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

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I. Global Economy and Financial Markets

Germany broadly agrees with the Fund's assessment of global economic prospects, its emphasis on medium-term risks and the Fund's urge to regain room for policy maneuver. It is now of key importance to broaden the recovery in order to make it sustainable, to reduce vulnerabilities and to build stronger institutions, including in the financial sector. Each country should assume responsibility for supporting global growth and for reducing prevailing imbalances, paying due regard to financial sector stability and fiscal sustainability. Structural reforms should not loose momentum. In order to support domestic and global adjustment, greater exchange rate flexibility should be allowed.

Prospects. Since the Dubai Annual Meetings, global economic prospects have improved considerably, supported by accommodative macroeconomic policies, increased optimism in financial markets and a surge in world trade. In a growing number of countries, price stability is prevailing, underpinned by rapid technological change and strong global competition. Companies have made considerable progress in cutting costs and raising productivity. Balance sheet adjustments have further progressed. A number of countries, including Germany, have implemented key structural reforms. In our view, preconditions for a sustained recovery are in place. We expect the recovery to accelerate during this and next year in Germany, and the euro area, driven by a strong growth in world trade, further improved fundamentals and pent-up demand for private investment and consumption. In addition, in Germany, the last step of the tax reduction package will provide further stimulus in 2005.

Risks. With global recovery further strengthening, additional upside surprises are possible, including for the euro area. However, downside risks cannot be ignored. Euro area domestic demand is slow to recover. Geopolitical risks remain. Oil and other commodity prices have surged to levels unusual for this stage of the recovery. Moreover, persistent global imbalances and asymmetric exchange rate adjustments bear the risk of abrupt and excessive exchange rate movements, possibly spilling over to other markets. Abundant liquidity and the search for yield have contributed to optimistic valuations in some asset markets, creating the danger of a disorderly correction. If materializing, the latter two risks could become mutually reinforcing.

Industrial countries. In order to support global economic adjustment, EU countries must increase their growth potential through further structural reforms combined with budget consolidation within the framework of the Stability and Growth Pact and more investment in R&D. Germany will continue with its structural reform agenda and reduce its budget deficit below the 3 percent limit in 2005. The U.S. should gradually increase its savings rate through lower budget deficits and higher private savings. In order to make the recovery sustainable, Japan should continue with structural reforms and market-based adjustment. With growth gaining strength and demographic challenges mounting, fiscal consolidation becomes of utmost importance, not only but most pressingly in Japan. In most industrial countries, years of postponed consolidation have to be made up for and room for policy maneuver has to be regained. It is therefore important to aim at a medium term budget position close to balance or in surplus. This task is best achieved by expenditure restraint, measures to broaden the tax base and improvements in tax compliance and is facilitated by a medium-term fiscal framework such as the Stability and Growth Pact.

Emerging Market Economies. Germany welcomes the progress made in several emerging markets economies (EME) which are pursuing sound macroeconomic policies and which have increased the stability of their financial systems. The decrease in Emerging Markets Bond spreads reflects stronger fundamentals including structural reforms, but also abundant liquidity and increased risk appetite. Despite progress, high public debt remains a risk in many countries. In particular, EME should give high priority to the development of domestic capital markets, which are instrumental in mobilizing domestic resources and channeling them into the most productive uses. At the same time, they reduce the dependency on potentially volatile international capital flows and provide a less risky source for debt financing. Therefore, one focus of the German G-20 Presidency is on institution building in the financial sector. Also, new financing instruments such as "Growth Indexed Bonds" deserve further consideration. If properly designed and accepted by markets, such instruments could contribute to broadening the investor base for EME. We encourage the IMF and the World Bank to analyze the pros and cons of such instruments. In cases where the domestic economy is strong and currency reserves are further accumulating, thereby indicating economic imbalances, greater exchange rate flexibility could foster the domestic and the global adjustment processes. In a number of cases, the move to greater exchange rate flexibility should be accompanied by a well sequenced liberalization of the capital account, supplemented with complementary structural reforms. On Argentina, we welcome the authorities' commitment to establish a timetable and process aimed at ensuring meaningful negotiations with all representative creditor groups and look forward to a collaborative agreement with creditors on a sustainable debt restructuring, which would attain broad support from creditors. This would improve external confidence, thus strengthening long term growth and debt sustainability.

Oil Exporting Countries. OPEC has to assume responsibility for a steady recovery of the world economy as well. Oil prices have already increased substantially above OPEC's upper price tranche, reflecting buoyant global demand, relatively low levels of reserves in oil importing countries and uncertainty over the steadiness of oil supply. Germany therefore calls on OPEC to review its recent decision to lower production quotas, also taking into account that oil prices have already risen substantially above OPEC's price range.

