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Statement by Mr. Schäuble
Germany

Statement by Mr. Wolfgang Schäuble

Minister of Finance of the Federal Republic of Germany

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I. Global Economy and Financial Markets

Global Economy

The global economic recovery is gaining momentum. Investment, trade growth and manufacturing continue to recover. Output gaps are small and closing or have already been closed in many economies. Unemployment is decreasing and several economies are approaching full employment.

While these are encouraging signs and developments, we cannot afford to be over optimistic or lose sight of the risks and challenges we still face. In the short term, uncertainties remain, including policy uncertainties in several major economies. Uncertainties about future growth and the resilience of our economies to future shocks may curtail investment and economic activity. Debt levels remain too high. In the longer term, the challenges of weak productivity growth and ageing populations remain. Whilst we have begun to analyze and tackle these issues, including under the German Presidency of the G20 this year, we cannot be complacent.

We should all be concerned about slow global trade growth and increased anti-free-trade rhetoric. Both are a threat to our common economic prosperity. Trade has given millions of people the opportunity to move out of poverty, and it has provided stability and brought prosperity across the globe. It has encouraged and advanced global cooperation and international dialogue. Trade can help us tackle the challenges and risks we face. Protectionist measures will only harm growth and harm those they claim to protect. We need more openness, not less: rather than resort to protectionist measures, the international community should work together to provide equality of opportunity so that the benefits of trade are better shared. We need to put in place efficient measures to assist those who inevitably lose out due to structural changes and increased competition as a result of trade.

Germany is committed to resisting protectionism in all its forms and continuing global economic and financial cooperation. We are committed to a rules-based international system, including multilateral institutions and fora where the international community can work together to make the system as effective as it can be.

We do not know where the next economic or financial crisis will come from, or when it will happen. We can, however, continue to work to make crises less likely and better prepare our economies to anticipate, respond to and recover from a crisis. We need to enhance our resilience: buffers that help to withstand and overcome crises have not yet been rebuilt in many cases. Monetary policy space is limited by already extended periods of very low interest rates and the widespread use of unorthodox policy measures and fiscal policy space is limited by too high levels of public debt. The G20 agreed earlier this year on a set of principles to enhance the resilience of our economies, and G20 Leaders put forward country-specific measures in the Hamburg Action Plan agreed in July – a vital first step, which must continue to be implemented to take effect.

This is not the time for global demand stimulus. Instead this is the time to increase resilience and to pursue structural reforms more vigorously to enhance the growth potential of our economies. Public spending should be sustainable and growth friendly, for example prioritizing public investment where it will be most efficient and cost effective. Private and public sector debt levels are still at record highs in many countries. High debt in many economies could become a severe obstacle for future growth or even the source of a new crisis. Hence, the time has come to bring debt onto a downward path. Only that will allow us to build the necessary buffers to withstand a future crisis.

Moving to sustainable public finances also improves equal opportunities across generations and secures stability. Reducing debt now means that future generations will not be overburdened with past debt. Stability helps the most vulnerable groups in the population – it is these groups who are less likely to have insurance against instability, and these groups are more likely to suffer from crisis-related cuts to public spending.

Euro Area Developments

The economic expansion in the euro area continues and has even gained additional momentum. GDP growth in the first half of the year was stronger than expected in many member states. Economic sentiments have reached pre-crisis highs, forecasts are revised upwards and risks are no longer tilted to the downside. The main driver of the recovery has been domestic demand, in particular private consumption, supported by steady employment growth, improving confidence of consumers and firms, and very accommodative monetary policy. In the last quarters, the strengthening of the world economy has contributed significantly to the increase in GDP growth. Headline inflation markedly increased at the start of the year, mainly driven by food and energy price developments, but has receded a bit and remains moderate. Underlying inflation is picking up, but only slowly.

The ongoing economic expansion is also the result of the ambitious reform efforts of the past years. However, these efforts should not be curtailed. Potential growth is still rather low, growth differences between member states remain and unemployment rates are still high in many countries. Continuing with structural reforms in product and labor markets that boost productivity and help to further reduce unemployment is essential. Public and private debt in many member states is still very high or even rising and consolidation has progressed only slowly. It is thus important to use the current economic environment as a window of opportunity to significantly reduce debt, also against the background of financing costs expected to increase. Ambitious structural reforms, growth friendly consolidation and adherence to fiscal rules are necessary to secure the sustainability of public finances and will strengthen the resilience of the euro area economy against future shocks.

