Statement by Mr. von Kleist, Executive Director for Germany,
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January 13, 2021

On behalf of our authorities, we would like to thank staff for the very constructive discussions and the well-written and insightful report. We appreciate the high-quality analysis, which rightly focuses on the most pressing challenges posed by the COVID-19 crisis and the German policy response to it.

Our authorities largely share staff's key findings and recommendations, in particular regarding the need for continued support to the economy until the recovery has firmly taken hold. Fiscal measures will continue to provide financial assistance to firms and households, including through the enhancements to Germany's short-time work allowance scheme *Kurzarbeitergeld*, while also promoting a strong, green, and inclusive recovery. To this end, Germany is undertaking large-scale targeted investments in renewable energies and the digital transformation. Our authorities are also committed to improving inclusiveness, inter alia through raising the disposable income of lower- and middle-income households through tax and pension reform as well as addressing gender inequities in the labor market.

The second wave of COVID-19 infections this winter has been more challenging for the healthcare system than the first wave in the spring of 2020. The rise in COVID-19 cases in late 2020 has necessitated renewed mobility and contact restrictions, which have been accompanied by new targeted fiscal support measures. The newly enforced measures are expected to bring about a decline in new infections, which ultimately should enable the lifting of restrictions. Nonetheless, the recent development doubtlessly dampens the start into the first quarter 2021. Our authorities expect that economic activity will pick up again and show a strong recovery over the course of the second quarter, contingent on infections staying on a low level and an on-schedule roll-out of the vaccines.

Crisis Response

Germany – like the rest of the world – has faced an unprecedented shock. Swift, determined, and in their scale unprecedented policy actions have preserved household spending, boosted confidence, safeguarded jobs, and supported companies. To put the policy measures into perspective, staff estimates that the overall fiscal impulse of around 6 percent of GDP has been twice as high as in response to the global financial crisis (GFC).

Our authorities remain committed to minimize economic hardship, reduce the risk of economic scarring, and enable a strong economic recovery once the rollout of the vaccines is well underway and mobility and contact restrictions can be successively lifted. They are monitoring the situation carefully and stand ready to employ further measures as needed, guided by the principles of timely, temporary, and targeted support for both the supply and demand side.

As summarized by staff in Boxes 1 and 2, Germany has put in place a comprehensive policy package. It inter alia includes wide-ranging public guarantees, grants, tax deferrals, a temporary VAT reduction, a one-off increase in childcare benefits, and the

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enhancement of *Kurzarbeitergeld*. Drawing on the success of this short-time work allowance scheme during the GFC, *Kurzarbeitergeld* contains economic scarring by preventing large-scale layoffs and insolvencies while supporting household incomes. Despite the unprecedented economic contraction, the unemployment rate has only risen from 3.3 to 4.4 percent from January to November 2020. The above-mentioned measures to stabilize the economy came on top of well-developed and extensive automatic stabilizers embedded in Germany's tax and social security system, which have been allowed to operate in full, playing an important role in mitigating the adverse impact of the shock.

Additionally, Germany has expanded health care spending both domestically and internationally, also by contributing to the provision and fair distribution of vaccines across the world. This included additional funding provided to the WHO of more than US$ 600 million in 2020 and to the GAVI vaccine alliance of US$ 600 million until 2020 and another US$ 600 million for the period from 2021 to 2025. The COVAX Advance Market Commitment mechanism received funding of € 100 million. Germany also significantly increased its voluntary contributions to the United Nations humanitarian system, providing US$ 424 million to the comprehensive Global Humanitarian Response Plan coordinated by UN-OCHA, thereby becoming its second largest donor in 2020.

Following years of budget surpluses when the economy was doing well, Germany had entered the crisis with a debt-to-GDP ratio of below 60 percent and with ample fiscal space for the needed large-scale fiscal support. The unprecedented fiscal response is in line with the constitutional debt brake as the escape clause was triggered, which was designed precisely for such exogenous shocks. The current experience illustrates that fiscal rules can ensure resilience of government finances, which in turn is a precondition for forceful fiscal action in a crisis.

