Statement by James Michael Flaherty
Minister of Finance, Canada

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
On behalf of Canada, Ireland, and the Caribbean countries I represent, I would like to take the opportunity to welcome the new Chairman of the International Monetary and Financial Committee (IMFC). Dr. Boutros-Ghali brings with him extensive experience that will greatly enhance the work of our Committee.

Today’s meeting of the IMFC is taking place at a time of global economic and financial uncertainty that 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. The United States has taken multiple steps, including a comprehensive plan to buy troubled assets, to address its financial crisis. Authorities in Europe have also taken decisive measures to support the financial sector. Nevertheless, financial markets remain under considerable stress and the impact is being felt globally. In these difficult times, a strong International Monetary Fund (IMF), working in partnership with its members, is essential to help promote global economic growth and stability through its surveillance and policy advice and, if necessary, extending financial assistance to assist its members facing financial and balance of payments difficulties.

I would like to take this opportunity to congratulate Managing Director Strauss-Kahn and his Staff for the hard work they have undertaken to modernize the Fund. Under the new sustainable budget environment that the Managing Director is bringing about, a range of important issues have been addressed, such as the development of a more strategic approach to Fund involvement in low-income countries; modifications to the Exogenous Shocks Facility; completion of the Triennial Surveillance Review; and the introduction of the first Statement of Surveillance Priorities. While much remains to be accomplished, I am confident that Mr. Strauss-Kahn’s leadership will continue to bring us together and create an atmosphere conducive to success.

Global 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. Although many economies have thus far demonstrated remarkable resilience to these shocks, the only reasonable conclusion is that today is a time of great uncertainty. 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.

Decisive actions have been taken by policymakers to contain the financial crisis. Faced with the extraordinary stress in the global financial system, authorities in the United States, Europe and elsewhere have responded with commendable forcefulness and imagination, with the aim of supporting financial stability and restoring well-functioning credit markets. In Canada, we are in the fortunate position that our financial system is not burdened with large amounts of troubled assets. Our banking and insurance industries remain well capitalized and our financial system sound. However, we are not immune to the financial turmoil that has gripped global markets. I have remained in very close touch with my Finance Minister colleagues in other major economies, and together stand ready to take whatever steps are necessary to stabilize the situation.

Major central banks have taken large-scale coordinated action to address global liquidity pressures. We need to ensure that our actions continue to be coordinated to address ongoing turbulence in the financial markets. 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.

A good deal of useful work has already also been done by the regulatory and supervisory authorities, notably the members of the Financial Stability Forum, to enhance the resilience of the global financial system for the longer term. This work will continue as a top priority. We should support the continued, and accelerated, implementation of the recommendations of the Financial Stability Forum such as a central clearing mechanism for over-the-counter credit derivatives, accounting and disclosure standards for off-balance-sheet activities and related risks, and a set of international principles for deposit insurance. Clearly, this work is only in its early stages. The IMF must play a central role in the initiatives aimed at developing sound international regulatory responses to the weaknesses in the financial system revealed by the current turmoil, drawing on the unique perspectives provided by its virtually universal membership.

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 which have adopted strong policy frameworks has 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.

Policymakers must continue to respond as needed. Today’s meeting provides the Committee with an important opportunity to take stock of developments and exchange perspectives and experiences, both on policy challenges in our own economies and on the role of the IMF in supporting growth and stability.

**Canadian Developments**

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 capitalized; 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 to 2.5 per cent. This 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 (G7) countries. According to the IMF’s fall outlook, on a total government basis, Canada’s budget surplus was 1.4 per cent of gross domestic product (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. We will continue this course.

**Irish and Caribbean Developments**

Let me now turn to economic developments and policy priorities in Ireland and in the Caribbean countries I represent in this Committee.

Reflecting the extended stress in international financial markets, higher commodity prices, and the impact of those shocks on trading partners, this has proven to be a challenging year for the Irish economy. GDP is likely to contract this year, unemployment is rising, and inflation has remained relatively high but is expected to ease
going into 2009. The adjustment in the output of the house-building sector is also having a significant dampening effect on the economy. As housing output moves back towards sustainable levels, a return to trend GDP growth can be expected over the medium term. The Government has recently enacted legislation to guarantee all deposits and borrowings in six Irish-owned banks and building societies. This is intended to provide security and stability to the financial sector.

Due to lower-than-projected tax receipts, mainly as a result of weaker property market activity, pressures have emerged on the public finances. To deal with these challenges, the Government has brought forward the Budget from December to Tuesday, 14 October. The Budget will set out steps to restore balance by prioritizing expenditure to reflect the changed realities and ensure that Ireland’s economy is in the best possible position to resume trend growth as international conditions improve. Ireland is better placed than most economies to meet the current challenges—it has a low level of public debt, an educated and young workforce, and a low tax environment for workers and business. The Government is committed to maintaining the priority of public investment in core economic infrastructure. At present, public investment is about 6 per cent of gross national product, which is around twice the European Union average.

