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

Statement Prepared for the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund

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

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The dominant issue at our meeting today is how to meet the target that we set in Singapore to reach agreement on an ambitious package of International Monetary Fund (IMF) reforms by the fall of this year. The deadline is short, but this provides a strong incentive to move ahead quickly. In doing so, it will be important that we do not lose sight of the rationale underlying this reform exercise—improve the Fund's legitimacy and effectiveness through a broad package of reform measures. This package should include IMF governance arrangements that better reflect the evolving economic weights of members, effective surveillance of members and the global economy, and a better set of tools for the prevention and resolution of financial crises. With these reforms, the Fund will be better able to respond to the challenges of economic and financial globalization, and remain a credible and effective guardian of a stable, market-based international financial and monetary system.

Global Prospects

We are encouraged that the outlook for the global economy remains positive, with the IMF projecting global growth of around 5 per cent in 2007 and 2008. Over the past year, growth has become more balanced, with Europe experiencing its strongest growth in six years in 2006 and the recovery in Japan gathering momentum. Combined with a moderation of growth in the United States, these growth patterns are favourable to unwinding global imbalances. Global economic fundamentals remain very strong, despite some recent turbulence in equity markets. The major world economies share many characteristics: strong growth, relatively low inflation, improving public finances, rising asset prices and low risk premia. However, there are risks to this outlook. As output gaps continue to narrow, there is a risk of rising inflation. Commodity prices are expected to remain at elevated levels, or perhaps increase further, a development that would be unlikely to contribute substantially to dampening inflationary pressures. In recent years, the economic and financial system has coped well with shocks, and we expect this to continue for the foreseeable future. But we must continue to work together to ensure that this remains the case.

Although the rebalancing of global growth is supportive of the unwinding of global imbalances over time, the size and persistence of these imbalances continue to pose a risk. In a global economy that is increasingly integrated, no country is fully isolated from disturbances in another. Therefore, it is clear that if we judge there to be risks of a disorderly adjustment, we must all play a role in helping ensure that these imbalances are unwound in an orderly fashion. As well, the Fund has a key role to play in this debate given its mandate to promote international monetary cooperation, and members must continue to support the Fund's multilateral surveillance efforts to this end.

Canadian Developments

Canada's economy continues to operate at a high level of activity after a few years of robust growth. Final domestic demand remains strong and continues to be the main driver of growth. Canadian real gross domestic product (GDP) growth slowed moderately recently, given weaker U.S. demand, the past appreciation of the Canadian dollar and a cooling of the Canadian housing market. In 2006, real GDP increased 2.7 per cent—down slightly from a year earlier—while final domestic demand grew 4.5 per cent on solid support from non-residential investment and consumer spending. Total consumer price inflation has been volatile in recent months, 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-per-cent inflation target. Solid personal income gains, very strong job growth and still-low interest rates, coupled with Canada's strong monetary and fiscal fundamentals, should support the Canadian economy through 2007, with growth accelerating towards 3 per cent in 2008.

Canada's fiscal situation remains solid. According to the Organisation for Economic Co-operation and Development (OECD), on a total government basis, Canada was the only Group of Seven (G7) country in surplus in 2006 and will likely be the only G7 country to remain 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 per cent in 1995 to about 27 per cent in 2006. Canada has had the lowest total government net debt-to-GDP ratio of any G7 country since 2004, and we expect this to remain the case. To strengthen Canada's ability to deal with economic shocks and challenges such as population aging, the Government aims—and is on track—to eliminate Canada's total government net debt by 2021 at the latest. By doing so, Canada will be able to count itself among the very few OECD countries that are in a net asset position.

Irish and Caribbean Developments

Let me now turn to developments in Ireland and the Caribbean countries I represent.

The Irish economy recorded another very successful year in 2006. Real GDP grew by 6 per cent, somewhat ahead of potential, and only a slight slowdown is expected in 2007. With unemployment steady at around 4 per cent, there is effectively full employment and the economy continues to attract substantial inward migration. Growth in 2006 was heavily focused on the building and construction sectors as the economy continues to close the large deficit in infrastructure and housing. The strength of domestic demand and the relative weakness of the export sector resulted in a current external deficit of more than 3 per cent of GDP.

