# International Monetary and Financial Committee

Thirty-Fourth Meeting
October 8, 2016

**IMFC Statement by Wolfgang Schäuble**
**Federal Minister of Finance, Germany**

On behalf of Germany

**Statement by Mr. Wolfgang Schäuble**

**Minister of Finance of the Federal Republic of Germany**

**to the International Monetary and Financial Committee**

**Washington, 8 October 2016**

## I. Global Economy and Financial Markets

### Global Economy and Euro Area

The global economy is continuing its moderate growth path with a light acceleration expected in the course of 2016 and 2017. However, growth still stays uneven across regions and countries. Although there has been a slowdown in growth in the past two years in many emerging markets, they still outperform advanced economies. This slowdown can be attributed to manifold reasons such as the necessary ongoing transition of the Chinese economy, low commodity prices, earlier exaggerations and domestic shortcomings in some countries, like insufficient structural reforms. The outcome of the UK Referendum adds to the existing uncertainties, which are already high due to geopolitical tensions. Fortunately, one can emphasize that many emerging market economies are today better prepared to weather the challenges compared to earlier decades, in particular because of higher buffers and more widespread flexible exchange rate regimes.

Monetary policy reaches its limits with negative side effects of unconventional policy measures becoming more and more visible. Repeated downward revisions in the past of both current global growth as well as potential growth highlight that structural factors are at play. Monetary policy can influence business cycle fluctuations, but it cannot ensure long run growth. It is no substitute for sound and sustainable fiscal policy and structural reforms. The private and public debts are still too high and low investor and consumer confidence are important obstacles towards a stronger acceleration of global growth.

This directly points to one of the major challenges lying ahead in the near future. Crises, as we were reminded not long ago, can have large economic and social costs. But due to high debt, both public and private, and the low interest rates the traditional policy room to react to adverse shocks with standard policy measures is small. Actions need to be put in place to bolster the resilience of economies. This means that the vulnerability of economies to crises has to be reduced and the capacity to absorb and overcome severe shocks needs to be strengthened. In addition, measures that address the structural challenges of the future, such as ageing, need to be put in place *now*. More resilient economies reduce the risks of negative spillovers to other countries and keep the global safety nets credible. To achieve this, an ambitious agenda is necessary. Domestically, public debt needs to be put on a declining path with sufficient fiscal buffers to react to shocks when necessary. With regards to private debt, the reliance on a growth model fueled by credit financed consumption growth has to be reduced. Real economies need to be sufficiently diversified and product and labor markets flexible to facilitate economic adjustments.

Internationally, dependence on volatile short term debt capital inflows needs to be reduced. Strong domestic policy action, tailored to specific needs and circumstances of individual countries, will increase each country's resilience and ensure that increased risks do not endanger the current growth path, but underpin it and make it stronger.

We are committed to build an open world economy, reject protectionism, promote global trade and investment, including through further strengthening the multilateral trading system, and ensure broad-based opportunities through and public support for expanded growth in a globalized economy. Germany has a vital interest in actively contributing to a strong and reliable trade system.

In the euro area, the economic recovery is continuing, despite headwinds caused by a global slowdown and recent geopolitical developments. Consolidation efforts undertaken over the last couple of years have led to visible results, including increased confidence and a first decline in 2015 for the euro area aggregate debt ratio since the onset of the Global Financial Crisis. Unit labor costs and current account balances have improved substantially, and unemployment rates are on a downward trend. While the growth projection for 2016 for the euro area is 1.6%, the outcome of the UK referendum and other sources of uncertainty may increase downside risks to the outlook. However, this should not be an argument for loosening fiscal policy which would not help the euro area to return to stronger growth in the long run. Several Member States still face substantial public deficits and high debt ratios, while efforts to consolidate public finances seem to have lost momentum more recently. Regarding increased risks to the economic outlook, it is important to raise potential growth through effective structural reforms and to reduce public debt through growth friendly fiscal consolidation and adherence to EU fiscal rules. The developments in recent years clearly indicated the importance of sustainable public finances in a Monetary Union. An effective combination of structural reforms and growth-friendly consolidation will ensure the sustainability of public finances, strengthen confidence, foster employment and increase the euro area's long-term growth perspectives.

