International Monetary and Financial Committee

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Statement by The Honourable Ralph Goodale
Minister of Finance of 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

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

The year 2005 marks the 60th anniversary of the inaugural meeting of the Board of Governors of the International Monetary Fund (IMF). The international system has changed significantly over the past six decades. Globalization, demographic shifts and the growth of global capital markets increase the importance of the sound policy frameworks and strong domestic institutions that are the foundations of domestic and global prosperity. The flows of goods, money and people across borders create challenges, requiring regular monitoring and possible remedies to maximize benefits and minimize costs. Moreover, we need to ensure all benefit from globalization.

At this meeting, in addition to our review of the global economic outlook, we take on the important task of reviewing the strategic directions of the IMF, including its role in low-income countries. This will lay the foundation for substantial reforms to the Fund's operations to enhance its relevance to the global community, its members and markets, and its contribution to monetary and financial stability, economic growth and poverty reduction.

I. Global Economy

In many ways 2004 was a banner year for the global economy. Growth was stronger than in any year since the mid-1970s. Strong growth in the United States and emerging Asia in particular underpinned the expansion. But other countries and regions also benefited. Sub-Saharan Africa and oil-producing countries in the Middle East enjoyed robust economic growth in 2004. Growth was also strong in Latin America, emerging Europe and Commonwealth of Independent States countries in 2004.

Perhaps the most disappointing aspect of global economic performance in 2004 was the slow growth in Japan and the euro area in the middle and latter part of the year.

The prospects for continued global expansion remain favourable in 2005, although growth this year can be expected to ease from the strong pace of last year.

As the IMF Outlook points out, however, downside risks have probably increased. Global payments imbalances have increased, which increases the risk of disruptive exchange and interest rate movements. The global expansion is also potentially vulnerable in the short term to rising and volatile oil prices. Should inflation pressures prove stronger than expected, interest rates could rise faster than expected. Should interest rates rise, some emerging market economies could find themselves facing a less benign financing environment.

Going forward, therefore, it will be important to address these risks in a cooperative manner. Those countries with fiscal deficits and high public debt burdens will have to implement credible fiscal consolidation, particularly in light of the long-term pressures from aging populations. More exchange rate flexibility on the part of China and some other Asian economies will be a critical element in the orderly unwinding of global imbalances. Emerging market economies must use the current favourable environment to strengthen policies to reduce their vulnerability to shifts in market sentiment.

The Canadian economy slowed in the fourth quarter of 2004, recording real gross domestic product (GDP) growth of only 1.7 per cent, as the strength of the Canadian dollar took its toll on exports. Nonetheless, final domestic demand growth remained robust, increasing 4.4 per cent, with stronger growth in all components, notably consumer spending and business investment. For 2004 as a whole, real GDP increased 2.8 per cent, while final domestic demand was up 3.8 per cent. The Bank of Canada has left the overnight target rate unchanged at each of the three most recent fixed announcement dates, citing the dampening effects on aggregate demand of the appreciation of the Canadian dollar, but noted that a considerable amount of monetary stimulus remains in the economy.

Healthy business and consumer confidence and solid job gains, coupled with Canada’s strong monetary and fiscal fundamentals, should continue to support Canadian growth through 2005. The December 2004 Department of Finance survey of private sector forecasters showed expectations for Canada’s real GDP growth to be 3.3 per cent in 2005 and 3.2 per cent in 2006, both up slightly from expectations in the September 2004 survey. The risks to the Canadian outlook are largely external, including the possible sudden, disorderly adjustment of large global imbalances, which could lead to a rapid and potentially disruptive appreciation of the Canadian dollar that would have a negative effect on aggregate demand.

Canada’s fiscal situation remains admirable. Canada was the only Group of Seven (G-7) country to record a fiscal surplus in each of the past three years and has seen its net debt as a percentage of GDP decline from the second worst in the G-7 in 1995 to the best in 2003. After recording a $9.1-billion surplus in 2003–04, the federal government is expecting balanced budgets or better in 2004–05 and in each of the next five fiscal years, after accounting for the fiscal impact of proposed new initiatives. The federal debt has declined steadily since 1996–97. This debt reduction, coupled with Canada’s strong economic growth, has resulted in a significant decline in the federal debt-to-GDP ratio, from its peak of 68.4 per cent in 1995–96 to 41.1 per cent in 2003–04. It is expected to continue to decline, reaching about 31 per cent by 2009–10. The Government is committed to keeping the federal debt-to-GDP ratio on a downward track, and in Budget 2005 reaffirmed its objective to lower the federal debt-to-GDP ratio to 25 per cent within 10 years.

