International Monetary and Financial Committee

Tenth Meeting
October 2, 2004

Statement by Mr. Goodale

Statement by The Honourable Ralph Goodale
Minister of Finance of Canada
International Monetary and Financial Committee
Washington, D.C., October 2, 2004

The International Monetary and Financial Committee statement on behalf of the constituency consisting of Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines

Introduction

The global recovery has advanced in most regions since the last time we met in April 2004. The prospects for strong growth are good in the short run, but some risks remain. There are vulnerabilities that need to be addressed to help ensure that the recovery can be sustained over the medium term. The IMF, under the leadership of its new Managing Director, Rodrigo de Rato, will continue to play a central role in promoting international financial stability and facilitating the strong and enduring growth we seek to achieve.

The Global Economy

The pace of economic activity in the first half of the year has picked up significantly in Sub-Saharan Africa and most oil-producing countries, notably Russia and Saudi Arabia. Growth remains robust throughout most of emerging Asia and central and eastern Europe. Economic conditions in the euro area have improved somewhat over the first half of the year, but the expansion is less vigorous than in most other economies. Growth in the second quarter increased significantly in Canada and the UK, but declined in the U.S. and Japan.

Against this background, the key policy challenge is to improve conditions for longer-term prosperity. In particular, it is important that fiscal policy in many economies be put on a sustainable track, particularly in those industrial countries that have substantial deficits and rising debt burdens and face long-term fiscal pressures from aging populations. Emerging market economies with high public debt burdens and heavy financing requirements are particularly vulnerable to sudden shifts in investor sentiment. This will be a concern during the transition to higher interest rates as the global recovery advances. Two key challenges for these countries are to implement a credible medium-term fiscal consolidation plan and to improve debt management to make their economies less vulnerable to large changes in interest rates and exchange rates. The current favourable economic and financial conditions provide an excellent opportunity for industrial and emerging market economies to address these challenges.

The Canadian economy slowed in 2003 due to a series of unforeseen shocks, and as a result real gross domestic product (GDP) expanded only 2 per cent. However, the economy strengthened towards the latter part of the year. Following solid growth in the fourth quarter of 2003 and in the first quarter of this year, real GDP growth accelerated to 4.3 per cent in the second quarter of 2004. The Bank of Canada raised its target for the overnight rate by 1/4 percentage point to

2¼ per cent on September 8, reducing the amount of monetary stimulus in order to avoid a buildup of inflationary pressures.

Healthy business and consumer confidence, solid job gains and low inflation should continue to support robust Canadian growth for the remainder of this year and in 2005. Since the time of the March 2004 budget, private sector forecasters have revised up slightly their forecast for growth in 2004 from 2.7 per cent to 3.0 per cent. Private sector forecasters expect a pickup in growth to 3.4 per cent in 2005.

Canada's fiscal situation remains strong. The Government of Canada recorded six consecutive annual budget surpluses from fiscal year 1997–98 to 2002–03, and the 2004 budget projects a balanced budget or better for 2003–04 and the next two fiscal years. Debt reduction, coupled with Canada's strong economic growth, has resulted in a significant decline in the federal debt-to-GDP ratio, from its peak of 68.4 per cent in 1995–96 to 44.2 per cent in 2002–03. The Government is committed to keeping the federal debt-to-GDP ratio on a downward track, and in the 2004 budget announced its objective to reduce the federal debt-to-GDP ratio to 25 per cent within 10 years.

I am pleased to report good progress in other countries which I represent at the IMF. In Ireland, investment and exports have picked up more rapidly than expected as the year began. Growth should exceed 4 per cent—supporting stronger-than-forecast employment and revenue gains. Public expenditure remains on target. As a result, the Irish authorities now anticipate a marginal fiscal deficit this year and a further reduction in the country's already-low debt ratio. Inflation has eased a little faster than initially forecast, and the more moderate outcome to the latest wage discussions under Ireland's social partnership should underpin this improvement going forward. With the European Union Presidency now passed to the capable Dutch, the Irish authorities are fully focused on enhancing the basis for sustained economic advance into the medium term. Their key priorities are to improve cost-competitiveness; to further develop vital business infrastructure; to continue refining public regulation; and to keep on a path of prudent fiscal management set in a longer-term context.