To safeguard Irish economic growth prospects, competitiveness needs to be enhanced, export levels raised and productivity improved. The maintenance of a low taxation burden will help raise potential output by stimulating private sector investment and encouraging higher labour force participation.

For the Caribbean, these are very challenging times with policymakers facing difficult options to sustain stability and the growth prospects of the region’s economies. Accelerating rates of inflation and rising inflationary pressures as a result of the spikes in fuel and commodity prices have emerged as the main challenge facing the region’s policymakers. The price increases have worsened already large current account deficits and exerted pressure on the limited fiscal resources. Governments have taken steps to help alleviate the impact on the poor and vulnerable groups. Such actions, while unavoidable, have exacerbated the problems of weak fiscal positions and high debt levels facing these countries.

The recent spate of tropical storms and hurricanes that caused widespread devastation and loss of lives in the Caribbean is a reminder of the vulnerability of the region to natural disasters. In addition to ongoing adaptation and mitigation efforts, the Caribbean Catastrophe Risk Insurance Facility (CCRIF) is a demonstration of the region’s commitment to proactively managing catastrophic risks and reducing fiscal exposures to natural disasters. We fully support the work of the World Bank, the CCRIF and Caribbean governments to develop complementary products to extend coverage to include floods.

Despite the deteriorating external environment and domestic shocks, the Caribbean has been fairly resilient, continuing to perform relatively well economically. Growth has been moderately strong driven mainly by developments in tourism, construction and
services, and the region continues to attract significant foreign direct investment flows. This reflects the benefits of strong domestic policies and structural reforms implemented over the years, and strengthened financial supervisory and regulatory frameworks. Policymakers are committed to continue implementing reforms and building the resilience of the region. Within this context, there remains a critical role for the international financial institutions and the donor community. We highlight the work of the Caribbean Regional Technical Assistance Centre, which remains invaluable in supporting the efforts of the region.

**The IMF’s Role in Low-Income Countries**

On behalf of my constituency, I commend 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 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 Reform**

Recent developments in the global economic and financial markets have demonstrated that growth and stability cannot be taken for granted, but require steadfast commitment to good policies and strong frameworks for international cooperation. The international community needs to work together to minimize potential risks and mitigate the negative effects of those risks that have been realized. For its part, the IMF is at the centre of the international architecture that Canada has supported for some 60 years. Its fundamental goal is to promote international economic and financial stability, and at this time the Fund’s legitimacy, credibility and effectiveness will be largely determined by how well it promotes cooperation between its members to successfully face our common challenges.

The steps the IMF has taken over the last year toward improving the quality of its surveillance, the responsiveness of its lending facilities and the legitimacy of its governance arrangements make it better equipped to fulfill this mandate. Yet in today’s challenging world, neither individual countries nor the IMF can stand still. Rather, we must work toward steady improvements in our capacity to deliver growth, stability and prosperity for the world’s people.

**Governance Reforms**

At our last meeting, we welcomed the successful conclusion of discussions on a new quota formula which undoubtedly enhances the legitimacy of the institution. The quota
and voice issue is, however, just one part of 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 IMFC, 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. I would also add that we 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.

More generally, I welcome the commitment shown by the Executive Board and the Managing Director to improve the IMF’s governance, through the establishment of a working group of Executive Directors and the committee of eminent persons appointed by the Managing Director in September. Academics and civil society groups will also have a voice in shaping the consensus position. We in this Committee and the broader membership must also address outstanding governance issues, such as ways to strengthen member engagement and how to better hold the Fund accountable for the quality of its work.

**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 Executive Board has just approved the first Statement of Surveillance Priorities (SSP)—something this Committee called for in the spring of 2006. 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. The IMFC should review progress on its implementation on an annual basis, as well as debate evolving surveillance priorities leading up to the next SSP in three years.

The SSP is one part of a broader debate that is needed to restore the international community’s buy-in for collective responsibility and action to mitigate stability threats. I am encouraged by the IMF’s enhanced cooperation with the Financial Stability Forum over the course of this year, and, in my view, the Fund should explore further how it can promote more collaboration with other international groupings and institutions. The interconnected global economy of the 21st century demands that IMF members work together through the Fund and other bodies to preserve the benefits of globalization and promote growth and stability.

Review of 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.

Conclusion

For me, two salient observations capture the context for this 18th meeting of the IMFC. First, the extraordinary financial challenges and continued economic risks we now face mean that a strong and effective IMF is more important than ever. Second, while the membership took advantage of recent calmer times to make historical advancements in the Fund’s governance arrangements, the time has now come for us to use that momentum and increased legitimacy to fully introduce a stronger surveillance framework and a modernized lending role for the IMF. I look forward to pursuing and accomplishing these shared goals with my IMFC colleagues.