Our authorities share the view that they should rather err on the side of caution regarding the duration of support measures, while duly taking into consideration possible negative side effects. As staff writes, due to the extraordinary effects of COVID-19, some firms may be viable but illiquid right now. However, given the high uncertainty it is very difficult to assess that in the current environment. It would not be in the public interest to let generally viable but momentarily illiquid firms go out of business – which could also have negative effects on the financial sector – although support measures will be phased out in a gradual and well-sequenced manner as the recovery takes hold. As staff notes, Germany's strong insolvency frameworks should facilitate the restructuring of unviable firms and repair of bank balance sheets comparatively quickly after the crisis.

As in many other European countries, COVID-19 infections in Germany increased significantly since October and Germany introduced new restrictions on social and business life. To counter the economic effects of this new lockdown, Germany has again reacted fast and forcefully. For businesses affected directly or indirectly by the first round of new shutdowns, an extraordinary economic assistance package was introduced for the months of November and December. Furthermore, the above-mentioned grant program (*Überbrückungshilfen*) was expanded and extended until the end of June 2021. It also includes

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special provisions for businesses affected directly or indirectly by the extended shutdown in December and future restrictions in 2021.

Beyond tackling the economic fallout from COVID-19 domestically, Germany has also been a strong supporter of initiatives at the EU level, to strengthen the EU's financial capacities in responding to the crisis. **During Germany's EU council presidency, the priority has been to guide Europe out of the crisis in a way that enhances European unity, economic strength, and social cohesion.** In particular, both the temporary Next Generation EU Recovery Package (NGEU) and the immediate European Pandemic Support (SURE, ESM, EIB) to mitigate risks for workers, businesses and sovereigns in an exceptional emergency have been major achievements for the EU, which are not only important from a macroeconomic perspective but also as a sign of strong European solidarity. Besides cushioning the economic and social impact of the crisis, the NGEU will support countries' efforts to promote sustainable and resilient growth by aiding the green and digital transition.

"Building better for the future"

Targeted investments in research and infrastructure to accelerate the green and digital transformation, as recommended by staff, in fact constitute a significant part of the stimulus package (see Box 1) as well as of existing long-term public investment plans. There will be, for instance, strong investment in a comprehensive charging infrastructure for electric vehicles and the promotion of hydrogen research and development as part of the National Hydrogen Strategy. At the same time, Germany is phasing out coal-fired power plants in an effort to reach the 2030 climate goals and achieve carbon neutrality by 2050. In Germany, nuclear energy is not considered a viable alternative to renewable energies given the technology's high tail risks and long-term costs associated with the safe management of nuclear waste.

Recognizing that green investments need to be accompanied by market incentives through carbon pricing which appropriately reflects the negative externalities of greenhouse gas emissions, a market-based mechanism for pricing the CO_2 emissions from fuels is being introduced. In an introductory phase, certificates are sold at fixed prices starting at € 25 per ton of CO_2 in 2021, gradually increasing to € 55 in 2025. The subsequent auction phase (beginning 2026) will start with a one-year transition period and a price corridor (€ 55-65 per ton of CO_2). The carbon pricing system aims to be socially fair and burden-neutral to the economy: Revenues will be returned to citizens and companies to avoid hardships and to further increase incentives for investments in climate-friendly technologies. The appropriateness of the regulations and potential adjustments to the mechanism will be reevaluated in the future with a view to reaching the climate targets. These national efforts go hand in hand with climate change mitigation measures that are undertaken at the EU level.

In regard to the distributional impact of the crisis, our authorities broadly share staff's assessment that women have been particularly affected due to their disproportionately large share in contact-intensive service jobs and marginal jobs. The closure of schools and childcare facilities during the current pandemic has led to an additional burden which appears to have been primarily borne by women. While we have made important progress in recent years in improving labor market conditions for women, such as expanding full-day childcare,

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more remains to be done. Moreover, we need to avoid possible negative long-term effects of the crisis on young and elderly workers. Therefore, the authorities will continue to closely monitor their labor market prospects.

The government also agrees with staff on the desirability of further raising the disposable income of low- and middle-income households. As additional steps into that direction, they have abolished the so-called solidarity surcharge for the lower 90 percent of all households and introduced a basic pension that will benefit many low-pension earners.