**Germany**

Our growth forecasts for the German economy continue to be 1.7% for 2016 and 1.5% for 2017. Domestic demand, both private and public, contributes to this positive outlook. Record levels of employment, rising nominal and real wages and low energy prices strengthen private consumption. However, challenges like an ageing population and a future normalization of interest rates continue to exist. Uncertainty in the global economy requires prudent fiscal policies to contribute to stability.

The German fiscal position remains sound. The general government budget is projected to run a slight surplus until 2020; the debt-to-GDP ratio will continue to fall below 60% by 2020. Fiscal policy has contributed to the fiscal space that Germany is using. The general government budget will continue to increase public investments with a focus on research and development, infrastructure and education, ensuring a sustainable long-run growth path. Public investment can particularly create an attractive framework to encourage private investments.

The general government has allocated another 10 bn. euros in 2017 for refugee-related spending. Without the necessary fiscal room for maneuver to deal with unexpected expenditures, which was created by spending restraint in previous years, this would not have been possible. At the same time, tax relief to middle and low income earners, families and single parents are combined with pension increases. In light of current economic and labor market conditions, Germany still has an expansionary fiscal stance.

**Financial Sector**

Financial markets have been exposed to reduce short term risk, but also to the unexpected outcome of the Brexit-referendum and increased concerns about medium term risk related to the profitability and crisis legacies of banks not least in Europe. Financial markets absorbed such tensions and have been functioning efficiently, demonstrating a strong capacity to process information, differentiate between individual financial institutions and adjusting to unexpected news.

Monetary policy has supported the efficient functioning of financial markets and reduction of short term risk. At the same time, it contributes to the gradual increase in medium-term risk, as profitability of financial institutions is squeezed and necessary structural reforms are not always advancing at the necessary speed. Fiscal and structural policies to raise global growth remain critical to bolster confidence also in the financial sector.

Financial institutions in Europe need to adjust to structural challenges, ranging from business models and related overcapacities, persistent low interest rates and a changing regulatory and market environment to the need to reduce significantly the levels of legacy assets in some banks and countries. Challenges for financial institutions in other advanced economies are different, but there are also significant similarities.

Emerging markets should use the favorable interest rate environment to address debt sustainability concerns in the private sector, and where relevant, contain the growth of credit and shadow banking.

Tackling non-performing loans and re-thinking business models in advanced economies needs to happen mainly on the basis of market processes. The public sector may support such processes through a coherent regulatory framework, stringent supervision and structural reform.

Reducing uncertainty about regulatory outcomes and stabilizing expectations, in particular with respect to bank capital requirements would be important. Furthermore, improved bank resolvability with credible and consistent bail-in provisions (including adequate levels of additional loss absorbing capacity) is particularly important for the capacity of financial markets to differentiate and deliver efficient processing of information without systemic contagion. Furthermore, persistently low interest rates warrant increasing attention to the balance between price stability and financial stability, from both monetary and macroprudential authorities.

**International Tax System/ BEPS**

It is crucial to further develop a fair and growth friendly international tax system. Therefore, it is vital that we continue our work against BEPS (Base Erosion and Profit Shifting) now that the BEPS project has reached the implementation phase. The inclusive framework will ensure that there is close monitoring of further implementation steps, while ensuring that all interested countries and jurisdictions can participate on an equal footing, making it a truly global initiative. Germany will continue to play an active part in this process and promote further international cooperation in tax matters.

Further progress in the area of tax transparency is still necessary. The G20 should reaffirm the need for the countries of relevance to endorse and to properly implement the Common Reporting Standard (CRS) without further delay. Moreover, we need to continue our work on the issue of beneficial ownership - nobody should be able to hide money behind secret structures in tax havens. All these aspects should take the legitimate interests of developing countries into account.