Doha Development Agenda. All of us will benefit from further trade liberalization. Therefore, WTO members should work hard to reinvigorate the Doha Development Agenda and to find compromise solutions on all central issues until the summer break at latest. Germany shares the view that the success of the Doha Round depends particularly on solutions regarding agriculture and the so-called Singapore issues. Germany is committed to play a constructive role, also regarding agricultural export subsidies. However, we expect other negotiating partners to act in the same spirit as market access for industrial goods and services remain important as well. Germany will undertake, together with its partners in the European Union, all efforts to achieve progress within the next weeks.

II. Crisis prevention and resolution

Surveillance. Surveillance remains the IMF's key instrument for promoting macroeconomic and financial stability, thereby contributing to crisis prevention. Surveillance has been strengthened in recent years, including through increased use of vulnerability assessments and a broader publication of IMF documents. While Germany supports measures to further increase the effectiveness of surveillance, the current institutional structure for conducting surveillance remains adequate, including for program countries. In view of its core mandate, the IMF needs to remain focused on macroeconomic and financial sector issues, working complementary to the World Bank, the OECD and regional development banks. Surveillance of exchange rate regimes, domestic financial markets, and global and regional linkages should be intensified. The work on the debt sustainability database should be accelerated and debt sustainability analyses of developing and emerging countries` debt profiles should be performed regularly.

Precautionary Arrangements. The current policy framework is sufficiently flexible to provide members in need with timely financial assistance. Going forward, we will not support a policy framework for precautionary arrangements allowing for exceptional access, which would put in question the Fund's recently agreed policy on exceptional access. Moral hazard problems would be exacerbated if the Fund takes the role of a general risk insurer, and efforts to foster private sector involvement would be thwarted. Precautionary exceptional access would also be incompatible with the IMF's systemic role to provide emergency assistance at "not-risk-adjusted" terms. Assessments of the potential need for Fund resources in capital account crises would be highly uncertain and arbitrary. The strain put on IMF resources could easily become overwhelming, also bearing in mind the Fund's already high exposure. From the member's perspective, negative signals to markets could arise. In contrast, precautionary arrangements within standard access limits can be a helpful complement to secure market confidence by means of a regular endorsement of a country's policies through the Fund.

Access Limits. Limits to official sector financing are fundamental in providing incentives for sound policies in borrowing countries and prudent risk-taking by private creditors. Access to Fund resources should be guided by regular access limits. Exceptional access should be restricted to truly rare cases. Risks for the Fund, resulting from large exposure to a few member countries, should be considered carefully. Thus, the consistent and strict application of the new exceptional access framework is essential to foster credibility of the IMF`s policy.

Preferred Creditor Status. Germany regards the preferred creditor status as indispensable for the IMF's lending policy. It is the prerequisite for the "not-risk-adjusted" lending terms. If challenged, the IMF would need to demand an extra premium reflecting the default risk of individual members. Moreover, the IMF would face the fundamental problem of creditor member countries questioning the security and liquidity of their quota subscriptions and becoming increasingly reluctant to deposit part of their foreign reserves in the Fund. Hence, the preferred creditor status needs to be preserved in order to maintain the co-operative nature of the Fund. To keep the preferred creditor status credible and enforceable it is critical that IMF credit makes up only for a minor part of a member's external debt. Therefore, restricted access to Fund resources is key.

Sovereign Debt Restructuring - Code of Conduct, and Collective Action Clauses. The debate on a Sovereign Debt Restructuring Mechanism has raised several important issues such as the aggregation of claims, the treatment of debt stocks, and the asymmetry of information which warrant further substantial work. Germany supports the ongoing efforts which are currently made by some G-20 member countries, notably Brazil and France, to promote the elaboration of a Code of Conduct for crisis resolution together with private sector organizations. Such a voluntary Code, based on agreed principles, would be an important contribution to make debt restructurings more orderly, transparent and equitable in cases where they are necessary to restore debt sustainability. We hope that such a Code can be completed and presented for endorsement to the international community later this year. Germany also welcomes the increased use of Collective Action Clauses (CACs) in sovereign bonds issued under foreign law. CACs are now clearly on the way to becoming a general market standard without having increased the borrowing costs of the countries using them. The German government is currently working on a comprehensive reform of the indenture law that will explicitly enable borrowers to use CACs in sovereign bond contracts issued under German law and thus contribute to a broader use of CACs.

III. Low-Income Countries (LICs)

The economic divide between rich and poor countries is one of the biggest economic challenges of our time. While the responsibility for progress in the fight against poverty lies primarily with the poor countries themselves, the international community clearly has to play a role as well. The IMF should continue to support low-income countries in line with its mandate and core competencies and help to create the preconditions for sustainable growth and poverty reduction, complementing the more longer-term financing of the World Bank and other development partners.

Millennium Development Declaration. The MDGs as part of the Millennium Development Declaration require a partnership between industrialized and developing countries and imply obligations on both sides. However, without good governance and promoting conditions conducive to mobilizing internal and external, private and public resources, development aid will not suffice to improve the living conditions in low-income countries. Moreover, advances have to be made in the areas of trade, health reform, land reform and debt relief. Only then will the commitment of the donor community to fulfill the 0.7 percent target or to come closer to it bring about a turn around for developing countries. We have noticed the progress made in many developing countries in this respect, and Germany reiterates its determination to fulfill its part of the Millennium Development Goal compact.