Given the demographic challenges that Germany faces, policies to raise productivity growth, and pension system reforms, that take inter- and intragenerational equity concerns into account, will remain high on the agenda for the years to come. Germany's publicly funded higher education system and well-established vocational training programs have served the country well and continue to provide a highly trained workforce.

Financial Sector

The financial sector has entered the current crisis much stronger than it had entered the GFC, thanks to the regulatory reforms implemented since then, in particular regarding the build-up of capital and liquidity buffers. These buffers, in conjunction with exceptional borrower support and fiscal measures, are expected to cushion the impact of the pandemic on banks' balance sheets. Therefore, we agree with staff's assessment that German banks are likely to withstand expected losses related to the increase in bankruptcies in the real economy across a wide range of scenarios. The resilience of the banking sector is limiting potential risks to financial stability, even though the persistently high degree of uncertainty makes it difficult to predict future developments.

While profitability of German banks has continued to be relatively low, this also reflects a highly competitive market that provides substantial benefits to firms and households as well as prudent risk-taking behavior. We agree with staff on the need to maintain restrictions on discretionary dividend distributions and share buybacks. Given the high uncertainty, temporarily retaining current profits as additional buffers will be beneficial both to the banks themselves but also to the stability of the financial sector at large. While staff's view is that smaller banks will likely suffer more losses than large banks owing to their high exposures to SMEs, our authorities note the high uncertainty and divergence regarding the effects on individual banks. Generally higher capital buffers of smaller banks also lead to better preparedness for potential losses through higher loss-absorbing capacity.

While housing prices have continued to rise further, our authorities do not see pronounced risks to financial stability from the housing market as households do not appear to be overly indebted by historical standards and there is no indication of substantially deteriorating lending standards. At the same time, developments in real estate and associated lending activities need to be monitored closely and steps are undertaken to improve the capacities of authorities to analyze potential risks by establishing the legal basis for a regular collection of data. The upcoming FSAP will provide an opportunity to discuss any possible need for real estate-specific extensions of the macroprudential toolkit in Germany.

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We take note of staff's recommendations regarding the need for reforms to Germany's auditing framework and accounting enforcement. In fact, our authorities share that assessment and the German federal government has proposed legislative measures such as the tightening of rules governing external audit rotation, stricter rules for civil liability of auditors, and enhanced enforcement powers for the supervisory authority (BaFin) to strengthen the integrity of financial and capital markets.

<u>Multilateralism</u>

Our authorities would like to reiterate their firm support for an open, fair, and rules-based multilateral trading system, which provides large economic benefits to all countries. We should not let trade tensions allow to weigh down the recovery but rather intensify efforts to defuse them and accelerate necessary reforms to modernize the WTO.

The government remains committed to promoting the international reform agenda on corporate taxation, in particular through supporting the establishment of a minimum taxation framework and addressing issues pertaining to digital taxation. A fair global tax architecture would not only be key to ensure a level playing field in the international taxation of companies. It would also ensure that firms pay their fair share to finance public goods – such as health, education, and infrastructure – in the jurisdictions where they benefit from them as well as to help generate sufficient tax revenue in countries across the globe, in particular in the aftermath of the crisis.

Our authorities would also like to emphasize their commitment to a strong, quota-based, and adequately resourced IMF to preserve its role at the center of the Global Financial Safety Net. In recognition of the IMF's central role in providing financial assistance in a catalytic manner to many crisis-affected countries, we are providing a loan of € 3 billion to the Poverty Reduction and Growth Trust (PRGT), a grant contribution of € 80 million to the IMF's Catastrophe Containment and Relief Trust (CCRT), and additional grants to the Fund's capacity development activities (€ 6 million each planned for the Covid-19 Crisis Capacity Development Initiative and the AML/CFT Topical Trust Fund).

The global community is in this crisis together – and it will only overcome it together. Therefore, the production and world-wide distribution of vaccines requires continued global cooperation. We are confident that the global economy will emerge from this crisis stronger and with a growing awareness that it needs concerted global effort – guided by the spirit of cooperation and solidarity – to tackle the key challenges of our time, be it a pandemic, climate change, or inequality.

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