Following a subdued economic performance recently, the Caribbean countries that I represent have embarked on a modest recovery, with growth returning in most of the countries in 2003. The recovery, for the most part, reflected a rebound in the important tourism sector, with visitor arrivals in some countries returning to pre-9/11 levels. While this may bode well for the future, the devastating economic and human impact of the recent hurricanes highlights the vulnerability of these countries and how quickly fortunes can be reversed. Amid this difficult and tragic situation, we welcome Managing Director Rodrigo de Rato's recent statement of sympathy and support for the affected countries. Canada and Ireland are providing urgent humanitarian relief to the hardest-hit countries. Since August, Canada has given $11.5 million to further relief and reconstruction efforts in the Caribbean countries affected by hurricanes, with Ireland pledging €450,000. In other areas the Caribbean is moving steadfastly to address other challenges through the implementation of its reform agenda. Much of the focus will be on advancing the implementation of the CARICOM Single Market and Economy initiative and ensuring that its establishment is on track for the 2005 deadline.

IMF Surveillance and Crisis Prevention

One of the Fund's primary goals is to reduce the frequency and severity of international financial crises. Surveillance is one of the most important instruments in the IMF's crisis prevention toolkit. The Fund has made considerable progress in strengthening its surveillance operations, especially by promoting enhanced transparency in member countries and improving its analytical tools for the early identification of a country's vulnerability to crisis. However, the surveillance function needs to continue to evolve in light of changes in the world economy. In the spring the International Monetary and Financial Committee called for further efforts to enhance the focus, quality, persuasiveness, impact and overall effectiveness of surveillance.

With this in mind, the Fund's recent biennial review of the implementation of surveillance efforts focused on how to make surveillance more effective across the whole membership. We endorse the key conclusions of the review: a sharper focus on the Fund's core areas of expertise, clearer and more candid treatment of exchange rate issues, enhanced financial sector coverage and better regional assessments. As well, in our view, debt sustainability assessments would be enhanced if they were conducted independently of regular country work.

Despite these efforts, not all financial crises can be prevented. Two years ago the Fund established clearer rules for determining exceptional access to its resources for countries that face financial crises. The new exceptional access framework should be strictly adhered to going forward, to help shape the expectations of members and markets alike, provide a benchmark for decisions regarding program design and access, safeguard the IMF's resources and ensure uniform treatment of members. In addition, the procedures for consideration of exceptional access requests should be strengthened by taking alternative forecasts into account and by giving timely and careful consideration to the financial implications for the Fund of granting exceptional access. The widespread adoption of collective action clauses in sovereign bond contracts is an important development in promoting the orderly resolution of financial crises, but further work is required on aggregation and other issues related to sovereign debt restructurings.

The Role of the IMF in Low-Income Countries

The IMF's role in low-income countries is changing. Most users of Poverty Reduction and Growth Facility (PRGF) resources no longer have a balance of payments need. Most have in the past also been prolonged users, having had numerous back-to-back programs. I am pleased to note that many have broken out of this cycle of repeat borrowing. But, as a result, many have progressed to low-access, almost token, programs needed, not for balance of payments reasons, but mainly to help signal to donors the Fund's assessment of the quality of their economic policies. We believe it is time to reconsider the nature of the relationship between poor countries and the IMF, including, in particular, the relationship between IMF concessional assistance and the surveillance process. Simply put, the Fund and low-income countries alike need mechanisms other than lending to support strong surveillance relationships and to help signal donors.

Expanded Use of Intensified Surveillance

This is why, prior to the spring meetings in Washington, Canada advocated the creation of a country-led intensified surveillance mechanism. Unlike a formal IMF program, there would be no Fund financing or IMF developed conditionality attached. Instead, the country would present a medium-term economic and fiscal plan developed with the benefit of advice from the Fund staff, but clearly "country-owned" with widespread internal support among key groups in society. The Fund would be asked to provide more frequent monitoring than typical surveillance, and the Board would consider staff assessments of the extent to which the country is achieving its own economic and financial goals. We believed then, as we do now, that such a mechanism would fill an important gap in the assistance the Fund provides to low- and middle-income countries. Most importantly, it has the potential to strengthen country ownership over the domestic reform agenda.

