International Monetary and Financial Committee

Twentieth Meeting
October 4, 2009

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

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

This past year has been very challenging for us all. Confronted with the biggest threat to the global economy in 70 years, many countries took extraordinary measures to protect both their economies and citizens from economic collapse. The “green shoots” of stabilization and recovery that we are now seeing are the result of the collective policy response that individual countries have implemented in a spirit of cooperation. In this respect, the events of the past year underscore the adage that crises have the benefit of focusing attention. As we emerge from a crisis atmosphere, we cannot reduce our efforts to deal with the many, shared global challenges:

- Despite encouraging signs of stabilization and indications of modest growth in the second half of 2009, the global outlook remains weak. As such, it is essential that stimulus measures are implemented fully. There is a risk that countries experiencing shallower recessions may want to exit sooner, without considering the impact of withdrawing national measures on other economies, and in turn compromising the global recovery.
- Looking forward to the post-crisis period, attention must shift to fiscal consolidation and medium-term debt sustainability. The goal should be to maintain confidence and create the fiscal space needed to meet long-term challenges such as climate change and ageing populations.
- As well, all financial sector regulatory reform elements that were agreed within the G20 need to be implemented.
- Finally, as the global recovery takes hold, unbalanced patterns of global growth will also need to be addressed. While global current account imbalances have eased in the wake of the global financial crisis, the improvement may prove temporary as the factors underlying their emergence remain unresolved. We need to facilitate timely, orderly adjustment in the global economy.

Given the IMF’s core mandate of promoting international monetary and economic cooperation, the Fund has a central role in helping us – its members – face these challenges and facilitate orderly adjustments to the global economy.

The financial and economic crisis has also underscored just how valuable it is for us to have strong development institutions to support us in global cooperation. These institutions have been instrumental in alerting us to the challenges facing developing countries through the crisis and have been on the front-line in responding to their needs.

The multilateral development banks have ramped up their lending significantly and are on track to meet the goal set at the London Summit of providing $100 billion in additional financing. They have also set up specialized crisis facilities to tackle critical gaps, such as food security and trade finance. And, shareholders have helped to support this with capital and other financial contributions.

Canadian Developments

In Canada, the rate of decline in real GDP eased to -3.4 per cent in the second quarter of 2009 after dropping by 6.1 per cent in the first quarter of 2009. However, Canada has fared much better than most other major advanced economies over the last year. Canada was the last major advanced country to enter recession, and the fall in output in Canada has been among the lowest of all Group of Seven (G7) countries since the start of the global recession. Current indicators suggest that the Canadian economy will recover in the second half of 2009 and gain momentum through 2010. To ensure that the economic recovery is secured, the Government will complete the implementation of Canada's Economic Action Plan so that growth takes hold and jobs are created and maintained. This requires the full implementation of the $61 billion in stimulus measures, including leverage from other levels of government over the next two years. In line with an expected sustained recovery, the IMF expects a rebound in growth of 2.1 per cent in 2010, the strongest performance of any G7 economy.

IMF and World Bank Reform

Our response to the recent crisis has put into sharp focus the critical role the Bretton Woods Institutions (BWIs) have to play in supporting our collective efforts. Since last year, the Fund and Bank have moved swiftly to adapt their operations to help members weather the economic and financial turmoil – we should applaud the efforts of management and the Executive Boards over the last year. While the institutions and their memberships acted decisively to address shortcomings, we need to take advantage of this momentum to push for further progress on strengthening the BWIs. This includes the need for members to provide clearer direction on the role we want the IMF to play in surveillance and lending regarding capital flows.

We need the BWIs to meet three tests in order to be ready for the challenges going forward. The IMF and World Bank need to be legitimate, credible and effective:

- Legitimate institutions require that voice and representation reflect the economic realities of the 21st century.

- Credible institutions require the necessary resources and instruments to achieve their agreed mandate, but also the trust of members.

- Finally, effective institutions require a strategic and accountable governance structure, as well as members committed to carrying out their responsibilities to the institutions and to each other.

These three characteristics are inter-related, and unless we make progress on all three fronts, we will have missed an historic opportunity.

Legitimacy

In terms of IMF legitimacy, a key challenge is to ensure that the Fund reflects the changing economic weight of members in the global economy, while also safeguarding the voice of the Fund's poorest low-income members. In this respect, I hope all IMF members will support the historic agreement among G20 Leaders in Pittsburgh:

- to a shift in quota share to dynamic emerging market and developing countries of at least five percent from over-represented to under-represented countries using the current IMF quota formula as the basis to work from; and
- to protect the voting share of the poorest in the IMF.

It is also important that we continue to move forward on the World Bank Group's voice and participation reforms and meet our goal of reaching a final agreement by Spring 2010.

Last fall we reached an agreement on phase one of these reforms. We now need to follow through with it, and to do so, we need members to signal their formal acceptance. Many of the members in our constituency have done so, including members from the Caribbean, as well as Ireland. I am pleased to say that Canada has taken many of the steps required for formal acceptance and we intend to complete the process as soon as possible.