PRGF. In addition to surveillance and well-targeted technical assistance, PRGF arrangements, linked to country budgets and PRSP cycles, have to remain an integral instrument of the IMF, given the financing needs of LICs and the expectation that many of them will, for the foreseeable future, face medium-term structural adjustments and protracted balance of payments problems. LICs attach great importance to the existence of a PRGF arrangement since the IMF´s seal of approval is a crucial signal for the donor community. We note that over the last couple of years, the use of the PRGF has created some remarkable successes. The PRGF is an important contribution of the IMF towards achieving the MDGs. Nevertheless, the goal of any PRGF arrangement should be for the country to eventually graduate to a surveillance based relationship. Germany welcomes the recent proposals for adjusting the PRGF to the challenges ahead. In particular, successively lower access to PRGF resources would make prolonged use less of a concern, help treating members more equally, and ensure a more effective use of resources. Moreover, we share the view that the PRGF should be used in a more flexible way in order to better cope with exogenous shocks. Germany does not support the proposal to rely more on grants as this would imply either reducing the financing volume of the PRGF or exhausting its resources and would raise several questions on the Fund's role and nature. Germany is in favor of establishing a self-sustained PRGF to begin operations in 2006 while supplementing its lending capacity with new bilateral loans. This would cover the required commitment capacity for 2006-2010 and would also provide significant resources beyond 2010. We hope that a broad-based consensus can be achieved soon and that many members are willing to provide the required funding. Germany is prepared to make a significant contribution to the required loan resources.

HIPC. Macroeconomic stability, satisfactory implementation of a PRGF-supported program and good governance remain essential for the successful completion of the HIPC Initiative. Germany welcomes the further progress; meanwhile 13 countries have reached the completion point. Germany will continue to relieve debt of the eligible countries, in total worth over € 6 billion and to raise the debt relief adopted by the Paris Club for these countries to 100 percent. Germany supports topping-up for HIPC countries by IMF and World Bank on a case-by-case basis if exceptional exogenous factors have caused a fundamental deterioration in these countries' economic circumstances. Furthermore, Germany is ready to discuss in the Paris Club the cancellation of additional commercial claims against HIPC countries so that full debt reduction is granted to them, provided that the relevant commercial claims originate from contracts concluded not later than the Cologne summit (20 June 1999). However, in the absence of a consensus in the Paris Club, Germany would not cancel those claims unilaterally.

IV. Other Issues

Financing of Terrorism. Anti-Money-Laundering and Combating the Financing of Terrorism (AML/CFT) issues should constitute a focal point of the Fund's financial sector work. Germany welcomes the decision by the Executive Board to make the AML/CFT assessment a regular part of all FSAPs and to make the Fund and the Bank fully accountable for comprehensive assessments of the AML/CFT standard. The FATF Working Group on International Financial Institutions is the appropriate organizational framework in which to enhance cooperation and agree on a clearly-defined division of labor. Issues related to the comprehensive approach and to the allocation of the assessment costs should be clarified as soon as possible. The cooperation between IMF/WB and FATF, which has already shown a positive effect in developing the joint AML/CFT methodology, should be intensified.

Quotas, Governance, Voice and Representation. The Fund's effectiveness as a cooperative institution depends on all members having appropriate voice and representation. We welcome the measures taken to enhance the capacity of Executive Directors' offices of developing and transition countries. Germany does not see a need to increase quotas at present, because of the Fund's satisfactory liquidity position. A new quota formula should be as simple and transparent as possible and should reflect a country's relative economic position in the world economy. Germany supports the proposals to incorporate a variable measuring financial openness in a new quota formula.

Independent Evaluation Office. Germany commends the Independent Evaluation Office (IEO) for its candid and frank assessment of difficult and sometimes delicate topics. For the Fund to present itself as a learning institution, lessons from evaluations should be further incorporated into regular operations. The IEO faces a major challenge to achieve the demanding objectives of the work program outlined for FY 2005. Continuation of the outstanding quality of the IEO`s work should deserve highest priority.

IMF Budget. Worldwide, governments have to consolidate their budgets and to streamline their expenditures. As an institution committed to sound public finances, the IMF cannot stand aside. Its administrative budget can no longer expand by an annual average of 7.9 percent, as witnessed during the last ten years. Germany therefore supports a constant administrative budget in real terms for the next years. The moderate increase in staff compensation for FY 2005 is a first step in this direction. Next, we have to set clearer budgetary priorities, based on the IMF's core responsibilities, to streamline less important activities and to identify areas where costs can be cut. In our view, containing the Fund's output could be supported by adding, as a rule, a sunset clause to new Fund activities. Furthermore, output in research, surveillance cycles, the frequency of program monitoring, travel expenditures and pension contributions are areas that merit closer scrutiny.