Germany

The growth forecasts for the German economy are positive: Expectations for real GDP growth have been revised upwards considerably in our autumn projection: +2,0 % for 2017 (after +1,5 % in spring) and 1,9 % for 2018. The economy is demonstrating steady growth on a broad base: wages and employment are increasing appreciably and low interest rates, relatively high corporate profits and positive trends in the production of investment goods and orders speak in favor of a sustained ongoing upward dynamic of investment.

On the back of continued favourable conditions for public finances, the German fiscal position remains sound. Budgets are close-to-balance or in surplus. On the one hand, pressure on government budgets was eased by favorable cyclical developments and by interest expenditure falling. On the other hand, the underlying fiscal stance is expected to be mildly expansionary with primary expenditure already exceeding potential GDP growth. The debt-to-GDP ratio is expected to further decline consistently and fall below the agreed-upon level in the Maastricht treaty of 60 % by 2020.

However, challenges like an ageing population and a future normalization of interest rates continue to exist and require prudent fiscal policies to contribute to future prosperity as well as stability. Furthermore there is an increasing need for action on the revenue side: Because of the progressive tax system, high employment levels and the noticeable increase in salaries and wages have caused the ratio of taxes to overall economic output to rise to 40 % of GDP, well above its long term average. The federal government's priorities therefore include placing growth- and job-friendly limits on the burden of tax and social security contributions.

As part of its growth-friendly fiscal strategy, spending on education, research and development has already been increased by 26 % over the past four years and will continue to be a main priority. Public investment spending is forecasted to grow by 5 % every year until 2021. Sustainable public finances – with a competitive expenditure and tax structure – and the promotion of life-long education play a decisive role in achieving more broad-based accumulation of wealth and further strengthening of labour force participation.

Financial Sector

The recent strengthening of global financial stability reflects the advanced regulatory framework becoming operative as well as the aforementioned rather positive economic development which is currently gaining additional momentum. However, this cyclical upswing and the associated low level of market volatility mask imminent threats to financial stability in many countries in the medium term. Given rising levels of private and public debt, the perpetuated accommodation of monetary policy apparently did not contribute to balance sheet consolidation. In fact, reduced debt servicing capabilities may imply significant vulnerabilities once interest rates will rise again. As a consequence, alongside monetary policy normalization, a priority should be on further advancing structural reforms as well as appropriate macroprudential and financial sector policies and supervision.

The combination of low interest rates and search-for-yield behavior has pushed asset prices to extraordinary levels, not necessarily supported by economic fundamentals. These stretched valuations may be subject to reversal if political risks materialize or unexpected events occur. A potential coexistence of search-for-yield and realizing market risks could generate substantive portfolio reallocation. Subsequently, a spill-over into wider asset markets may cause a sudden drying up of liquidity, thereby undermining financial stability and ultimately putting growth at risk.

At the same time, the market environment for financial institutions remains challenging. Despite the recently increasing profitability of financial institutions, many banks and insurance companies will have to adapt their business models in the medium term. In this regard, the use of financial technology may help financial institutions lower operational costs – at least in the medium term – and thereby raise profitability. Within this new digital environment, cyber risk appears as a major risk, which has to be addressed internationally.

In Europe, despite remarkable progress, non-performing loans need to be continuously reduced to sustainable levels in a decisive manner and in full respect of the existing rulebook. The first case of bank resolution under the new European resolution regime has illustrated its overall effectiveness. In particular, private investors had to bear losses while taxpayers' money was safeguarded and market distortions were avoided. Nevertheless, we might have to learn some lessons from cases of market exit under national insolvency law. We need to ensure that we further strengthen the protection of taxpayers' money and building-up adequate bail-in buffers, both in terms of quantity and quality.

At the global level, only a well-monitored and responsibly regulated financial sector will be resilient enough to provide a sound basis for sustainable growth. Therefore, we should remain committed to support the timely, full and consistent implementation of the agreed financial sector reforms and prevent a rollback of regulatory standards.