On phase two of these reforms, including the re-alignment of shareholding, we think it is worth taking stock of the progress we have made so far. In our view, we have taken two very important steps forward. First, we have broad recognition that the World Bank should finally have its own unique formula for representation and that the past practice of basing it loosely on IMF quotas and making ad hoc adjustments is no longer adequate. Second, we have support for this to be a dynamic process, so that representation can reflect the natural evolution of our global economy. This will provide the foundation to move over time towards parity in voting power and beyond, between developed and developing countries. At the Pittsburgh summit, Leaders agreed that in this phase there would be an increase of at least 3% of voting power for developing and transition countries.

Developing a formula that is acceptable to the membership as a whole and is right for the bank as a financial institution will require a lot of work over the next six months. In Pittsburgh, leaders also laid down key principles to help guide this exercise.

First, as the World Bank is a financial institution, economic weight should remain the primary foundation for the shareholding formula. The formula should be dynamic in order to take into account changes over time in economic weightings.

Second, the formula should take into account the relative strengths of donors' contributions to IDA, in order to provide incentives to maintain strong support.

Third, there is a need to be fair to everyone in this exercise, which means setting one standard from which under-represented countries will move up and over-represented countries will move down in shareholding, regardless of whether they are categorized as a developed or developing country. That said, we support the preservation of the voting power of the smallest and poorest states, to ensure an adequate minimum level of voice.

And finally, voice must be matched by responsibility. In this regard, it will be critical that new shares have an appropriate paid-in portion, so that we are all making equal effort to support the Bank's financial capacity.

Legitimacy, however, is not just about quota and voice. It is also reflected in an open, transparent and merit-based selection process for the Managing Director, President and senior management that does not reserve a place for select countries. The best candidate for the job needs to be selected, irrespective of nationality, based on their qualifications and factoring in the need for diversity.

By the 2010 Spring Meetings, the IMF and World Bank Executive Boards should present to Governors a process for Managing Director, President and senior management appointments that fulfills these criteria. We as Governors should endorse those processes through a Governors vote and implement them for all future competitions. This effort needs to be matched by the Regional Development Banks, as endorsed by G20 Leaders in Pittsburgh.

Credibility

The second pillar that we need to continue to make concrete progress on is BWI credibility, which means two things. First, the institutions need sufficient resources and the right tools to do the job. I am encouraged here because much has been achieved in the last year to bolster Fund resources and reform its lending facilities. Indeed, its credibility as global fire fighter has been re-established through innovations like the

Flexible Credit Line and low-income country facility reforms, the SDR allocation, NAB expansion efforts, and the upcoming increase in IMF quotas. We now need to take time to see how these important reforms will work out in practice before we look to implement further changes.

[But, as we look ahead, it is important that we collectively give greater consideration to the future role of the IMF in promoting international financial stability. While the traditional role of the Fund—to promote international monetary cooperation and financial stability by supporting a judicious balance of financing and adjustment— will continue to remain relevant, we must also face the reality that our collective economies operate in an environment where private capital flows dwarf those from the official sector. Indeed, the international financial crises of the past 15 years have demonstrated the need to deal effectively with capital account problems in a way that does not impose an unsustainable adjustment burden on members on the one hand, or undermines the efficient allocation of capital on the other hand.

To many, the current crisis has revealed that the Fund was designed for a world with only limited financial integration. The lack of an explicit mandate of macro-financial stability in all its dimensions – financial sector, domestic macroeconomic polices, and currency arrangements – is a testament to this. While such an explicit mandate may not impose severe practical limits on the effectiveness of Fund surveillance, the reality is that it does not reflect what the Fund actually does or the new direction in which it is moving. Credibility demands that the Fund's mandate remains relevant and up to date, and as IMFC Members we have a fiduciary responsibility to ensure that the Fund remains a relevant and credible institution.

To this end, I am very pleased that the Chairman of the IMFC is hosting a meeting dedicated solely to the question of IMF mandate. It is a first step, for as the Managing Director rightly noted in his letter to the IMFC on the role of the Fund post-crisis, it will be important that we all work together to articulate a common vision of the Fund's role in the post-crisis global architecture, one that makes explicit that macro-financial stability is an integral part of the Fund's mandate. Our first task in Istanbul must be to define a venue to continue this productive discussion, so that this important review may begin.]

The efforts of the World Bank Group in responding to the crisis should be recognized – it moved quickly to more than triple lending and put in place innovative, specialized crisis facilities such as the Global Food Response Program and the Global Trade Liquidity Facility. By being flexible and creative, the World Bank Group has succeeded in front-loading a large amount of resources.

The World Bank Group's vigorous response has placed pressure on its resources and we are open to a dialogue on its financial capacity – it must have enough resources to address the crisis, and fulfill its important mandate post-crisis.

