



International Monetary and Financial Committee

Fourteenth Meeting
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**Statement by James Michael Flaherty
Minister of Finance, Canada**

On behalf of Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada,
Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent
and the Grenadines

**Statement Prepared for the
International Monetary and Financial Committee
of the Board of Governors of the International Monetary Fund**

The Honourable Jim Flaherty, Minister of Finance for Canada,

**on behalf of Antigua and Barbuda, Bahamas, Barbados, Belize, Canada, Dominica,
Grenada, Ireland, Jamaica, Saint Kitts and Nevis, Saint Lucia,
and Saint Vincent and the Grenadines**

Singapore, September 17, 2006

We meet today at an extraordinarily important time for the International Monetary Fund (IMF) as it implements the Medium-Term Strategy proposed by Managing Director de Rato and endorsed by this Committee. There is increasing recognition across the IMF's membership of the importance of implementing real reforms that will strengthen the Fund's ability to fulfill its mandate to promote international financial stability in an increasingly globalized world. We need to make progress in a number of key areas. Quota reform is one of those areas. But quota reform is only one part of a broader package of needed reforms. Making surveillance more effective and modernizing the Fund's governance structure are also vital. Real and lasting reform of the institution will require a renewed commitment to achieve agreement on a comprehensive second stage of reforms within two years. By reaffirming our commitment to the IMF, we will renew the institution and build a more flexible, market-based global financial system. At this critical juncture, the world is looking to us to show leadership and vision in carrying out this important and ambitious reform agenda.

Global Prospects

This meeting occurs in the context of a continued strong global economy. We have seen stronger than expected growth in the first half of this year, and the global economy is expected to grow 5.1 per cent this year and 4.9 per cent in 2007. The outlook continues to be stable in the face of increasing inflationary pressures and high energy prices, though we do find ourselves faced with risks that are slanted to the downside. In particular, growing global inflationary pressures and inflation expectations may require further interest rate increases. Given the current environment, we need to encourage open communication of monetary policy to prevent uncertainty over policy direction from spilling over into global financial markets. Although no major disruption to global growth is expected, we need to be vigilant in monitoring early-stage expansions underway in many parts of the world and ensure that we continue positive work in the area of reducing global imbalances.

Canadian Developments

The Canadian economy remains strong. In 2005, real gross domestic product (GDP) increased 2.9 per cent, the same pace as in 2004, underpinned by healthy consumer spending and non-residential business investment. Well-anchored expectations are helping to keep consumer price inflation low and stable. Solid personal income gains and robust corporate profit growth, coupled with Canada's strong monetary and fiscal fundamentals, should continue to support Canadian growth in 2006 and 2007, with estimated increases in real GDP of about 3 per cent in both years. This solid growth performance is especially noteworthy in a context in which Canada has experienced a substantial appreciation of its exchange rate, an appreciation that in part reflects a contribution to the resolution of global imbalances.

Canada's fiscal situation remains solid. On a total government basis, Canada was the only Group of Seven (G7) country in surplus in 2005 and will likely be the only G7 country to remain in surplus in 2006 and 2007. Total government net debt, as a percentage of GDP, has declined steadily from a peak of over 69 per cent in 1995 to under 27 per cent in 2005. Canada has had the lowest net debt to GDP of any G7 country since 2004, and this situation is also expected to continue.

Irish and Caribbean Developments

Let me now turn to developments in Ireland and the Caribbean countries that form part of the Constituency I represent at the International Monetary and Financial Committee (IMFC). The growth prospects for the Irish economy remain positive. In recent years, growth has averaged close to 5 per cent per year and, in the absence of major shocks, this pattern seems likely to persist in 2006 and 2007. Employment growth has been a particular feature of the economy in recent years, while unemployment has remained stable at a little over 4 per cent. There has been very significant inwards migration, especially from Eastern Europe, in addition to a continuously rising labour participation rate.

With a high dependence on imported energy and with recent increases in European Central Bank official interest rates feeding into the consumer price index through the mortgage rate, there has been a recent spike in inflation to 4.2 per cent, although the underlying rate is less than 3 per cent. The tightening of monetary policy, however, should impact favourably on Irish inflation going forward. The overall fiscal position will again be close to balance in 2006, reflecting the health of the economy and spending restraint. Overall, the remarkable success of the Irish economy over the past 15 years is continuing and the economy is well placed to cope with shocks, should they occur.

