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Statement by the Hon. **JAMES M. FLAHERTY,**
Governor of the Fund and the Bank for **CANADA,**
at the Joint Annual Discussion

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Our meeting comes at an important time for both Bretton Woods institutions. In the case of the IMF, we stand on the threshold of major reform that will better equip the institution to meet the challenges of a rapidly globalizing economy. In the case of the World Bank, with less than a decade to achieve the Millennium Development Goals, we need to redouble our collective efforts to achieve concrete and effective development results.

The IMF -- Strengthening Reform

The forces of globalization have provided unparalleled opportunities for economic growth and private entrepreneurship, but at the same time raise the cost of inappropriate policies. The key lesson to be drawn in the evolving global economic is that adaptability and innovation are vital to success. This lesson is as true for the IMF as it is for the rest of the world. Fundamental and innovative changes are needed to ensure the IMF's continued relevance in a world where the economic influence of emerging market economies is growing, where the smallest and poorest countries need to be better integrated into the world economy and not marginalized, and where the Fund's surveillance and lending roles must continue to adapt.

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.

Perhaps the most pressing issue of IMF governance is reform of Fund quotas. 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. Canada fully supports Mr. de Rato's planned reforms, including the initial *ad hoc* increase for four highly underrepresented countries – China, Korea, Mexico and Turkey just approved by the Board of Governors. 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 timeframe proposed by the Managing Director.

The IMF's legitimacy and effectiveness also requires 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. 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 is the IMF's core business. 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 to 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 on-going work by Fund staff and Executive Directors to re-visit 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 on-going 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.

The World Bank – Focusing on Effectiveness

Canada is strongly committed to reach the MDGs by the 2015 target. Meeting these goals requires that developing countries manage their economies effectively and follow through on national poverty reduction strategies. For their part, donor countries must increase the effectiveness of their aid. Ensuring predictability of aid flows is critical to allowing developing partners to commit to essential reform and capacity building measures. Developing countries also need to receive longer-term commitments to core areas of funding, especially for the provision of services to the poor.

Donors must reduce the aid management burden, particularly on the poorest and smallest states, in line with commitments under the Paris Declaration on Aid Effectiveness. Progress on these issues is important to secure stronger results on the ground. The Bank should draw on its recent experience in Africa and continue to promote stronger donor alignment, harmonization and coordination. In this regard, we encourage the expansion of recent efforts by the World Bank to prepare Joint Assistance Strategies with other donors based on national development strategies, such as poverty reduction strategy papers (PRSPs). In addition, because the collection of accurate and timely statistics is critical to gaining an accurate understanding of progress achieved and the challenges that remain, national statistical capacity be routinely appraised in the context of World Bank Country Assistance Strategies.

Strong governance is key to effectiveness. Aid must be delivered in ways that support our partners' capacity to govern and promote accountability for the use of public resources. The World Bank has demonstrated that it is a leader in governance and anticorruption. We welcome the Bank's efforts since we met last Spring to articulate a broad strategy to promote a more coherent, transparent and results-oriented approach. Going forward, we need to deepen our understanding of the challenges that weak governance and corruption pose for the development process and address more specifically how the Bank can meaningfully address these issues. As well, there remains a need for clear operational guidelines to better understand how decisions should be taken on World Bank support in situations where weak governance and corruption present real risks.

In countries where corruption is a challenge, we need to have clearer rules on the Bank's terms of engagement. We continue to urge the Bank to remain engaged even in countries where corruption represents a significant challenge, because without the Bank's efforts, there may be little progress forward. But the World Bank cannot tackle these issues on its own, and we look to continued progress in developing a common approach to tackling corruption, involving other donor partners as well as other Multilateral Development Banks.

In effect, we all need to engage in the fight against corruption. International institutions must ensure that their in-house operations meet high integrity standards and that their interventions in member countries promote good governance. Developed countries must lead by example by trying to ensure that the operations of their governments and corporations are models of transparency and accountability.

Fragile states present special challenges. Canada welcomes the World Bank's ongoing support for fragile states, including in post-conflict situations. Canada is actively involved in assisting a number of fragile states, with large development assistance programs, for example, in Afghanistan and Haiti.

While it is clear that the Bank has made considerable progress in its involvement in fragile states over the past four years, more needs to be done. Canada is working with the Bank to set up a Fragile States Partnership and Knowledge Initiative to develop and strengthen knowledge about effective approaches in fragile states. One area for further work is the Bank's aid allocation system. While we support a performance-based allocation system to determine IDA aid volume, we believe that there is scope to refine the system to be more effective in responding to the special challenges of state fragility. In this area, the IDA 14 Mid-Term Review provides an opportunity to make real progress as we prepare for the upcoming IDA 15 exercise.