Moreover, we welcome the recent decision by the G20 to start working on tax policy issues in the field of tax and growth and tax certainty.

## II. International Financial Architecture and IMF Policies

**IMF Quotas and Governance**

We welcome the implementation of the 2010 quota increase and other reforms in early 2016, which is of great importance for the Fund’s credibility, effectiveness and legitimacy. With the quota increase the Fund’s character as a cooperative, quota-based institution has been strengthened and its own resources have been augmented to a comfortable level.

We look forward to further progress in the discussions on the 15th General Review of Quotas. For a successful outcome, we deem the appropriate sequencing crucial when discussing its elements. Given its decisive role for any eventual agreement, we will first need to agree on the adequate size of the Fund in terms of quotas and a potential need for quota increases. In a second step and on this basis, a fruitful discussion on the quota formula and an ensuing possible quota shift to dynamic countries that are underrepresented with a view to their position in the world economy can follow.

These steps and discussions towards a successful and substantial outcome, which form an integrated package, need a realistic timeframe. Thus, Germany supports the view of the IMF that the current deadline of 2017 for completion of the 15th quota review needs to be lengthened in an appropriate manner.

Germany will continue to constructively engage in the discussion of all elements of the review. This includes the quota formula, which should continue to adequately reflect the unique role and mandate of the Fund and has to take into account the interests of all member countries.

**The Global Financial Safety Net Architecture and the Fund's Lending Toolkit**

The architecture of the global financial safety net (GFSN) and the Fund's lending toolkit are once again prominent on the agenda. The IMF has made important contributions to the GFSN debate and has started to address the IMFC's call from the spring meetings to review its lending toolkit. While considering the IMF's lending instruments a sufficiently rich menu, we look forward to its comprehensive review in order to make sure that the full set of instruments is well targeted and designed to meet members' needs in line with the Fund's mandate to make its general resources temporarily available under adequate safeguards to members to support their adjustment policies for correcting balance of payments problems. This also includes addressing weaknesses of current instruments, such as the exit problem of the FCL instrument.

The current GFSN architecture has been strengthened on several levels in recent years, leaving it well-equipped to deal with shocks. The IMF – with its universal membership and unique financing mechanism – represents a global, non-discriminatory and uniform safety net for its member countries. The recent doubling of its permanent quota resources, together with a steady decline in credit outstanding since the crisis peak, puts the Fund in a comfortable financial position and provides confidence that it will be able to fulfil its role as crisis lender for countries in need. Here, appropriate communication by the Fund could help to counteract perceptions of an alleged "stigma" associated with an IMF engagement, by re-emphasizing the notion of a "seal of approval" that goes along with the adoption of an IMF-supported program. Attempts to easing conditionality which are meant to address "stigma" would rather risk undermining this effort and the needed focus on the sustainable benefits a country can achieve under an IMF program. In this regard, it is also important that countries implement IMF programs with a sufficient commitment and ownership, thus sending a signal of strength to the markets.

Concerning the discussion on a reform of the Fund's lending toolkit, we underscore the need for a well-balanced perspective that appropriately takes into account the crucial contribution of strengthened resilience of individual economies for a stable international monetary system. Strong domestic policy action to increase resilience, including the build-up of sufficient own reserves, coupled with enhanced macroeconomic and macro-prudential surveillance, is a key priority for effective crisis prevention.

The discussion, therefore, should avoid putting too much emphasis on the further expansion of financing or insurance elements. When discussing specific proposals on how to further develop the GFSN of the Fund's lending toolkit, we should assess them not only in terms of their ascribed benefits, but also take into account potential drawbacks. We need to make sure that reforms are consistent with the mandates of the institutions that are part of the GFSN. This necessarily constraints the possible level of coordination among the different layers. We also need to safeguard the financial integrity of the system and its institutions, first and foremost the IMF. In general, reforms to the GFSN must not give rise to moral hazard or undermine appropriate incentives for strong, stability-oriented policies at the national level.

