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Statement by Honorable 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, and St. Vincent and the Grenadines

Statement prepared for the International Monetary and Financial Committee of the International Monetary Fund

The Honourable James M. Flaherty, Minister of Finance of Canada

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

Washington, DC, April 22, 2006

This meeting of the International Monetary and Financial Committee presents us with an historic opportunity to reinvigorate the IMF and empower it as the guardian of the market-based international monetary system. The Strategic Review of the Fund's role, launched by the Managing Director two years ago, stresses the importance of accountability and results. We have before us concrete suggestions to transform many aspects of the Fund's surveillance, lending and capacity building in order to strengthen its partnership with all of its members. We must also address questions of governance, including the under-representation of a number of systemically-important emerging-market economies. As IMF members, we must act to renew the Fund and imbue it with a culture of accountability and achievement and with a strong voice in resolving global imbalances.

Global Economy

This meeting occurs in the context of a strong global economy, with growth continuing to exceed expectations. This prosperity has continued in the face of challenges, particularly the surge in oil prices. That these price increases have thus far had only a transitory effect on inflation is a testament to the work of our central banks in creating and defending an environment of low and stable inflation. Going forward, we need to set the stage for continued economic stability, in part by ensuring that the global imbalances, which are unsustainable in the long-run, are resolved in an orderly manner. The current favourable environment of strong global growth provides a good opportunity to work toward this objective.

Let me now briefly turn to economic developments in Canada, Ireland, and the Caribbean countries. The Canadian economy remains strong. In 2005, real 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 still-low interest rates, coupled with Canada's strong monetary and fiscal fundamentals, should continue to support Canadian growth in 2006 and 2007 with estimates of real GDP growth of about 3 per cent in both years.

Canada's fiscal situation remains solid. Canada was the only G-7 country to record a fiscal surplus in each of the past three years and is expected to remain the only G-7 country to record a surplus in 2006 and 2007. The federal debt, as a percentage of GDP, has declined steadily from a peak of over 68 per cent in 1995-96 to under 39 per cent in 2004-05.

The Irish economy continues to prosper. Real GDP grew by 4.7 per cent in 2005 and growth at a broadly similar rate is expected in 2006. Domestic demand was the main impetus to growth in 2005, while there was some deterioration in the current external account. Construction and house building were particularly strong, while the volume of consumption rose by 5.6 per cent. In 2005, employment grew by more than 4 per cent, with much of the increase being accounted for by inwards migration. With a buoyant economy and rising oil prices, inflation has risen in recent months, with the European Union harmonized index of consumer prices averaging 2.2 per cent in 2005 and rising to 2.7 per cent in February 2006. Despite record levels of housing supply, house prices continue to rise sharply and have even accelerated somewhat in recent months. On average, house prices rose by more than 9 per cent in 2005.

In line with the policy of maintaining broad fiscal balance, the General Government balance recorded a small surplus of 0.4 per cent of GDP in 2005, while a small deficit is envisaged this year. The General Government debt ratio has fallen to less than 28 per cent of GDP. With its consistently high growth rate, low unemployment and broad fiscal balance over many years, the Irish economy remains well placed to face the challenges of the globalized economy.

The economic recovery in the Caribbean which began in 2003 continued in 2005. Growth was observed in the construction, mining and tourism sectors even as agricultural output was interrupted in those countries hit by hurricanes in 2005. The devastating human and economic impact of the hurricanes continues to highlight the vulnerability of these countries to shocks. Inflation remained stable in most economies but fiscal outcomes did not improve as expected following declines in the effective oil tax rates of several countries. While there was some improvement in the primary balance of several countries, meaningful debt reduction was difficult to achieve as governments struggled with the financing of hurricane reconstruction and dealt with the consequences of rising oil prices.

The IMF continues to provide valuable assistance to the Caribbean countries that I represent, through increased policy dialogue and through Fund-supported programs in two countries. In this regard, Dominica’s performance under the Poverty Reduction and Growth Facility (PRGF) has been exemplary, while Grenada has recently been approved to receive assistance under this facility. In other areas, the Caribbean moved with conviction to address other challenges by furthering structural reforms to improve their investment climate, strengthen competitiveness and enhance regional cooperation. Regarding regional cooperation, the first phase of the Caribbean Community (CARICOM) Single Market and Economy came into effect on January 2006 with six countries signing with the remainder expected to sign by June 2006.