The strength of the economy and higher energy prices contributed to an increase in the rate of inflation. The harmonized index of consumer prices (HICP) rose by 2.75 per cent on average in 2006. The inflation differential over other Monetary Union countries widened somewhat. The European Central Bank tightened monetary policy through the course of 2006, and a moderation in the HICP to 2.5 per cent is expected in 2007. The strength of domestic demand, and especially the housing sector, contributed to a very strong fiscal outturn. Buoyant revenue led to an unexpectedly large surplus of 2.3 per cent of GDP and a fall in the debt-to-GDP ratio to 25 per cent. For 2007, a surplus of 1.2 per cent of GDP is budgeted. Within the budget, there is a continuing major emphasis on infrastructural investment to ease bottlenecks and boost the productive capacity of the economy.

In 2006, the Caribbean countries I represent experienced another year of economic expansion. Growth was robust, underpinned by the rebound in the tourism and agricultural sectors, as well as stimulus from activities related to the Cricket World Cup 2007 and continued strong foreign direct investment flows. Inflation was moderate, in spite of high oil prices and robust growth. On the fiscal side, strong growth in revenue resulted in higher primary surpluses in a number of countries. However, the debt overhang remains a major challenge for many countries.

Progress has been made in deepening and advancing the regional integration process with the implementation of the Caribbean Single Market component of the Caribbean Single Market and Economy (CSME). Agreements have also been reached on contributions for the Regional Development Fund, which will provide assistance to those disadvantaged by the operations of the CSME. The Fund should be fully operational by July 2007. We encourage the international donor community to support this crucial integration effort.

Caribbean countries are extremely vulnerable to natural disasters. This has led Caribbean governments to seek assistance to access affordable catastrophic risk insurance. Thanks to the response of the World Bank and with the support from several donors, including Canada (the largest donor), the Caribbean Catastrophe Risk Insurance Facility, the first ever multi-country catastrophic insurance vehicle, is now a reality. We also believe this innovation can be expanded to small developing states in other regions of the world.

IMF Reform

In September 2006, I concluded my statement to the International Monetary and Financial Committee by emphasizing the need for a more comprehensive IMF reform package that goes beyond quota reform and addresses a broader agenda, including Fund surveillance, the institution's role in crisis prevention and resolution, and the Fund's financing sources. Fully implemented, this package of measures will enhance the Fund's capacity to safeguard global financial stability.

This statement still holds true today. We accomplished a great deal in Singapore, but we must work together to accomplish more. The Managing Director's Medium-Term Strategy has identified a number of priority areas for reform. Today, I would like to focus on four of these issues.

Quota and Voice Reforms

Successful governance reform is critical to enhancing the IMF's legitimacy in the eyes of its member countries. This requires significant progress in better realigning quota shares with the economic weight of member countries in the global economy. It also means that quotas and voting shares need to be responsive to changes in the global economy. I believe a successful quota reform exercise should have the following elements:

- A new quota formula that is simple, transparent and principles-based, and is aligned with the purposes and mandate of the IMF to promote growth and support the orderly integration of members into the global economy. The formula should be robust to future changes in the global economy so that the relative shares of dynamic economies continue to increase.

- A second round of quota increases that results in higher shares for the most dynamic economies, which can be found in all major regions of the world. To the maximum extent possible, major industrial countries should forgo potential quota increases in this round in order to maximize the realignment of relative quota weights.

Enhancing the participation and voice of low-income countries in the IMF is another important element of the reform package. I am encouraged that the Fund is making headway on developing the mechanism for increasing and protecting the level of basic votes, as well as studying ways to strengthen the effectiveness of small and low-income member participation in Executive Board discussions.

It should be noted that a new quota formula and subsequent quota realignment are not ends in themselves. They are means to an end. Agreement on quotas that are more representative of the global economy will enhance the Fund's legitimacy and the persuasiveness of its policy advice. To get that agreement, however, Fund members will have to demonstrate flexibility. Members must be prepared to rise above narrow self-interest in pursuit of an institution that can better deliver the global public good of a stable world economy. In short, quota and voice reforms must be principled and robust, and reinforce Fund legitimacy over the long term.

Surveillance Reforms

No less important to the IMF reform agenda is ensuring that the Fund has the tools and the appropriate governance structure to carry out candid, targeted and even-handed surveillance that is capable of identifying threats to external stability. More effective surveillance will improve the Fund's capacity to evaluate monetary, fiscal, financial sector and exchange rate policies that have the potential to adversely affect the international monetary system. It will also allow the Fund to engage in a constructive dialogue with members aimed at addressing risks to their prosperity and that of the global economy.

