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

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We are experiencing a time of global economic and financial uncertainty that in some respects is unprecedented in the last half century. Virtually no country is immune to the risks stemming from the turmoil in global financial markets and many are facing serious dislocations from the sharp hikes and volatility in commodity prices we have witnessed. In these difficult times, having strong global institutions like the World Bank and the IMF is a tremendous asset. We must use the momentum for reforms in both institutions to ensure they are fully equipped to pursue their important mandates.

Global and Canadian Prospects

The global economy continues to be buffeted by shocks emanating from the turmoil in many parts of the global financial system and by increases in the prices of commodities central to people's standards of living. Growth in the major advanced economies has slowed sharply, and although emerging markets will remain the major driver of global economic growth, their pace of growth is expected to slow. This has made it increasingly important for countries to work together to promote a return to strong sustained global growth and stability. I believe that Finance Ministers should meet again in the coming weeks to ensure continual progress. The Government of Canada also supports the idea put forward by President Sarkozy of a leaders' summit to review measures to strengthen the international financial system.

Many economies are better placed today to weather these shocks due to past improvements in policy frameworks. Canada, along with others, took the necessary measures in recent years to put public finances on a sound footing. This has provided us with the flexibility to respond to signs of a softening of growth with timely fiscal stimulus while continuing to maintain a balanced budget. While headline inflation has picked up globally as a result of oil and commodity price increases, the increased credibility of central banks who have adopted strong policy frameworks have generally kept inflation expectations well-anchored. However, signs of higher inflation are more worrying in several emerging market economies, many of which are sacrificing some of their monetary policy independence by limiting the flexibility in their currencies.

Economic growth in Canada has weakened since the end of 2007 as a result of the United States slowdown, which, coupled with a higher Canadian dollar, has significantly reduced Canadian exports. However, as a result of the strong dollar and higher commodity prices, Canadian consumers and businesses have benefited from rising real incomes and profits. As a result, domestic demand growth in Canada remains solid despite slower growth overall. Moreover, Canada's economic fundamentals remain strong: employment has continued to increase this year; the unemployment rate remains near a 33-year low; the financial sector remains strong and well-capitalised; the financial positions of consumers, businesses and governments are sound; and core inflation remains low and stable. The IMF expects Canadian growth to be 0.7 per cent in 2008, increasing to 1.2 per cent in 2009.

Core inflation pressures remain contained at 1.7 per cent in August 2008, despite a recent uptick in headline inflation. Total consumer price inflation was 3.5 per cent in August, compared to a recent low of 1.4 per cent in March 2008 reflecting increases in the prices of energy and food products following sharp increases in world prices earlier this year. On October 8th , the Bank of Canada joined other major central banks in a simultaneous reduction of policy interest rates by 50 basis points. This significant action will provide timely support for the Canadian economy.

Canada's fiscal situation remains strong. In fact, it remains the best of the Group of Seven (G-7) countries. According to the IMF's fall outlook, on a total government basis, Canada's budget surplus was 1.4 per cent of GDP in 2007 and is projected to remain in surplus for 2008 and 2009. Canada also has a very strong track record on debt reduction. Our total government net debt, as a percentage of GDP, has declined steadily from a peak of nearly 71 per cent in 1995 to about 23 per cent in 2007.

The IMF's Role in Low-Income Countries

Canada commends the recent work done by Staff and Management to address the particular needs of low-income countries through the presentation of a comprehensive approach to IMF engagement in these countries. In order to achieve economic growth and poverty reduction, and to reach the Millennium Development Goals, macroeconomic and financial stability are essential. This is why the Fund's work is so important and must remain focused and effective, especially in the context of a more stringent budget environment. Key to this will be avoiding the re-emergence of unsustainable debt in post-debt-relief members and preventing its emergence in other low-income members. Coherence with the World Bank and other institutions and development partners remains fundamental to the effectiveness of the Fund's activities in low-income countries, and should be strengthened further wherever possible.

IMF Governance Reforms

Subsequent to the successful conclusion of discussions on a new quota formula this past spring, it is now time to address a broader reform agenda for the Fund's governance. The April 2008 report of the Independent Evaluation Office highlights broad areas that need to be addressed, such as strengthening the strategic role of the International Monetary and Financial Committee, increasing the strategic focus of the Board of Executive Directors as well as clarifying its oversight role, and clarifying the accountability of the Managing Director and Staff. We also need to make further progress to open the selection process for the heads of international financial institutions. I believe that these are all relevant issues which, once resolved, will lead to a more legitimate and effective institution.