I am pleased to report good progress in other countries I represent at the IMF. In Ireland, the pace of growth quickened in 2004 to exceed 5 per cent and, with inflation declining to the euro- area average by end-year, the external accounts posted a very minor deficit. Although employment rose by 3 per cent, unemployment eased only slightly—reflecting strong labour force growth, due in broadly equal shares to domestic demographics, a further increase in labour force participation and continuing in-migration. Aided by this economic performance and some one-off tax receipts, the public finance surplus strengthened to 1.3 per cent of GDP. Growth in 2005 is anticipated to be close to 5 per cent. Despite continuing strong public investment, the fiscal accounts (cyclically adjusted) should be in broad balance. Looking forward, the Irish authorities are particularly focused on enhancing economic competitiveness in a relatively fully employed economy, and preserving a sound fiscal position—keys to sustaining growth and preparing Ireland to meet the challenge of population aging.

During 2004, the Caribbean countries that I represent continued the economic recovery started in 2003. The recovery, for the most part, reflected expansion in the important tourism sector, with strong growth in both long-stay and cruise ship visitors in some countries, as well as a rebound in agricultural output in others. At the same time, however, the devastating economic and human impact of the hurricanes that struck parts of the Caribbean during the last quarter of 2004 highlights the vulnerability of these countries and how quickly fortunes can be reversed. Financing reconstruction places an overwhelming fiscal burden on these countries. We therefore welcome the decision to subsidize emergency natural disaster assistance for Poverty Reduction and Growth Facility (PRGF)-eligible members and Canada is providing $5 million to this effort. One country in our constituency has since taken advantage of this. However, a more fundamental dialogue has to take place regarding issues such as options for catastrophe risk insurance for countries that are disproportionately susceptible to natural disasters. Work is ongoing at the World Bank and elsewhere, and I believe that these initiatives deserve our support and encouragement. In other areas the Caribbean is moving steadfastly to address other challenges through the implementation of its reform agenda. Much of the focus will be on advancing the implementation of the Caribbean Community (CARICOM) Single Market and Economy initiative and country preparation for the single economic space by January 2006.

II. Reflections on the IMF's Strategic Directions

The Fund remains the key instrument to promote global financial stability. This was the Bretton Woods "vision" for the Fund. And its key roles—as a forum for the promotion of global financial stability and multilateral cooperation, a source of advice on policies, and a provider of temporary financial support—remain relevant today.

At the same time, the environment in which the Fund operates has changed in 60 years. These changes present new challenges for the IMF in terms of *how* it pursues the Bretton Woods vision. And that is why the strategic review of the institutions is so important. It is an opportunity to take stock of what has changed and how the Fund, and indeed the Bretton Woods institutions more broadly, have evolved. The goal should be to ensure the continuing relevance and effectiveness of these important institutions.

The key challenges faced by the Fund are well known. With flexible exchange rates and secure access to private capital markets, large industrialized members no longer draw on Fund resources, reducing the policy traction of Fund advice on these members. Moreover, the nature of the Fund's lending has evolved. In the Bretton Woods era of fixed exchange rates, the IMF provided short-term revolving credits in order to facilitate adjustment to temporary balance of payments difficulties. More recent arrangements have entailed longer-term lending and very large programs to a relatively small number of countries. These developments create potential financial challenges for the Fund.

These challenges pose a number of questions to be considered in the context of the strategic review of the Fund. The first strategic question is: what should the Fund be doing? Once the role is clear, the next question is: how should the Fund be organized?

