

WORLD BANK GROUP

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

J

INTERNATIONAL MONETARY FUND

Press Release No. 20

October 22, 2007

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

**Statement by the Hon. James Michael Flaherty,
Governor of the Bank and the Fund for Canada,
at the Joint Annual Discussion**

I would like to extend my appreciation to Managing Director de Rato at this, his last Annual Meeting and welcome the appointment of Mr. Dominique Strauss-Kahn as the new Managing Director. Mr. Strauss-Kahn brings to the IMF a wealth of experience and a strong vision for the Fund. I would also like to take this opportunity to welcome Robert Zoellick as the new President of the World Bank. I am confident that the experience and knowledge that Mr. Zoellick brings to the job will ensure that the Bank can effectively deliver on its development mandate.

Global and Canadian Prospects

Since our last meeting, the global economy has been slightly weaker than anticipated and the outlook has further clouded as a result of the turmoil in financial markets. This heightened uncertainty is putting the resilience of the global financial system and effectiveness of our institutions to the test. The challenge facing policymakers is to carefully examine the root causes of the current financial volatility and draw the appropriate lessons for policy responses at the national and international levels.

The losses in the relatively small US sub-prime mortgage market quickly disseminated to global markets via the market for asset-backed securities and, although quick action on the part of the Bank of Canada and other major central banks helped sustain market liquidity, certain market segments remain stressed. Nevertheless, the fundamentals of the global economy remain sound and the IMF continues to project growth of around 5 percent in 2007 and 2008.

The slowdown in the US economy and the depreciation of the US dollar should help moderate the US current account deficit and help unwind global imbalances. However, global imbalances remain significant and continued progress is needed on implementing the recommendations that emerged from the multilateral consultations.

Canada's economy continues to operate at a high level of activity, owing to robust domestic demand. However, the tightening of credit conditions, the appreciation of the Canadian dollar to parity with its US counterpart, and the weakness in the US housing market are expected to reduce Canadian exports and negatively affect growth. As a result, the IMF expects Canadian growth to ease to the 2.5 percent range in 2007 and 2008. Total consumer price inflation in Canada has been volatile over the last year, largely due to energy prices. However, well-anchored expectations have helped keep core consumer price inflation relatively stable and near the Bank of Canada's 2 percent inflation target.

Canada's fiscal situation remains solid. On a total government basis, Canada again posted a surplus in 2006 and will likely be the only G7 country in surplus in 2007 and 2008. Total government net debt, as a percentage of GDP, has also declined steadily from a peak of nearly 71 percent in 1995 to about 27 percent in 2006.

IMF Surveillance

Significant progress has been made on the Medium-Term Strategy since our meetings in the Spring. I welcome the decision by the Executive Board to adopt the 2007 Decision on Bilateral Surveillance, replacing the 30-year old 1977 Decision. The 2007 Decision puts more emphasis on members' domestic policies as well as giving the Fund the ability to better identify domestic macroeconomic and exchange rate policies that lead to external instability. It also reinforces the principle that surveillance should be applied to all members in a uniform and even-handed fashion that promotes open, two-way dialogue.

A second area of progress took place in August, when the Executive Board came to consensus on the desirability of a triennial Statement of Surveillance Priorities. The Statement of Surveillance Priorities will work in conjunction with the Fund's triennial surveillance reviews to ensure that the right issues are focused on in a frank, fair and flexible manner in support of global economic and financial stability.

Quotas and Voice Reforms

Progress at better aligning IMF governance arrangements with developments in a rapidly changing global economy, is essential to strengthening the legitimacy of the IMF. As a result, agreement on a package of reforms to the structure of IMF quota and voting power is a key priority for Canada.

Important progress has indeed been made in recent months. We all agree on the overall objectives of quota reform, which are to increase the voting share of developing countries (particularly dynamic economies) and to increase the voting share of PRGF countries. We also agree on some elements of the quota formula. However, divisions remain on key issues and we will need to redouble our efforts if an agreement is to be reached by the Spring meetings. Progress will require flexibility on the part of all members of the IMF.