**IMF Resources**

Based on a broad consensus among the IMF membership to support the Fund's objective of maintaining temporary access to bilateral borrowing, Germany stands ready to participate with a new temporary loan agreement based on broad participation and a globally equitably burden sharing. We strongly welcome the newly introduced governance structure for a bilateral loan agreement that gives creditors voting rights for the activation according to their contributions requiring a qualified majority of 85%. Germany emphasizes that the credit lines are neither intended to serve as a bridge to a future general IMF quota increase nor as a permanent supplement of the same. Beyond ensuring sufficient financial resources, the Fund has to keep its focus on surveillance and a thorough assessment of the macro-financial developments to contribute to crisis prevention, and thereby, fostering confidence and stability.

**IMF Surveillance**

Surveillance remains a core function of the Fund that constitutes an important contribution to enhance the countries' own efforts to strengthen their resilience. For the Fund to successfully carry out its surveillance task, it is essential that its advice is adequate, consistent and convincing, focusing in particular on macro-critical issues and sustainability, including manageable public debt situations.

We emphasize the importance of regular consultations between the Fund and all its members, which are part of the obligations of IMF membership, and call on the Fund not to relax its efforts to further reduce the number and duration of cases of excessive delays of Article IV consultations or deficiencies in the provision of data which undermine the integrity of the surveillance process.

**Sustainable Development and Financing for Development**

We welcome a closer collaboration with reform-oriented African states to support the aspirations of their citizens and to strengthen their political, economic and social fabric.

Therefore, we suggest a “Compact with Africa” (CWA) to strengthen investment in African countries, especially investments by the private sector, to improve sustainable growth and job creation.

Besides ODA, remittances constitute an important economic factor for many low income countries. Therefore, guaranteeing a safe, well-regulated, but also adequately priced flow of remittances is of high priority. Clarification of regulatory standards and strengthening capacity building through technical assistance in these areas can contribute to supporting the flow of remittances.

Germany welcomes the ongoing review of the IMF and World Bank Debt Sustainability Framework for low-income countries. Stress tests could help managing debt risks. In this regard, we see merit in taking the total debt into account, including domestic debt, when analysing the debt issues. We also support the Paris Club’s and Paris Forum’s discussions of a range of sovereign debt issues. During the German G20 presidency we will continue to deal with the issue of promoting sound and sustainable financing practices.

**Sovereign Debt Restructuring**

Germany welcomes the Fund’s ongoing work to draw lessons from recent developments in sovereign debt restructuring and their implications for its policy framework. We strongly support efforts to strengthen the existing contractual market-based approach in order to facilitate efficient and effective sovereign debt restructuring measures in case of need. In this regard, we welcome the IMF’s important contribution - in its advisory function - that encourages the broad use of modified pari passu and enhanced collective action clauses (CAC) in new international public debt issuances.

We also look forward to the Fund’s views of state-contingent debt instruments, including GDP-linked bonds, and their possible use and contribution to enhance the resilience of economies.

**SDR**

With the inclusion of the Renminbi in the SDR basket by October 1st we have made a meaningful step towards a basket composition that better reflects the role of currencies in the global trading and financial system. The Chinese authorities, the Fund and all IMF members have comprehensively prepared for the SDR basket adjustment through reforms and technical provisions in order to permit all operations and transactions in Renminbi with the Fund as they are feasible in all other currencies determined as freely usable.

**Digital Finance**

Digital finance and financial innovation can lead to more efficient financial systems: they facilitate competition and lower transaction costs. On the other hand, we have to keep an eye on digital finance’s implications for financial stability.

During our G20 presidency we will therefore encourage countries to closely monitor developments in digital finance.

A peer exchange between countries on best policy practices for achieving digital financial inclusion could furthermore help those who lack access to digital payments and services. Financial inclusion in addition covers aspects of ability and affordability to use financial services which involves a certain level of financial literacy to properly manage risks.