Surveillance Reforms

IMF surveillance is at the heart of the Fund's mandate of promoting global stability and important innovations have been made in this area. Recent developments in global financial markets underscore the appropriateness of the Managing Director's vision for the IMF as being an international centre of excellence on linkages between the financial system and the real economy. It will be critical to continue to strengthen the IMF's analytic capacity in this area and to continue to improve the manner in which it communicates its analysis of macro-financial developments to policymakers and the public.

In June of last year, the Fund adopted the 2007 Decision on Bilateral Surveillance over Members' Policies to further improve the effectiveness of its surveillance activities. Since then, we have noticed improvements in the focus of Article IV reviews, although the all-important goal of increasing the candour of surveillance reports remains a work in progress. The time has now come to support the full implementation of the 2007 Surveillance Decision, including the use of the ad-hoc consultations process to ensure that concrete results are achieved.

In this respect, I am very pleased that the International Monetary and Financial Committee has just endorsed the IMF's first Statement of Surveillance Priorities (SSP). I view the new SSP as an important complement to the 2007 Surveillance Decision in that the SSP provides the opportunity to enhance the focus of IMF surveillance on the most pressing issues, promote greater consensus within the membership on the key economic vulnerabilities and risk and the need to address them, and improve the accountability of the IMF for its surveillance outputs. It is important that we use the SSP to its full potential.

Review of IMF's Financing Role and Instruments

The recently launched strategic review of the Fund's lending tool kit is timely. The global economy has changed so much since the Fund's tool kit was originally designed that mere incremental changes are unlikely to ensure a modern and appropriate mix of lending facilities. While some aspects of lending have already been addressed, such as changes to the Exogenous Shocks Facility, critical work is also needed to ensure coherence and effectiveness across the range of instruments. More fundamentally, the Fund should look back at the context in which each lending instrument was first created to evaluate its relevance to address today's challenges.

Food and Fuel Prices

High global food and fuel prices continue to be a critical development concern, and we commend the Bank and Fund for drawing early attention to the crisis and helping to place it high on the international agenda. This crisis requires a rapid and effective response. In this regard, we welcome the prompt action taken by the Bank to facilitate a coordinated and multifaceted response. With offices in more than 100 countries, the Bank is well positioned to integrate a response to the food crisis directly into existing country programs, aligning with the country's priorities in harmonization with other donors. Likewise, we are pleased with the prompt action by the Fund to provide advice, technical support and in some cases funding through PRGF programs. We also welcome recent reforms to the Exogenous Shocks Facility to make it a more effective crisis response tool.

Action is not only needed to relieve the immediate effects of the current food crisis. As the recent High Level Event on the Millennium Development Goals (MDGs) noted, the first MDG, to reduce hunger by half, is unlikely to be met by 2015. Thus, food security is an on-going and serious problem that must not be forgotten once the current crisis is no longer at the top of the international agenda. As an illustration of the size of the challenge, it is expected that food production in Sub-Saharan Africa will need to double or even triple over the next few years to meet local demand.

In this context, we encourage the World Bank to focus on investments to promote sustainable forms of agricultural production, especially those that would benefit smallholder farmers who are most in need of support. It is especially crucial to ensure that programs are designed to be equitable and to meet the needs of the most vulnerable, often women and girls. Another key part of the solution will be to foster innovations for increased agriculture productivity, including through public-private partnerships.

World Bank Reform

Enhancing the participation of developing and transition countries in the World Bank's decision-making processes is an important objective and we are pleased with the discussion and work to date on the Bank's Voice and Participation reform exercise. We will continue to support and participate in these efforts.

Adjustments to increase the voting power and shareholding of developing and transition countries and an additional seat for Africa at the Executive Board are important components of voice reform, and we look forward to agreements on these options. We believe that further measures to improve focus and communication within the Executive Board are equally important, and in this regard, we look forward to the World Bank's management and the Executive Board elaborating a set of specific reforms. We are also pleased with the steps the Bank has taken to improve the voice of developing and transition countries in their operational work, such as the appointment of more developing country nationals to senior management positions and the decentralization of their operations. We encourage the Bank to continue to explore what more can be done in this regard.

Stronger engagement of developing and transition countries in the World Bank's decision-making will yield many benefits. Strong participation of all members at the Board of Governors and the Executive Board will be a key backdrop for the Bank becoming an even better platform to support dialogue and collective action on global issues. It can help improve the design of new sector strategies and instruments as developing and transitions countries bring lessons learned from their own country programs to the table. Finally, more voice for the Bank's client countries at the operational level will help with the success of lending programs by ensuring that projects are properly tailored to country contexts and that governments have a true sense of ownership and accountability over them.