II. International Financial Architecture and IMF Policies

We welcome that issues relating to the international financial architecture remain at the center of discussions at the IMF in line with its mandate to promote the stability of the international monetary system. It is important that policies are generally guided by the appropriate incentives. In this context, the IMF plays a crucial role under its surveillance mandate. With its broad experience and expertise on the global level, the Fund should continue to support countries as a trusted advisor in identifying and addressing economic and financial risks and unsustainable developments. We are looking forward to the upcoming comprehensive surveillance review which should also evaluate the effectiveness of the Fund's contribution to strengthening the resilience of its member countries.

GFSN

An adequate Global Financial Safety Net (GFSN) that contributes effectively to crisis prevention and resolution is a key component to underpin the stability of the international monetary system. The IMF represents the only truly global component of the GFSN, offering a uniform and non-discriminatory safety net for all member countries in case of a balance of payments need. Regional Financing Arrangements (RFAs) and foreign reserves apply at regional or national level, while central banks can address liquidity needs of markets in line with their mandates. The GFSN as a whole has been considerably strengthened over recent years and is financially stronger than ever. It has proven its reliability in past crises and has allowed for flexible and tailored responses. Nevertheless it cannot – whatever strength it may possess – substitute for necessary efforts at the national level. Resilience against crises remains first and foremost a national responsibility, being grounded in sound domestic policies. It would therefore be unwise to create expectations of a steadily expanding coverage and insurance under the GFSN, which may undermine national incentives to strengthen resilience, which would be a destabilizing rather than a stabilizing factor.

Regional Financial Arrangements (RFAs)

Germany welcomes the Fund's ongoing work to enhance collaboration between the IMF and the different RFAs and the recent adoption of the operational guidelines by the Board. We are in full agreement with the Fund that due to the extensive heterogeneity of the existing RFAs a more decentralized approach is the best option to enhance collaboration efforts. We also concur that for the foreseeable future the most important tasks will lie in further information sharing and in establishing a regular dialogue between the concerned parties. Moreover, further test runs to establish how collaboration might be best employed in practice seem warranted to us. Collaboration should be voluntary on both sides, fully respecting the different characteristics, decision-making procedures and mandates of all institutions concerned.

The IMF's Toolkit

We welcome the adoption of the new Policy Coordination Instrument by the Executive Board. We believe it will be a useful addition to the set of instruments available to the Fund. By providing a seal of approval for the solidity of the pursued economic policies of a country, the instrument will be able to send a positive signal to potential investors and thus support the Fund's catalytic role. This can also help strengthen the interaction between the different layers of the GFSN and thus make it even stronger.

Germany welcomes the upcoming review of the FCL and PLL which needs to reflect the experiences gathered so far with these precautionary instruments and address the challenges that have materialized. Foremost, this pertains to the prolonged use of precautionary facilities and the unresolved challenge of establishing stronger incentives for a timely and credible exit strategy. In Germany’s view, the FCL review should assess the instruments against the well-established principles governing IMF lending, which are embedded in the Fund’s Articles of Agreement. Besides safeguarding the Fund’s resources, this includes primarily the revolving nature of Fund resources, which implies that resources are being made available only on a temporary basis to a country to become available soon again for other members if needed. Also while prequalification can help mitigate concerns about the lack of ex-post program conditionality and might contribute to reducing a perceived ‘stigma’ of the IMF, it is critical that the criteria are sufficiently strong to prevent a “conditionality gap” that would neither be helpful for the members concerned, nor for the safety of the Fund’s resources.

15th General Review of Quotas

Germany remains committed to work constructively towards the completion of the 15th General Review of Quotas within the agreed timeline and toward an IMF adequately resourced to pursue its mandate. It is crucial that discussions on the quota formula and the 15th General Review will continue to be treated as an integrated package that includes the adequate size of the Fund as well as considerations on the quota formula and the distribution of quota shares. While we believe that a realignment of quota shares should result in an increase in the share of dynamic economies in line with their positions in the world economy, a plausible and credible perspective for a possible quota increase would need to be the material precondition for the ensuing discussion about the quota formula and quota distribution. In line with this package approach we stand ready to consider plausible scenarios for a possible quota increase in order to foster the quota-based character of the Fund and to facilitate a realignment of quota shares.

