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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 recovered rapidly and a global growth rate of around 4 1/2 % can be expected in 2011. The speed of the recovery, however, differs across regions with emerging Asia and Latin America currently being more vibrant than Europe and the US. While in many industrial countries, high unemployment and the ongoing repair of the financial sector result in only moderate growth, domestic demand is the main driver for growth in many emerging markets. But also within the group of advanced economies, some still depend largely on stimulus measures introduced during the crisis, while in others the recovery is on firmer, more sustained footing. There are still significant risks to the recovery, including rising public debt and bank exposure to real estate in many industrial countries as well as risks of overheating in emerging economies.

Global financial stability has improved but has not been completely restored. Further strengthening of bank balance sheets and consistent, country specific strategies to exit from public support measures are important elements in ensuring a sustainable upswing.

Germany

The German economy is experiencing a broad-based upturn. In 2010, Germany's real GDP rose by 3.6 %. With the strongest increase of GDP since the German reunification a big part of the slump in GDP due to the crisis has been caught up.

In the course of last year, the upswing has substantially broadened and is now self-sustained, supported by a considerable expansion of investment in machinery and equipment and a sustained increase in private consumption. In 2010, contribution to growth from internal demand increased to two thirds. Hence, there are clear signs that the impetus from foreign trade and an improved labour market have now led to stronger domestic demand. Looking at the picture currently painted by 'hard' economic data and confidence indicators, we are reassured that the upswing in Germany will continue, yet at a more moderate pace.

The labour market demonstrated encouraging robustness during the economic crisis. In the present upswing, it is now benefiting from the noticeable increase in macroeconomic activity. In 2010, employment reached the highest level on average since the German reunification and unemployment continued to fall considerably in March this year. On top of this, households' income prospects have recently taken a marked turn for the better. This should help private consumption to further unfold.

Against the background of increasing public debt, it is of high importance to reinforce confidence in the long-term sustainability of public finances. To reach this goal, Germany has implemented ambitious measures in order to consolidate public budgets.

With the budgetary "Zukunftspaket", the Federal Government has laid the foundation for growth-friendly consolidation, in compliance with the requirements of the new constitutional debt brake and in accordance with the strategy agreed upon in the G20. The budgetary package limits government consumption, reduces subsidies and gives priority to R&D.

The consolidation efforts and the favorable economic situation will lead to a reduction of the general government deficit to about 2 ½ percent of GDP already in 2011. Thus, the deficit will again fall below the deficit ceiling stipulated by the European Stability and Growth Pact, already two years earlier than required in the excessive deficit procedure. With ongoing fiscal consolidation Germany will also meet the medium-term fiscal obligations in the EU as well as the agreement reached at the G20 Toronto Summit.

Financial Sector Reform

Germany will further strengthen its policies to prevent future financial 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. 2011 will be an important year with crucial decisions to be made. IMF members should support this process by bringing in the necessary legislation to ensure that the new global framework is implemented, in particular with regard to strengthening the capital and liquidity regime. This framework will contribute to overall resilience of the financial system, address systemically important financial institutions, broaden the scope of oversight and regulation to include all financial products, institutions and markets, and set incentives for market discipline. It will also be important to strengthen the framework for macro-prudential supervision. In this context, Germany welcomes the fact that the IMF and the FSB have conducted their recent biannual Early Warning Exercise.

One of the most pressing challenges ahead is the development of an appropriate framework to deal with systemically important financial institutions. Germany welcomes the recent progress in the FSB towards the determination and regulatory treatment of global systemically important banks. The experience of the crisis has strongly 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 as well as balanced and targeted regulatory measures with regard to the shadow banking system. To effectively detect and reduce systemic risk stemming from shadow banking 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.

II. IMF Policies

Germany welcomes the progress in implementing the IMF reform agenda. Considerable progress has been made with the comprehensive quota and governance reforms 2008 and 2010, modernizing its surveillance and upgrading the lending framework. IMF resources have been increased substantially with the enlarged and augmented NAB now being in force. The completion of the gold sales has brought the implementation of the new income model a significant step ahead. Germany is fully committed to support the overall goal of the IMF reform, i.e. to strengthen the Fund's legitimacy and effectiveness.

Broader governance

The 2010 governance reform, including the decision to review the composition of the Executive Board while keeping its size unchanged, has strengthened the governance structure of the Fund and has enhanced the voice- and representation of emerging and developing countries.

While Germany welcomes considerations to increase the role of ministers and central bank governors in strategic decision making, this should not restrict the role of the Board of Governors and of the Executive Board. The overall division of labour between the Executive Board, the IMF management and the IMFC appears to serve the Fund well.

Germany supports the initiative to select Heads and Senior Management of all International Financial Institutions in an open, transparent and merit-based process, irrespective of nationality and gender. We endorse the plans to make progress on IMF staff diversity by creating a balanced distribution in terms of geographical origin as well as professional and academic background.

IMF surveillance

Surveillance is the Fund's key tool to support macroeconomic and financial stability at the global, regional and country level. The financial and economic crisis has clearly highlighted the need to further enhance Fund surveillance. Germany, therefore, welcomes the Fund's ongoing efforts to strengthen financial sector surveillance, to develop a comprehensive framework for analyzing macro-financial interlinkages, and to enhance the multilateral dimension of surveillance. Hence, Germany supports the initiative to experiment with spillover reports for the five major systemic economies. At the same time, bilateral surveillance should remain the key pillar of the Fund's surveillance framework. Therefore, options should be explored to also strengthen the analysis of spillover effects in regular Article IV reports.

The forthcoming 2011 Triennial Surveillance Review should be used to review options to improve the effectiveness and analytical strength of surveillance. In this context, the findings of the recent IEO evaluation on the "IMF performance in the run-up to the financial and economic crisis" are very useful. Analysis should be strengthened by making best use of all the expertise available among Fund staff. Moreover, policy advice needs to be candid and evenhanded.