However, several important factors remain unknown at this point. The path of the recovery is unknown; and this has a great influence on what its financing needs will be going forward. It is also unclear how much of the $1.5 billion in paid-in capital that is currently in an unusable form at the Bank will be released as usable equity. We also do not know how much capital will come in through the upcoming voice reform agreement.

As the World Bank Group does not face an immediate financing shortfall, however, we can take the time necessary to evaluate its long-term needs and do a comprehensive analysis of all possible solutions, including temporary ones. We should consider how mechanisms such as contingent capital could be used to increase World Bank lending at times of crisis. On this same timeline, we can also look at whether the current pricing model is sustainable.

Credibility also requires the World Bank Group to have a toolkit that is responsive to the needs of its clients. Through the crisis, the Bank has made a lot of effort to help developing countries protect public expenditure programs and implement urgent measures. But we need to continue strengthening the Bank's crisis response capabilities, especially in the predictability and flexibility of its financial support. In particular, the Bank has had limited flexibility in responding to the needs of low income countries and we need to look at options to address this. An important consideration is how to provide assistance through times of difficulty, without creating future debt sustainability problems.

Finally, a key component of IMF credibility is gaining the trust of members, which – while the situation is definitely improved – in some cases remains a challenge for the IMF. In practice, this means the Fund must give its members analytically-strong, candid, even-handed policy advice. Even-handed means similar circumstances yield similar advice, while reflecting relevant national circumstances. But the membership must also be receptive to critical advice. We cannot compromise on the Fund's role as a tough truth teller.

Effectiveness

The third pillar of BWI reform is effectiveness, and it means two things. First, the institutions need a modern, accountable governance structure. Governors need an effective venue to set the strategic direction for the Fund and Bank, which argues for seeking improvements to the IMFC and DC. We should continue to seek improvements in the deputies and communiqué development processes.

In turn, the Managing Director and President need to implement the strategic direction set by Governors. That means giving the Managing Director and President the leeway to operate, but Governors and the Executive Boards in turn must hold them and senior management to account for their performance. The Executive Boards need to focus on strategic policies, streamline their workload and promote institutional accountability.

In short, we need to make progress on corporate governance issues if the Fund and World Bank are to reach their full potential. For the IMF, this reform effort should maintain an effective forum for Governors to provide strategic direction to the Fund, and engage capitals in holding the IMF to account for its lending and surveillance decisions. Article IV reviews and the governance arrangements for IMF lending should encourage efficiency and accountability. Management and staff must have the independence they need to speak truth to power, but must be constrained by clearly-defined responsibilities, performance standards, and reporting mechanisms. The Manuel Committee report and the recommendations of the IMF's Independent Evaluation Office will be very useful in this exercise.

With respect to fostering a more strategic and accountable governance structure, we think the internal governance reforms led by the Executive Board's Committee on Governance and Administrative Matters, are very important. The reforms aim to lift the Executive Board and senior management out of transactional procedures to allow them to focus more on setting strategic direction. However, we need to make sure that we follow through properly on these and we believe it would be useful for to confirm in the spring that full implementation has been achieved.

While I believe these reforms are needed, they are not enough. The IMF is a member-based institution, and if members do not take their responsibilities seriously, it does not matter if the IMF is legitimate or credible. It still will not be effective. The Fund membership needs to improve its record of responding to and implementing IMF policy advice.

As mentioned, this latest crisis has demonstrated the interconnectedness of the global economy. We all face immense challenges that will only be tackled through collective action and we need to avoid policies that have negative spill-over effects for each other. Thus, transparency amongst governments and with markets is critical. Article IV and FSAP reports have a key role – IMFC members should publish their reports as a symbol that we are taking our responsibilities seriously. Systemically-important countries should also commit to regular, published, FSAP updates.

Beyond transparency, real cooperation is needed between IMF members and with the Fund. This is why I fully support G20 efforts to institute a new peer review mechanism under the G-20 Framework for Strong, Sustainable, and Balanced Growth, announced in Pittsburgh last week. While the modalities for this exercise must be set, I see a strong role for the IMF in this process as a trusted advisor and tough truth teller to the large economies.

Another area for continued attention is deepening the country-led development model and enhancing the Bank's ability to listen and respond to its client's individual needs. In this respect, true decentralization of decision-making is critical, including in fragile states. We believe we also need more opportunities to hear directly from borrowing countries about their experiences with the Bank. In this respect, we would ask management to strengthen the voice of borrowing countries in the IDA replenishment discussions, including new ways of facilitating real dialogue and collaborative generation of ideas.

Conclusion

In closing, we have made significant progress on BWI reform since last year. We now need to finish the job to ensure the institutions are legitimate, credible and effective. We all need to show flexibility, look beyond narrow self-interests and invest political capital in making this happen, because we need a strong IMF and World Bank to help sustain the cooperation we need to succeed over the coming years. I hope the roadmap that I have laid out here will help in this regard.