The latest quota calculations based on an updated data set clearly underline that the current formula captures dynamic developments in the world economy quite well. Thus, the existing formula already delivers on the aim of increasing the Fund's representativeness and preserving the Fund’s legitimacy and thus does not need to be fundamentally changed. In accordance with the 2013 Report of the Executive Board to the Board of Governors on the Outcome of the Quota Formula Review, the main variables of the quota formula should remain both GDP and openness as they best capture the unique role and the mandate of the IMF as a monetary institution to promote trade and the openness of economies. Hence, openness is an indispensable part of the formula, and its weight should at least be maintained.

In our view the four principles that underpinned the 2008 quota reform remain valid and should, together with the outcome of the 2013 Quota Formula Review and its key building blocks for an agreement on a possible new quota formula, continue to guide the upcoming discussions. We consider it crucial that the discussions and decisions on the elements of the quota review are fully anchored in the relevant IMF bodies.

Fund Resources

Germany reaffirms its commitment to a strong, quota-based and adequately resourced IMF at the center of the GFSN. We take note of the recent discussion in the IMF on the adequacy of the Fund's resources and look forward to staff presenting possible scenarios for "landing zones" for the adequate size of the Fund based on sound and realistic assumptions. This should enable the needed compromise on the adequate level of the IMF's own resources that the Fund needs to fulfil its mandate by providing catalytic finance to members with a BOP need in order to incentive private investors to invest or stay invested in the country. It will be important that Fund financing will crowd-in and not be seen as crowding out the private sector. We are confident that the Fund is well-equipped with own resources that have been doubled in early 2016 to fulfil its mandate.

Capital Flows

Germany supports and looks forward to further work by the IMF on the issue of how countries can reap the benefits that free movement of capital can bring while shielding themselves with appropriate policies from disruptive effects of volatile capital flows. In this vein we also encourage the Fund to continue exploring the interaction between capital flow measures and macroprudential measures and their effectiveness and look forward to the new macroprudential database that will inform the discussion on this issue as well as on financial stability issues in general.

Improving Debt Sustainability

Germany attaches great importance to the aim of ensuring debt sustainability. With many countries facing high or rising public debt levels, the Fund can and should play an important role in monitoring debt developments and advising countries on their debt policies to help prevent unsustainable debt.

The Operational Guidelines for Sustainable Financing endorsed by the G20 in March 2017 fully reflect the responsibilities of both borrowers and lenders in financing decisions. Moreover, these guidelines recognize the importance of the IMF's Debt Limit Policy and the Fund's provision of technical assistance to debtor countries as well as its role as a venue for dialogue between sovereign creditors, debtors and financial institutions. Germany welcomes the outcome of the Board discussions on the review of the Debt Sustainability Framework for Low Income Countries and supports continued discussions about sovereign debt issues in the Paris Club and in the Paris Forum. We are looking forward to the upcoming review of the Fund's Debt Sustainability Analysis for Market Access Countries next year.

Debt sustainability can also be supported by an appropriate choice of debt instruments. In this context, state-contingent debt instruments, including GDP-linked bonds, might play a useful role to enhance the resilience of economies. We welcome the Fund's advisory role to support countries in their efforts to ensure debt sustainability also in this area.

Sovereign Debt Restructuring

Germany further welcomes the Fund's work stream concerning sovereign debt restructuring issues and its contribution to strengthening the existing contractual market-based approach in order to facilitate efficient and effective sovereign debt restructurings in case of need. We strongly support the IMF's important contribution to monitor and encourage the use of modified pari passu and enhanced collective action clauses (CAC) in new public debt issuances, as well as its work on options to increase their share in the outstanding stock of debt.

Sustainable Development and Financing for Development

The Fund should continue to contribute to the 2030 Development Agenda through its surveillance, lending, and capacity development in line with its mandate. Building resilience should be the priority of these endeavors, e.g. we see the work of the Fund to support countries in mobilizing domestic resource mobilization as crucial. Remittances continue to be a very substantial part of some developing countries' and emerging economies own resources. The IMF and the World Bank through technical assistance have played an important role in our efforts to improve the environment for remittances. With regard to remittance providers' access to banking services the dialogue between the public and the private sector that started in March 2017 during the German G20 Presidency is further pursued with a high-level FSB Roundtable at the margins of the IMF Annual Meetings with the aim of adequately addressing remaining issues in this area.

