the discussion on the definition and measurement of global liquidity. Germany concurs with the findings, that there is currently no agreed unique concept of global liquidity and welcomes further work in this field. Further works on the issue of global liquidity including the monitoring of liquidity developments should be conducted by the IMF together with other relevant institutions.

Germany supports the call on the IMF to conduct further work on improving its metrics to assess reserve adequacy. Such metrics can be a useful additional tool for discussions with countries in the context of surveillance. At the same time, we recognize the inherent difficulties in assessing reserve adequacy and developing appropriate metrics, and the importance of taking into account country-specific circumstances in this context.

- Lending Framework and Global Financial Safety Net

Fund-supported programs have benefited many countries, affording them much-needed time to undertake reforms and to bring about the domestic adjustment necessary to regain macroeconomic stability. The IMF's lending framework has undergone extensive modifications in the past, including in response to the economic and financial crisis. With the Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL) new facilities were introduced that aim to support countries with strong fundamentals and policies.

While we welcome the discussion for further enhancements of the IMF´s toolkit to support countries during systemic stress, any amendment should be based on a thorough assessment of the existing instruments as well as financial implications and moral hazard concerns. Conditionality should continue to feature adequately in the Fund´s lending toolkit.

We are open to discuss strengthening the IMF toolkit within the FCL and PCL in order to provide short-term liquidity lines to FCL and PCL eligible countries. In any case these characteristics should preserve the overall FCL/PCL criteria currently in place, also with regard to maintaining ex post conditionality for the PCL (including in particular prior actions and a letter of intent from country authorities).

- Regional Financial Arrangements

Germany welcomes the recent work on principles for enhanced IMF-RFA collaboration. A fruitful cooperation between RFAs and the IMF could benefit from respective comparative advantages in surveillance and prevent "facility shopping". However, as the existing RFAs are at very different levels of development and possess different aims and institutional capabilities any cooperation between an RFA and the IMF should be tailored to the specific circumstances and be based upon non-binding rules, while respecting the prevailing mandates.

- SDR Basket

Germany welcomes the work towards a criteria-based path to broadening the composition of the SDR basket in a medium-term perspective. The composition of the basket should continue to reflect the role of currencies in the international financial system. Expansion of the basket should be based on clear and transparent criteria, and be adjusted over time as needed to reflect currencies' changing roles and characteristics. The "freely usable currency criterion" has served the stability and the reserve asset character of the SDR well. Any adaptation of criteria, or of indicators for their interpretation, should not compromise on these important features. Expanding the set of indicators will require improvements in the availably of relevant data, in particular higher participation in reporting. Therefore, we explicitly support efforts for data improvements.

It is important to acknowledge that the internationalization of currencies will continue to be a market-driven process which will have important policy implications for all countries. This process will enable countries to increase their degree of exchange rate flexibility, and to rely less on capital control measures moving towards a more liberalized capital account and thereby a decreasing need for foreign reserve accumulation.

IMF governance

The current governance structure and division of labor between the Executive Board, the IMF management, and the IMFC has served the Fund well and has enabled timely and effective decision-making in response to the challenges that have arisen over the course of economic and financial crises. Nevertheless, Germany is open to discuss ways to further improve the Fund's governance structure, including strengthened ministerial involvement. In any case, the roles, competences, and responsibilities of the Board of Governors and the Executive Board should be preserved.