Since the spring, this proposal has made progress. Jamaica, a pioneer in developing the new approach, is now embarked on an intensified surveillance relationship. Several other countries have indicated their interest in this instrument. As well, useful discussions have taken place on the potential of a Policy Monitoring Arrangement (PMA), which has stressed many of the features that we have supported for intensified surveillance. We support the PMA with the important caveat that such a mechanism not be driven by the need for upper credit tranche conditionality.

Moving forward, we should aim for three objectives.

- First, we should support countries requesting intensified surveillance, especially when it might help them exit from prolonged use of Fund resources. We should not, however, lose sight of the basics—i.e., those embarking on such a program must take the initiative in developing a country-led program based on clear goals and consistent policies.

- Second, we should work to ensure that the surveillance resulting from this intensified relationship is of the highest possible quality, so that the signal sent to donors, creditors and investors is fully credible. In some cases, this could mean that the commitments undertaken by the country are as strong as those under a traditional Fund program.

- Finally, more resources for capacity building should be directed to helping countries define and implement their own programs, with a view to exiting from reliance on Fund concessional resources.

Achieving Debt Sustainability

The Heavily Indebted Poor Countries (HIPC) Initiative continues to provide critical debt reduction for the most indebted countries and is having a major positive impact, in conjunction with the poverty reduction strategy process. For benefiting countries, debt service-to-export ratios now average 10 per cent while poverty reducing expenditures have significantly increased. However, the challenge of meeting debt service obligations continues to be a major concern for many low-income countries relative to the extent of poverty that still exists and the challenges of meeting the Millennium Development Goals. The fact that at least 37 of the 65 International Development Association–only (IDA-only) countries have, or had, unsustainable debt burdens based on HIPC thresholds, and largely a result of international financial institution (IFI) lending, indicates a systemic problem. More action is needed for HIPCs and non-HIPCs:

- IFIs are now the dominant creditors of poor countries. Hence, to ensure that debt loads do not place heavy burdens on these countries, we must focus on the role of IFI financing, preventing future crisis and relieving existing pressures. As we noted in the spring, the proposed framework for assessing debt sustainability is a step in the right direction. We must address the issue of increasing the provision of grants and also turn our attention towards IFI debt service relief. Moving forward, our efforts should be guided by the principles of additionality and equity of treatment—to us, these are two key principles. As well, more collaborative efforts are needed between the Fund and the World Bank in their debt sustainability assessments in order to provide a consistent set of measures from which to base policy decisions.

- Eleven countries, many of which are in conflict, still require time to advance the peace process and normalize relations with development partners before benefiting from the HIPC process. We support the proposed extension of the sunset clause to allow time for these countries to put in place the necessary reforms. Looking forward, it will be important to develop a concrete plan to help countries remaining outside of the HIPC process that have unsustainable debt burdens.

- In pressing ahead, we must maintain the financial integrity of the Fund while ensuring the necessary resources are available to assist those countries emerging from conflict and considering the implications from the related discussions on increasing the provision of grants and debt sustainability. We should take the steps needed to ensure that the future lending capacity of the Fund, in particular the self-sustained PRGF, is not compromised in a way that would jeopardize access by low-income members to Fund concessional assistance.

The Independent Evaluation Office

All institutions need to learn from experience and adapt to changes in the environments in which they operate. Since it was established in 2000, the IMF's Independent Evaluation Office (IEO) has played a key role in providing independent assessments of Fund surveillance, program design and lending operations. In 2004 the IEO's evaluations of the IMF's work in Argentina, and of the Poverty Reduction Strategy Papers and PRGF in particular, have provided management, staff and the Executive Board with ways to strengthen the Fund's crisis prevention and resolution and poverty reduction efforts. We support the IEO's 2005 work program and look forward to the reports planned for next year, including those on the Fund's financial sector work and its approach to capital account liberalization.

Conclusion

We are encouraged by the positive outlook for the global economy but mindful of the risks that remain and the vulnerabilities that need to be addressed to sustain the recovery. We encourage efforts to meet these challenges, including through continued adaptation of the Fund's policy and surveillance instruments. We support the continuing efforts of the Fund to strengthen the relationship with its low-income members through working to meet their changing needs. Further action is required on ensuring the long-term debt sustainability of many low-income countries and in doing so, we emphasize the principles of additionality and equity of treatment.