Revitalizing the IMF as Guardian of a Market-Based International Monetary System

The global financial and economic landscape has changed considerably over the last two decades and our challenge is to forge a common view on the proper role of the IMF in a globalized international financial and monetary system. Canada, Ireland and the Caribbean reaffirm our support for a market-based international monetary system.

Among the most important developments in the global economy and international monetary system has been the enormous growth in recent years in private capital flows and the corresponding increase in cross-border holding of assets. Globalization has not only expanded consumption and investment opportunities, but also has allowed imbalances to grow and the scale of crises to increase. This has clear implications for the role of the Fund. First, it must approach its activities from the perspective of enhancing the efficiency and stability of markets. Second, to better support this market-based international monetary system, it must strengthen its effectiveness in persuading countries not to pursue policies that undermine the prosperity of their neighbours or the stability of the system as a whole. National borders now have little meaning; at least in terms of economics and finance, we are truly living in a "global village".

A market-based international monetary system requires clear "rules of the game" and adherence to them by all countries. As the institution at the centre of the system, it is essential that the IMF has both the capacity and an unambiguous mandate to monitor key economic and financial trends and, through analytically strong and effectively communicated policy advice, to help countries, regions and the world mitigate vulnerabilities before they become serious risks to national and international prosperity. In sum, we have a common objective – global prosperity – which can be best achieved through multilateralism and cooperation.

In designing a strengthened IMF, we need to adopt a "can do" attitude with an eye to pragmatism and results. The Managing Director has set out a comprehensive plan of action to reinforce the IMF's position at the centre of the international monetary system. We welcome the proposals. In taking these forward, we should not lose sight of the fact that the IMF is most effective when it is most persuasive. And it will be most persuasive when it has at its disposal strong analytical resources, has the proper incentives for candour, and understands the importance of communicating its policy advice. The Fund should be straightforward in its public communications, particularly in cases where it believes that a country's policies undermine its own prosperity and that of its neighbours. And in its role as confidential policy advisor, it should not hesitate to deliver messages in the most frank and hard-hitting manner possible.

Members of my constituency consider two aspects of the Managing Director's reform agenda – governance and surveillance – to be particularly critical in breathing new life into the Fund and establishing a more valuable partnership between the Fund and its members.

On governance, concerns about the widening disparity between quota shares and the growing international economic weight of a number of emerging-market members threatens to erode the legitimacy of the institution. We support action on this issue through a two-stage approach. The first stage would see ad hoc quota increases for a small number of systemically-important emerging-market economies at our next meeting in Singapore as a "downpayment" for additional governance reforms that would follow in the second stage. This second stage must have a clear deadline to ensure concrete action. At a minimum, reforms in the second stage should address the need to protect the voice of the poorest, clarify the roles of the Executive Board and management, and introduce greater transparency and the principle of merit into the selection of senior management. The Executive Board needs to focus on strategic issues and management needs to pay more attention to results.

Turning to surveillance, economic and financial integration has created new challenges and the Fund and its membership must adapt accordingly. To be relevant, the IMF must focus on the right issues and it must have the right processes in place to ensure that its advice has a real impact. Global financial markets underscore the need for increased emphasis on financial sector issues and public and corporate debt dynamics. The current global imbalances debate suggests the need for a closer look at regional and global linkages. Finally, the IMF must pay greater attention to exchange rate regimes and how country choices impact the allocation of benefits of globalization and risks to the global economy.

The most critical challenge facing the global community and the Fund today is the resolution of global imbalances, which reflect large current account deficits of some key economies mirrored by large current account surpluses of other nations. These imbalances are underpinned by mismatches of savings and investment on a global scale. The existence of a dual exchange rate system further aggravates the problem and delays the adjustment process.