Securing a Stable Source of Financing for the IMF

As we know, the Fund's traditional means of financing its operations has become increasingly unsustainable. We need to consider the income options presented by the Committee of Eminent Persons on the Sustainable Financing of the Fund (the Crockett Committee) and I look forward to further analysis from Staff. I also encourage ongoing efforts to identify efficiency-enhancing measures at the Fund, improve the link between inputs and outputs in the budgeting process, and slow the growth in nominal

administrative expenses. I would encourage members to continue to keep all options on the table, as a package of measures will likely be required to successfully address the current financing challenge.

The IMF's Role in Low Income Countries

The Fund's low-income members face particular challenges in establishing macroeconomic stability, building efficient financial sectors, developing sound legal and business frameworks and investing in infrastructure. Those that have been the recipients of the Enhanced HIPC Initiative and MDRI debt relief should use the fiscal space created by debt relief to accelerate economic growth and reduce poverty. This requires a commitment to restrain excessive external borrowing to avoid another run-up of unsustainable debt.

In their efforts, these authorities will require the well-coordinated assistance of the Fund, the Bank and the rest of the international community. I therefore welcome the recently approved Joint Management Action Plan to improve coordination and communication between the Staffs of the Fund and the Bank and the more focused role for the Fund in the Poverty Reduction Strategy process and low-income countries more generally. I also encourage all borrowers and lenders to participate fully in the HIPC debt relief process, and to respect the Low-Income Country Debt Sustainability Framework.

A Strategic Direction for the World Bank

Much of the focus of our discussion this weekend was on defining the future role of the World Bank. We welcome President Zoellick's articulation of key priorities for the Bank going forward. The challenge now is to translate these broad priorities into an appropriately focused role for the World Bank Group.

In Canada's view, four criteria must guide the long term strategic direction of the Bank. First, the strategy must be implemented in such a way that it has relevance at the country level, but also allows the Bank to focus its support in areas where it has a comparative advantage. Second, the Bank needs to continue to work on building partnerships with other donors and strengthening the relationship between the different institutions that make up the World Bank Group. Third, innovative ways to mobilize and leverage private sector investment to achieve development goals, such as Advance Market Commitments, must be given greater attention. Finally, delivering results is paramount, and represents an even greater challenge in the context of global public goods.

We would also like to take this opportunity to highlight two areas where Canada's priorities intersect with important aspects of the World Bank's strategic direction.

First, the Bank's work in fragile states, including Afghanistan, Haiti, and Sudan reinforces our efforts in these countries. Canada is a major supporter of the Afghanistan

Reconstruction Trust Fund (ARTF) and we believe it is a model of "best practice" for structuring and managing trust funds in post-conflict situations. Canada also welcomes the Bank's recent participation at NATO meetings regarding Afghanistan. This is a positive first step. We would encourage continued efforts to strengthen coordination between international organizations actively engaged in Afghanistan.

Second, Canada strongly supports the Bank's work in the poorest countries. The International Development Association plays a unique role in creating a platform that supports the successful delivery of other bilateral and vertical programs. We welcome the Bank's recent commitment to transfer US\$3.5 billion to IDA15. We look forward to a successful IDA15 replenishment.

In Canada's view, as we move forward in our discussions on the strategic direction of the World Bank it will be necessary to ensure that the Bank's governance structure evolves with changes in the international economy. Canada has been a strong supporter of reform efforts at the Fund and views voice and representation issues as no less important at the Bank. However, discussions on World Bank reform must take into account differences in the ownership structures, as well as the differing roles played by these two institutions in the global community.

World Bank governance reforms require a multifaceted approach that goes beyond voting power. As an example, Canada is open to exploring ways to ensure that clear demonstrations of members' strong and consistent support to the Bank, such as through IDA contributions and other ODA spending related to the Bank, are more fully recognized in the institution. In this respect, we encourage developing countries to take up their full subscriptions to IDA.

More generally, there are a few basic principles should guide our discussions on World Bank governance reform: we must ensure that all developing members can benefit from governance reforms; we must ensure that any adjustments to shareholdings continue to be primarily based on each member's weight in the global economy; and we must preserve the IBRD's ability to borrow at the lowest interest rate spreads from international capital markets.

Underlying all of our efforts is the need for solid financial stewardship. The Bank's business model must evolve if it is to continue to meet the demands of its members and provide services that effectively address a spectrum of development needs. To this end, we would urge consideration of a full review of the Bank's longer-term financial situation. This should be with a view to finding significant efficiencies, as well as a better understanding of the growing demands on net income and the potential to leverage Bank resources to meet development needs.