There was increased economic activity in most of the Caribbean countries in the Constituency in 2006, underpinned by a pickup in tourist arrivals and a construction boom, the latter largely due to preparations for the 2007 Cricket World Cup. These countries, nonetheless, continue to face risks associated with large current account deficits, the macroeconomic impact of higher oil prices and elevated levels of debt.

Stabilization and consolidation efforts continued in the two countries—Dominica and Grenada—receiving Fund financial support through the Poverty Reduction and Growth Facility. Dominica’s growth performance has been solid; while in Grenada, which was ravaged by storms in 2004 and 2005, the Fund supported program is providing the foundation for a comprehensive medium-term economic reform program.

The assistance being provided by the Caribbean Regional Technical Assistance Centre (CARTAC) has been invaluable to my Caribbean constituents. The current program cycle expires at the end of 2007 and an evaluation, coordinated by the Fund’s Office of Technical Assistance Management, is currently underway. We urge continued Fund and other donor support for Phase III of CARTAC for the period 2008–2010. With the first phase of the CARICOM (Caribbean Community) Single Market and Economy initiative having been formally adopted earlier this year, we urge the Fund to further strengthen its regional surveillance activities. We believe that new modalities may be needed to enhance regional surveillance, and we support work by the Fund in formalizing these modalities.

IMF Reform

We are all aware of the fundamental changes that have taken place in the world economy in the last two decades. In concrete terms, globalization has translated into the ability of firms and individuals to easily invest in the markets of economies across the globe; into new and innovative financing for both private and public sector initiatives; and into massive flows of goods and capital across borders.

These developments have provided unparalleled opportunities for economic growth and private entrepreneurship, but at the same time have increased the costs of inappropriate policies. A key lesson to be drawn is that adaptability and innovation in response to change are vital to success. This lesson is as true for the IMF as it is for the rest of the world. Fundamental and innovative reforms are needed to ensure the IMF’s continued relevance in a world where the economic influence of emerging market countries is growing, where the smallest and poorest countries need to be better integrated into the world economy and not marginalized, and where even the largest countries can be affected by spillover effects from others’ policies. The Fund’s surveillance and lending roles need to continue to adapt to be relevant and effective in this new environment.

Under the guidance of Managing Director de Rato, we have before us a broad and innovative set of policy responses to the challenges facing the institution. A stable and equitable financing model for the IMF itself will need to be considered as part of the reform package. Moreover, ensuring that IMF financing facilities serve the needs of members, while promoting sound economic and financial policies, will be a difficult but important task.

Today, I would like to focus on the challenges of moving forward on the reform of quotas and voice, as well as the role of the IMF in bilateral and multilateral surveillance.

Quotas and Voice

Perhaps the most pressing issue of IMF governance is reform of Fund quotas. Quotas determine the amounts that countries can borrow from the Fund in cases of balance of payments or budgetary problems and the resources that countries in good financial health can be asked to provide the Fund to help other members. They are also the major factor in determining countries' voting power at the Fund. Proper alignment of quotas with countries' economic and financial weight in the global economy is essential to the Fund's legitimacy as an international institution. Legitimacy in turn is key to ensuring that the Fund can serve as an appropriate forum for members and that the Fund's policy advice is heeded.

The Managing Director has developed an innovative and workable two-stage process that is aimed at renewing the Fund's governance structure. Canada fully supports Mr. de Rato's planned reforms, including the initial ad hoc increase for four highly under-represented countries—China, Korea, Mexico and Turkey. We view this ad hoc quota increase as a meaningful “down payment” on more comprehensive reform. Looking ahead, we see considerable merit in a second round of ad hoc quota increases that would follow agreement on a new quota formula in the second stage of reforms. We remain committed to making meaningful changes in the quota formula to better reflect global economic realities, and we are committed to doing this in the two-year time frame proposed by the Managing Director.

The IMF's legitimacy and effectiveness also require a stronger voice for low-income countries. Accordingly, we support at least a doubling of basic votes and an amendment to the IMF Articles that will introduce a mechanism to safeguard the share of basic votes in total voting power against erosion in the future.