Early Warning Exercise

Germany agrees that the complex feedback between sovereign and banking risks and the real economy currently is the most relevant challenge for financial stability. There is no sound alternative to front-load the repair process of vulnerable fiscal positions and to address the remaining weaknesses in the banking system.

Tight supervision and concrete timetables for these measures are already built into IMF/EU stabilization programs. However, sovereigns and banks which still have easy access to capital markets should use the benign global economic environment prudently to strengthen their balance sheet at relatively low costs of repair.

Prevention of the built-up of new systemic risks within financial systems is key. Germany is confident that the strengthened macro-prudential framework both at national, regional and international level (e.g. ESRB) will have the capacity to provide timely and effective policy recommendations. Notwithstanding these tangible "lessons learned" after the financial crisis it is clear that many developments with potentially systemic implications, for example, in the shadow banking sector, whose activities are often located in off-shore financial centers, requires continued international cooperation.

Reform of the International Monetary System

- **Capital flows**

Financial globalization and the corresponding free movement of capital have served countries well by contributing to growth through a more efficient allocation of capital. At the same time extreme volatility and sudden stops can have profoundly destabilizing effects. Given that our present knowledge of the main determinants and drivers of international capital flows is incomplete, the Fund which has a unique mandate to oversee the stability of the international monetary system, should take on a more active role in monitoring global capital flows with the aim of enhancing global stability.

Germany supports the development of guidelines, covering both originating and recipient countries. Such guidelines could enable the Fund to aid its member countries in developing policies that deal with the capital account. While allowing enough flexibility to take into account the individual countries' specific circumstances these best practices should emphasize a typical hierarchy of policies with macroeconomic and prudential policies and structural measures as primary capital flow management tools. We recognize that situations may arise where capital flow measures are appropriate to complement – as a "last line of defense" -

sound macroeconomic and macro-prudential policies in order to protect an economy from shocks, e.g. should flows be excessively volatile with important repercussions on financial stability. Capital flow management measures should never aim to substitute for or perpetuate inappropriate macroeconomic policies such as keeping exchange rates undervalued, and hence should be targeted, temporary and reversible.

- **Global liquidity and reserve adequacy**

Drivers of global liquidity are not yet fully explored. Its definition and measurement depends largely on the purpose of the underlying analysis. Hence, there is no agreed universal concept of global liquidity. We welcome further work on the definition and measurement of global liquidity, as recently conducted by the IMF and the BIS, as well as the respective discussions in the G20 Working Group on the Reform of the International Monetary System. As central banks play a critical role with respect to securing the provision of global liquidity, their unique function and their independence should not be put into question.

Germany welcomes further work on assessing reserve adequacy and the drivers of reserve accumulation. In this regard, the conditions and extent to which reserve accumulation contributes to global imbalances and instability need to be assessed. Issues of imbalances have also to be discussed in connection with possible exchange rate misalignments. When discussing reserve adequacy, due consideration should also be given to the motivation of reserve accumulation, including its role in crisis prevention.

We welcome the IMF’s work on new metrics to assess the adequacy of reserves. However, such metrics can only be seen as an additional tool for discussions with countries in the context of surveillance. The analysis should pay due regard to different country-specific characteristics and motives and causes for reserve accumulation.

- **Financial Safety Nets and Regional Financial Arrangements (RFAs)**

Germany welcomes the substantial progress made in enhancing the financial instruments of the IMF, including last year's changes to the Flexible Credit Line (FCL) and establishment of the Precautionary Credit Line (PCL). However, as requested by the Leaders in Seoul, we have to “do further work to improve our capacity to cope with future crisis” and explore “a structured approach to cope with risks of a systemic nature”. This includes an assessment whether there are remaining gaps in the coverage and content of existing instruments to cope with systemic shocks. We look forward to the review of conditionality and design of IMF-supported programs, which will give us insights into the effectiveness of the recent changes and developments in the Fund’s lending toolkit.

We welcome the exploration of ways to improve collaboration between regional arrangements and the IMF. In Europe, our collaboration with the IMF is already well advanced as reflected in our joint IMF-EU programs. We appreciate working together with the IMF when designing the programs and believe that we could share our experience with other regions. Furthermore, we feel that an area of potentially fruitful cooperation will lie in a cooperative effort regarding the surveillance of the member states of a Regional Financial Arrangement (RFA). Additional surveillance by a RFA could usefully complement the assessment of the IMF and vice versa. However as the existing RFAs are at very different levels of development and possess different aims and institutional capabilities any cooperation between a RFA and the IMF should be tailored to the specific circumstances.

- **SDR – Role and Composition**

We welcome the opportunity to discuss the role of the SDR in the International Monetary System. However, enhancing the role of the SDR as an alternative reserve asset on its own will not provide a remedy to all the challenges of the International Monetary System. When fostering SDR's role, not only political and legal hurdles need to be taken into account but also possible downside risks. Providing unconditional liquidity by large SDR allocations could risk moral hazard and would loosen monetary control with possible consequences for global price stability. Review of the currency composition of the SDR basket should ensure that the composition adequately reflects the relative importance of currencies with respect to their use in world trade and financial transactions. We are open for including other currencies into the basket if clearly defined criteria are met.

Role of the IMF in Low-income countries

The IMF should continue to advise low-income countries (LICs) in addressing external vulnerabilities, including debt vulnerabilities, and rebuilding policy buffers in the framework of its surveillance. With its Poverty Reduction and Growth Trust (PRGT), the IMF is in a position to help LICs to overcome their balance of payments problems. The revolving nature of PRGT resources should be respected and the target to achieve self-sustainability of the PRGT remains valid and important.