



**International Monetary and  
Financial Committee**

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**Statement by The Honourable Jim Flaherty, Minister of Finance for Canada,  
on behalf of Antigua and Barbuda, the Bahamas, Barbados, Belize, Canada,  
Dominica, Grenada, Ireland, Jamaica, Saint Kitts and Nevis, Saint Lucia,  
and Saint Vincent and the Grenadines**

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

**The Honourable Jim Flaherty, Minister of Finance for Canada,**

**on behalf of Antigua and Barbuda, the Bahamas, Barbados, Belize, Canada,  
Dominica, Grenada, Ireland, Jamaica, Saint Kitts and Nevis, Saint Lucia,  
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**Washington, DC, April 24, 2010**

**Introduction**

Thanks to the extraordinary and highly coordinated policy actions of governments and multilateral financial institutions over the past 20 months, the global economy has stabilized and modest growth has emerged. This recovery remains fragile, however, particularly in advanced economies, and many shared global challenges remain. To address these challenges, we must build upon the global macroeconomic cooperation that allowed us to bring about a timely and appropriate response to the crisis.

The International Monetary Fund (IMF) is central to these efforts as the “bricks and mortar” embodiment of international economic and financial cooperation. But, as its members have acknowledged, the Fund is in need of reforms to ensure that it can deal effectively with the financial crises of the 21<sup>st</sup> century, which originate in the capital account, not just the balance of payments problems for which it was designed in the mid-20<sup>th</sup> century. The case for reform is clear: the environment in which the Fund operates has fundamentally changed as a result of the global financial integration of the past three decades. And yet, the underlying objective of the Fund remains valid. The architects of the Bretton Woods system endowed the Fund with the role of assisting its members strike the right balance between financing and adjustment. The challenge is to remain true to this mandate.

This would not be an easy assignment at any time; it is all the more important in the wake of the biggest financial and economic crisis since the Great Depression. Our efforts to reform the Fund must be informed by the lessons that the crisis made clear. One central message is that the moral hazard arising from the financial sector bailouts is going to be a legacy problem for governments and regulators. While we commend the successful confidence-building measures that the IMF took during the crisis, we need to ensure that future proposals regarding the Fund’s role, size and lending toolkit do not send the wrong messages about risk-taking and prudence.

**Canadian Developments**

Reflecting Canada’s financial, economic and fiscal strengths, together with extraordinary policy actions, Canada has weathered the global recession better than most other major industrialized countries. Real gross domestic product (GDP) increased by 5.0 per cent in

the last quarter of 2009, led by a significant and continued rebound in final domestic demand, which has been the strongest of all Group of Seven (G7) countries. The IMF expects Canada to be one of the fastest growing economies among G7 countries in 2010 and 2011. However, the global recovery remains fragile. For this reason, the Government will complete the implementation of Canada's Economic Action Plan—a two-year C\$62-billion plan (equivalent to about 2 per cent of GDP on average per year) to support economic growth and create and maintain jobs.

The Government will bring Canada's finances back to balance over the medium term by ending the temporary measures as scheduled in early 2011, putting in place targeted measures to restrain direct program spending growth, and undertaking a comprehensive review of government administrative functions and overhead costs. These measures will allow the Government to bring the federal deficit to 0.1 per cent of GDP in 2014–15.

### **Irish Developments**

After two exceptionally difficult years, there is mounting evidence that conditions in the Irish economy are stabilizing. Hard data for the opening months of the year have been reasonably encouraging, while more timely soft data paint a similar picture. A resumption of modest expansion during the second half of the year is now widely anticipated, although negative carry-over and the continued correction in the residential construction sector mean that full-year activity is projected to decline by 1¼ per cent. Falling output over the past few years has been accompanied by a substantial deterioration in the labour market, although signs are that unemployment is now close to peak.

The necessary fiscal consolidation is continuing. Following measures amounting to 5 per cent of GDP for 2009, additional measures amounting to 2½ per cent of GDP have been implemented for this year. For this year, the adjustments are almost exclusively on the expenditure side, and have involved public sector pay cuts, reductions in social welfare rates and various program cuts.