Canada is also sensitive to the special challenges facing the offices of the two African Executive Directors at the IMF, who each represent constituencies of more than 20 countries. We support efforts currently underway to ensure that these offices are in a position to effectively represent the members of their large constituencies, many of which are involved in IMF lending and technical assistance programs.

As the IMF reforms its governance structure to better reflect the global economic weight of its members, we must all remember that IMF membership entails shared responsibilities and obligations. Indeed, as a member's role and voice in a global institution increases, it is reasonable to expect that the scrutiny placed on its responsibility to its partners and the stability of the international system will increase as well. This point also has relevance for the reforms we are undertaking on surveillance.

Surveillance

The Managing Director has taken an important and very welcome step toward strengthening the effectiveness of IMF surveillance through the recent launch of a multilateral surveillance exercise aimed at promoting high-level dialogue among key members of the global economy to address global imbalances. I am encouraged by the

progress being made in these consultations and look forward to a report on their outcome at the next meeting of the IMFC.

This multilateral consultation mechanism could provide an effective and useful forum in which to consider other issues critical to the smooth functioning of the global economy. Indeed, we believe that consultations led by the IMF with selected capitals on key global economic issues should become a regular feature of Fund surveillance, with partner countries selected in a flexible and pragmatic manner linked to critical issues affecting the global economy.

The effectiveness of multilateral consultations, and of the IMF's surveillance activities more generally, will depend on an approach that combines the strong analytic competence of the IMF staff with a clear recognition of the underlying objectives of the consultations. This will require priority setting and accountability for results on the part of the Fund's membership. This, in turn, requires a number of steps.

First, it will be important to define in a more rigorous fashion the principles upon which IMF surveillance should be based. Up to now, while imbalances and distortionary economic policies have often been highlighted in Article IV reviews of member economies, the Fund's surveillance activities have been criticized for not being effective in reducing the likelihood of crises or in promoting stability. As well, the Fund has been reluctant to act forcefully when it identifies instances where countries failed to live up to their obligations, and, in particular, where countries are engaging in policies that negatively affect other members or even the stability of the international monetary system. A challenge of more effective IMF surveillance is, certainly, for the Fund to find the right balance between its role as a "trusted advisor" to governments, and its core responsibilities to support a well-functioning global economy.

Second, the Fund needs a clearer operational approach—specific rules to clarify how the Fund will discharge its responsibilities by undertaking surveillance of fiscal, monetary, exchange rate and financial sector policies, and identifying cases where domestic economic and financial policies can have adverse international spillovers. These rules should clarify the steps to be taken when countries are found to be engaging in currency manipulation and/or competitive devaluation—activities prohibited by the Fund's Articles of Agreement—and should provide a firm basis for actions to address the situation.

In this context, I welcome the ongoing work by Fund staff and Executive Directors to revisit the 1977 Decision on Surveillance over Exchange Rate Policies, which should lead to a clearer and more effective understanding of IMF members' responsibilities and the Fund's role in supporting the international financial system.

Third, there must be clear accountability for results, based on the priorities agreed and endorsed by the Fund's membership. In this respect, an important step forward was the agreement at the last meeting of the IMFC on a new annual remit for both bilateral and multilateral surveillance through which the Managing Director, the Executive Board and

the staff would be accountable for the quality of surveillance. We look forward to working with other Fund members, as well as the Managing Director and IMF staff, to develop a first remit that identifies key priorities for Fund surveillance in the year ahead.

This approach, implemented in the Fund's ongoing multilateral and bilateral surveillance activities, together with effective use of innovative mechanisms such as the current exercise on global imbalances, will make a major contribution to strengthening the IMF's role in promoting the stability of the international system.

Looking Forward

In the quest to reinvigorate the IMF, the successes here in Singapore are real and significant. The progress on quota reform will greatly improve the governance structure of the Fund. IMF reform, however, goes beyond quota reform alone: there is an important agenda we need to pursue in the areas of surveillance, Fund financing, and crisis prevention and resolution before the IMF can be fully transformed into the modern and representative international institution the world needs to safeguard global financial stability. We can take credit for what we have achieved at Singapore, but we need to press on with these important remaining challenges.