The IMF has a critical role to play as global coordinator, to help resolve these imbalances in an orderly fashion. Since global imbalances, as well as other issues of systemic importance, are problems not of just one country but of many, we need a multilateral format for consultations. We therefore support the proposed strengthening of multilateral consultation procedures. In this regard, yesterday's conference on Global Imbalances was an important step. But this needs to be followed by an agreement to strengthen the IMFC as the body for multilateral economic and financial policy coordination.

Ultimately, surveillance is about the promotion of good public policy. And surveillance will be most effective if it takes place in the context of good governance based on strong political and economic institutions. In addition to its long-standing Article IV surveillance activities, the IMF has more recently promoted good governance through support for the Standards and Codes initiative, launched in 1999, and operationalized through the targeted surveillance instruments of the Financial Sector Assessment Program and the Reports on the Observance of Standards and Codes.

These have unquestionably helped to promote domestic and international financial stability through the dissemination of international best practices in key areas of macroeconomic relevance – namely the financial sector, fiscal transparency and data dissemination and quality. It is time to ask whether a more comprehensive approach, broadening surveillance to include some aspects of the political institutional context, should be considered to identify additional vulnerabilities and assess the efficacy of international efforts to foster good governance. This could take the form of a "ROSC for

Governance", which could integrate the Fund's existing work on good practices for fiscal, monetary, and financial policy with broader perspectives, including those embodied in the World Bank's Country Policy and Institutional Assessment methodology.

Devoting more resources to more relevant multilateral and regional surveillance, and to systemically-important issues and countries, will entail trade-offs. We stand ready to support the proposed two-track country surveillance process under which greater resources would be devoted to systemically-important countries and issues of systemic importance, and with a streamlined procedure for other countries. We also agree with other measures to streamline internal governance processes to assure more effective decision-making processes, while keeping costs low.

The Fund must also heed the call of emerging market economies, which have challenged the Fund to help them benefit from economic and financial integration. The Fund is responding with concrete proposals, including a new contingent financing instrument which requires careful examination. In our view, any new instrument must be consistent with the Fund's exceptional access framework, which disciplines its lending activities, enhances risk management and provides greater certainty to markets. In designing the new instrument, the Fund must pay careful attention to lessons learned with similar instruments, including the Contingent Credit Line and the previous use of precautionary exceptional access for exit purposes. Finally, broad-based consultations will be necessary to ensure consistency with identified country needs, and to clarify access guidelines, pricing and the exogenous shocks to be covered by the instrument. We remain to be convinced that these complex issues can be resolved.

The Fund has made substantial progress in assisting low-income countries resume economic growth. Under the Multilateral Debt Relief Initiative, the Fund has made a clean break with the "lend and forgive" cycle by eliminating the debt owed by nineteen small and poor countries. It has also introduced the Policy Support Instrument to foster a new non-borrowing relationship between the Fund and its small and poor members. The IMF has established the Exogenous Shocks Facility to assist small and poor members in recovering from financial difficulties outside of their control, including high oil prices. Canada has contributed to the costs of IMF debt cancellation and will contribute to the Exogenous Shocks Facility.

The IMF should build upon this strong base to strengthen further its assistance to low-income countries according to its mandate and comparative advantage. The IMF needs to work with low-income countries to prevent the re-emergence of unsustainable debt burdens. It should assist them to build and strengthen fiscal and debt management capacity and integrate debt sustainability considerations into Fund activities.

The Fund will need to work closely with the World Bank, which plays a leading role in coordinating assistance to low-income countries. We call on the Fund and the World Bank to clarify further their division of labour, based on clear accountabilities and a focus on results. The IMF plays an essential role in informing the macroeconomic policy choices of its small and poor members. But this role must be tempered with the need to work effectively with developing countries, the multilateral development banks, bilateral development agencies, and the United Nations (especially in post-conflict cases).

Conclusion

The world will continue to change and barriers dividing us will continue to fall. We need strong international institutions, including a reinvigorated Fund, to ensure a well-functioning, market-based international financial system. But the Fund also needs us, its members, to empower it with the necessary support – cooperation, finance and attention. It is time to get to work.