In considering the Fund's strategic directions, we believe that a stable macroeconomic environment is an essential prerequisite for sustainable economic growth. The Fund has a unique role in assisting its members to achieve macroeconomic stability through surveillance and capacity building aimed at the development and implementation of sound fiscal, monetary, exchange rate and structural policies. At the same time, in fulfilling these responsibilities, we must recognize that it is countries themselves who are ultimately accountable to their people for their economic performance. For this reason, it is important that the Fund work to create the conditions for a productive policy dialogue with members, and that member countries have the maximum possible degree of ownership over the policies that they implement.

In order to help its members realize their full potential for prosperity, the Fund should strengthen its activities in the following areas.

Strengthening Systemic Surveillance

The global financial system and economy are becoming more complex and integrated, underscoring the critical importance of surveillance that looks at systemic issues, linkages among countries, and potential spillovers from national policies, as well as traditional country-focused surveillance. The key issue is how surveillance should respond to the increased magnitude of global imbalances and the potential risks they pose to international financial stability. As part of this process, there is a need to ensure that adequate resources are devoted both to surveillance of systemically important countries, where enhanced surveillance is critical to global stability, and to issues that can be best understood at the systemic level. In this respect, thought should be given as to how the Fund can best complement the enormous amount of analysis and "surveillance" undertaken by private financial markets.

Mechanisms for Intensified Surveillance of National Policies

There is growing recognition of the need for the Fund to develop mechanisms other than lending to support strong surveillance relationships with developing countries and to help signal creditors and donors. This is why Canada has supported creation of a country-led intensified surveillance mechanism. Unlike a formal IMF program, there would be no Fund financing attached to such a policy-monitoring arrangement. Rather, the Fund would be asked to provide more frequent monitoring than typical surveillance, and the Board would assess the extent to which the country is achieving consistent economic and financial goals. These assessments could provide a valuable role in signalling to donors, markets and members of civil society whether the country is making satisfactory progress on a consistent economic program of its own devising.

Intensified surveillance arrangements could be especially useful for countries which wish to avoid further debt accumulation, or indeed which may already be in debt distress. Ironically, under present international arrangements, countries seeking debt relief are required to borrow from the IMF. We urge creditors to re-examine their policy of linking debt relief to a regular Fund arrangement, with a view to ensuring that the smooth functioning of the creditor-borrower relationship is not compromised in situations where a regular Fund arrangement is not necessary.

Clarifying Crisis Resolution

The Fund must build on recent initiatives, such as the exceptional access framework and collective action clauses, aimed at improving the resolution of capital account crises and clarifying the “rules of the game” governing the roles of the Fund, borrowing countries and international investors. The Fund must strengthen its approach to crisis resolution to clarify situations in which the Fund has a lending role in capital account crises, versus those where the onus should be on affected countries to implement alternatives, including restructuring of their external debt. The goal should be, in the words of the Managing Director, to support “only programmes that put members firmly on the road to external viability, and…not protect the imprudent from the consequences of their decisions.” To this end, the Fund needs to better understand the causes and dynamics of capital account crises, and how affected countries can regain access to international capital markets. In addition, further consideration is needed of what additions to the Fund’s policy “toolkit” and broader legal and contractual provisions in debt contracts would facilitate the orderly resolution of sovereign debt problems.

Adopting a More Strategic Communications Approach

In order to have its maximum impact toward achieving a stable and more prosperous global economy, the Fund must complement its existing solid analytic capacity with a sustained, strategic communications approach that allows it to engage effectively in key national and international policy debates, ranging from those involving national economic policies to global systemic risks and architecture issues. The Fund should be able to explain its policy advice to the citizens of its member countries, defend its policy advice, and listen and learn in order to serve its members and their citizens better.

Applying Modern Management "Best Practices"

As a major financial institution, it is important that the IMF's management arrangements and corporate governance reflect advances in best practices, include clear lines of accountability and embrace principles of transparency. The strategic review of the Fund's activities provides an opportunity to develop these arrangements in order to equip the Fund to respond to the needs of its membership now and in the future.

Integrating Capacity Building and Technical Assistance

The IMF helps member countries achieve strong sustained growth by providing assistance and training aimed at strengthening their capacity to pursue good economic and financial policies, based on good underlying governance and strong institutions. In recent years, the Fund has reinforced its efforts by establishing regional technical assistance centres in the Pacific, the Caribbean, East and West Africa and the Middle East. We welcome the Fund's intention to establish three more centres to cover all of Sub-Saharan Africa over the medium term.