In this respect, reform of the framework that underpins Fund surveillance is an important issue that must be addressed. Over the past 30 years, significant differences have emerged between the 1977 Decision on Surveillance Over Exchange Rate Policies and current surveillance practices. This divergence has made it increasingly difficult to guide surveillance activities and to hold the Fund accountable. To update and improve the Fund's surveillance activities, progress is necessary in two key areas:

- First, we need to revise the 1977 Decision on Exchange Rates to put more emphasis on members' domestic policies as well as give the Fund the ability to better identify domestic macroeconomic and exchange rate policies that cause negative spillover effects. This will also reinforce the principle that surveillance should be applied to all members in a uniform and even-handed fashion.

- Second, we should also move quickly to introduce a surveillance remit, under which policy-makers could identify surveillance priorities and instruct the Fund to pursue them. This would both increase the flexibility of surveillance and improve the Fund's accountability. In doing this, we can increase support for the tough and often coordinated actions needed to promote international monetary stability and orderly adjustment of imbalances.

It is also important that these changes can be made without introducing new obligations for members, or changing the Fund's emphasis on constructive dialogue and persuasion.

Securing a Stable Source of Financing for the IMF

A third element that is highlighted in the Medium-Term Strategy as key to the long-term viability of the Fund is changes to the institution's financing model to promote greater predictability of income. Financial conditions in emerging markets have improved considerably over the last five years, and affordable access to international capital has reduced many emerging market countries' reliance on Fund resources. Paradoxically, this has exposed the Fund to significant financial pressures, as it has traditionally funded the bulk of its operations from its lending operations. The recent decline of lending volumes combined with the early debt repayment by major borrowers has reduced Fund income to historically low levels. The IMF is facing an income shortfall and will run a budget deficit for fiscal year 2007, with rising deficits expected in subsequent years.

It will be important for Fund members to work together to identify a sustainable financing model that supports the lending, surveillance and technical cooperation roles of the Fund, while ensuring that the institution remains on a solid financial footing. To this end, I welcome the recent release of the report by the Committee of Eminent Persons on the sustainable financing of the Fund, commissioned by the Managing Director to assess this problem. The Committee's recommendations are balanced and innovative, and provide a sound basis for progress. I look forward to a constructive and open debate on the Fund's financing model, as well as how the Fund can further improve its operational efficiency given current budgetary constraints.

The Role of the Fund in Low-Income Countries, and Technical Assistance

Our low-income members face particular challenges in establishing macroeconomic stability, building efficient financial sectors, developing sound legal and business frameworks and crafting effective policies for particular key sectors. In a global economy where jurisdictions compete for scarce direct investment, it remains a preoccupation even for members that have attained middle-income or advanced industrial status.

In their efforts, these authorities will require the Fund's continued attention to prevent the re-accumulation of unsustainable debt, to accommodate aid flows, and to observe international standards and codes in public financial management, financial sector policy and data dissemination. The absence of timely and reliable economic and financial data can be an impediment to policy-making, as we have observed in the discussions toward a new quota formula.

In our constituency, our Caribbean authorities appreciate the Caribbean Regional Technical Assistance Centre's (CARTAC) help in improving public expenditure management, tax and customs policy and administration, and macro policy analysis. CARTAC has proven to be an efficient multi-donor program and a fine example of Paris Declaration principles in action; we encourage other donors to join the United Kingdom, the European Union, Ireland and Canada in this effort.

In the provision of technical assistance, it is key that the Bank and the Fund collaborate effectively with each other and with other bilateral and international agencies. I therefore welcome the recently released report to the Managing Director and the World Bank President by the External Review Committee on IMF-World Bank Collaboration.

Looking Forward

The overarching goal of the package of reforms under the Managing Director's Medium-Term Strategy is to ensure that the IMF remains a relevant, effective and representative institution in an era of large and open global capital markets and increasingly dynamic economies. Canada remains committed to an ambitious reform agenda. Quota and voice reforms are fundamental to improved governance, while policy reforms are critical to enhancing the Fund's role in surveillance and crisis prevention. I look forward to working with my colleagues to achieve a successful outcome in these important areas.