Compact with Africa (CWA)

We have launched the G20 Compact with Africa initiative in recognition of the opportunities and challenges in African countries. Ten African countries have joined the initiative (Cote d'Ivoire, Morocco, Rwanda, Senegal, Tunisia, Ghana, Ethiopia, Benin, Egypt and Guinea). Through contributions by the respective countries, AfDB, IMF and WBG as well as interested G20 partners, the individual resulting Investment Compacts aim to improve the framework for private investment as well as improve the catalyzing use of public funding. Our joint efforts will focus on improving sustainable and inclusive economic growth, thus addressing poverty and root causes of displacement.

The first "Report to G20 Finance Ministers and Central Bank Governors on Compacts" sketches a realistic roadmap for the improvement of framework conditions to promote private investment in Compact Countries. The G20 Africa Advisory Group will monitor progress in Compact Countries and advance the CWA process.

We welcome the IMF's efforts to integrate the Compact with Africa and the Individual Country Investment Compacts into their Africa strategy and coordinating effectively with the World Bank and the AfDB. It is of utmost importance that the three IOs continue to strengthen their cooperation and provide sufficient resources for this joint effort. We call on other partners to participate in the CWA process and contribute bilaterally to individual investment compacts. We encourage the private sector to seize the economic opportunities that Africa offers.

We are encouraged by the CWA countries which show strong ownership of the process. We support African priorities, in particular the African Union's Agenda 2063. The African Union and NEPAD are also important partners in promoting the initiative.

International Tax Issues

The growing cooperation in tax matters is a true success story for the G20 and ultimately the global community. With the ongoing implementation of the OECD/G20 BEPS recommendations a new era in international tax cooperation is being created. Meanwhile, the Inclusive Framework on BEPS has more than 100 members worldwide already, the majority of them neither G20 nor OECD members. Hence, it is of upmost importance to further promote developing a fair and growth friendly international tax system. Aggressive tax planning strategies need to be prevented rigorously in order to avoid tax evasion and to ensure a level playing field for all businesses.

Under Germany's G20 presidency and with substantial support by the OECD, tax transparency has tremendously been enhanced. The automatic exchange of information on financial accounts under the Common Reporting Standard (CRS), which commenced among the first 49 jurisdictions in September 2017, marks a milestone in the common efforts for more transparency around the world. In this context, it is all the more important that remaining jurisdictions begin with exchanging information by September 2018 at the latest. As regards the implementation of the agreed international standards on tax transparency, there was only one country on the OECD list presented to G20 Leaders at their summit in Hamburg. Again, this shows the progress in improving tax transparency. Nevertheless, there is still work to be done in this field. Relating to enhanced accessibility of beneficial ownership information, OECD and FATF were asked by G20 Leaders in July 2017 in Hamburg to report on progress in early 2018.

Referring to the new tax topics that were added to the G20 tax agenda within this year, G20 Leaders in Hamburg reaffirmed the Finance Ministers' agreement from March 2017 in Baden-Baden to enhance tax certainty. Therefore, OECD and IMF have proposed a set of practical tools to be implemented and were asked to review progress in 2018. Concerning the challenges to tax the digital economy, a discussion at G20 level was initiated under

Germany's presidency in order to correspond to growing pressure to do further work in this area. In that respect, the OECD has been asked to deliver an interim report to the G20 by the IMF and WB Spring Meetings 2018. It is key for a fair and global international tax system to avoid further uncoordinated unilateral actions and to prevent increasing fragmentation of the international tax rules.

Digital Finance

The effects of digitalization are particularly visible in the financial industry. It is speeding up the globalization of markets and presents both potentially enormous opportunities as well as unprecedented challenges. This is why we should monitor and actively shape the digitalization of financial markets. Our main goal must be a level-playing-field for all market participants. The regulatory framework for the digital transformation of financial services should have financial stability and consumer protection at its core. It should enable digitization and not hinder innovation. It should furthermore address possible emerging risks due to technological innovation effectively. We call on the IMF to keep a close watch on current and future developments in this area and ensure that global financial stability is not compromised.