The IMF should, as a core aspect of its mandate, continue to build capacity in its areas of expertise, namely: macroeconomic and monetary policies, exchange rates, tax policy and revenue administration, expenditure management, financial sector sustainability, and macroeconomic and financial statistics. Since demand for technical assistance will always exceed supply, in addition to looking at ways to better integrate capacity building with its lending and surveillance activities, the IMF should carefully examine the manner in which it allocates technical assistance to ensure that scarce resources are mobilized in ways that ensure that they have the maximum impact.

III. ROLE OF THE FUND IN LOW-INCOME COUNTRIES

The IMF is an important partner in the international effort, reinforced under the Monterrey Consensus, to strengthen cooperation in supporting rapid, sustained growth and poverty reduction, as well as progress toward the Millennium Development Goals. Donors and official creditors look to the Fund to support the macroeconomic policy reforms needed to achieve high growth and poverty reduction over the medium term, through policy advice and capacity building as well as financial assistance. Fund assistance also supports countries' efforts to ensure that an appropriate policy environment is in place so that higher levels of aid can be put to good use.

External adjustment in low-income countries aims to place an economy on a more sustainable long-term path for growth. The Fund needs to address some important challenges and knowledge gaps in its effort to provide credible and sound advice. Fund staff need to enhance their understanding of the sources of growth. Together with the World Bank, the Fund has developed a debt sustainability framework to guard countries against debt distress. Besides work on the debt sustainability thresholds, the two institutions should explore possible measures that would prevent imprudent borrowing by poor countries and irresponsible lending by creditors.

Refocusing PRGF Lending

The Fund's 78 low-income members require substantial development resources provided on highly concessional or grant terms. Most of these development resources are needed for purposes that clearly fall outside the Fund's mandate and are better addressed through the multilateral development banks and bilateral donors. These agencies are able to offer more substantial amounts of assistance on much better terms, including grants.

In this context, the Fund's unique role is to provide financial assistance and associated specific policy advice to all members facing balance of payments needs. The PRGF, unfortunately, has evolved beyond its role of providing short-term, exceptional balance of payment support to provide de facto longer-term development finance, which is better served by other international institutions. In our view, the PRGF should only provide rapid assistance to alleviate short-term external payments distress. The IMF would play a similar financing role, for actual balance of payment needs, in both low-income and middle-income countries, but without exposing the quota resources of the IMF to the significant credit risks implicit in lending to the poorest countries. This should be the main rationale for Fund assistance.

Supporting Poverty Reduction Efforts Through Further Debt Relief

Canada, Ireland and all of the countries I represent feel that more needs to be done to help reforming low-income countries focus on poverty reduction instead of repaying old debt. In February 2005, Canada announced its commitment to cover the debt-service obligations of eligible reforming low-income countries to the International Development Association (IDA) and the African Development Fund. Canada urged other donors to do the same. The benefits would be available until 2015 to all countries that have completed the Heavily Indebted Poor Countries process and to other low-income (IDA-only) countries that have the ability to use these savings for development. This provides poor countries with immediate fiscal space to implement their poverty reduction strategies. Reducing the debt service paid by poor countries to the IMF is critical. Canada has also called on donors to agree on the need to provide further IMF debt relief and to be prepared to finance this cost.

Further IMF debt relief must be considered in a broader context, together with Fund lending capacity, sources of financing and the broader role of the Fund in low-income countries. Moreover, four principles—additionality, financial integrity of the Fund, equality of treatment of low-income countries, and strong linkage between debt relief and poverty reduction—should guide the development of any IMF debt relief plan.

IV. CONCLUDING REMARKS

We welcome the ongoing efforts of the IMF to adapt to new global economic challenges and the changing needs of their membership, its willingness to listen and learn from experience, and its desire to cooperate with other development partners. In this regard, we look forward to concrete progress in the Managing Director's review of strategic directions. We urge IMF management to take into account views of International Monetary and Financial Committee members and be bold in its review of the Fund's critical surveillance activities, crisis prevention and resolution toolkit, capacity building initiatives and its assistance to low-income countries.