Significant action has also been taken to restore the health of the banking sector. Banks' balance sheets are being strengthened through the sale of impaired assets on significantly discounted terms to the National Asset Management Agency (NAMA) accompanied by a recapitalization to take account of the losses incurred on the transferred loans, as well as likely further losses on banks' other loans. This is being done with the aim of creating a buffer in Irish banks' capital positions which will place them in a better position to access funding and assist in the recovery of the economy. This process has made clear, that while the costs of restoring the banking system will be large, there is now certainty about the overall size of these costs.

### **Caribbean Developments**

My Caribbean counterparts are grateful for the support that the IMF and other international financial institutions (IFIs) have provided and continue to provide to Haiti.

The Caribbean economies are still facing significant challenges in the aftermath of the global economic crisis, with a very lagged pace of recovery projected. Therefore, fiscal and external sector pressures remain highly elevated. Weak conditions are expected to persist through most of 2010, with a mild strengthening towards the end of the year and into 2011. This is dependent, of course, upon a strengthening in tourism receipts and remittance inflows—mainly linked to the improvement in household confidence in the United States. It is also conditioned upon better prices for commodities exports.

While there has been an urgent short-term need to achieve macroeconomic stabilization, medium-term priorities for the region centre around transitioning to more sustainable paths for fiscal policies; achieving substantial and lasting debt reductions that create more space for spending on social sector programs; and fostering a more supportive environment for robust, private sector-led growth. Efforts to strengthen financial sector regulatory frameworks are ongoing, with heightened emphasis on regional cooperation to address systemic issues. A number of Caribbean countries have either engaged or are in the process of engaging IMF-supported programs to advance their reform agendas. More generally, the IFIs and external donors continue to provide valuable technical assistance to strengthen policy frameworks and institutions in all countries.

As highly vulnerable island states, often with relatively small populations and economies, there continues to be strong justification for ensuring the Caribbean's access to adequate and appropriate financing at the IMF and multilateral development banks. In this regard, more focus will have to be directed at supporting initiatives that enhance the region's resilience to domestic and external shocks, natural disasters, and the effects of climate change.

### **IMF Reform**

The economic and financial crisis revealed the deep global integration of modern financial markets and economies. Consequently, the IMF must appropriately adapt how it promotes international economic stability and cooperation. The Fund's crisis response of bolstering its resource levels and reforming lending tools was necessary, but as the economy continues to recover, the IMF needs to more effectively prevent crises. And it will have to ensure that the way in which it prevents crises does not sow the seeds of an even greater, more damaging crisis in the future. Reforms at the IMF must position the institution to carry out this mandate legitimately, credibly and effectively. Equally important, we must ensure that reforms to the Fund's toolkit balance the objectives of crisis prevention and resolution against the pernicious effects of moral hazard. We must not forget the central lesson of the crisis.

Increased legitimacy, credibility and effectiveness at the IMF will only be possible if we properly align the role, tools, resources and governance of the Fund. A clear agreement on the Fund's role is the starting point from which we will be able to determine the resources and tools that the Fund needs. In parallel, we need to make appropriate changes to the Fund's governance structure to ensure it is managed accountably.

## *Role*

The high degree of global economic and financial integration makes the Fund's core function of international monetary and financial cooperation as important as ever. While some have called for IMF involvement in new areas and created pressure to expand the IMF's mission, the Fund is best equipped to achieve its purpose by modernizing its core surveillance and crisis lending functions. The Fund should continue the role it has taken since its inception: to identify and act on threats to economic stability, and when crises do occur, strike the right balance between IMF financing and needed policy adjustments to restore confidence and strengthen the macro economy.

## *Tools*

It is clear, however, that the escalating nature of the financial crises that we have witnessed over the past 20 years has made it more difficult for the Fund to deliver on its assigned role. As a result, today it is viewed by some as less credible in its policy advice and less effective in its ability to assist members strike the right balance between financing and adjustment. In this respect, lessons from the crisis have taught us that we must identify financial sector vulnerabilities early, and act on global imbalances and other threats. To increase the Fund's surveillance effectiveness, practices must evolve to meet financial innovation and global economic trends. The IMF needs to be in a position where it can provide clear advice on national-level events and the resulting regional or global spillover effects. But this advice must be credible if member governments are to act before "problems" escalate into "crises".

Four specific proposals merit consideration. First, reviews under the joint IMF and World Bank Financial Sector Assessment Program should be mandatory for countries with regionally or systemically important financial sectors. Such a requirement would better inform analysis of their strengths and vulnerabilities, and lead to a clear understanding of necessary responses. Second, to increase coordinated policy actions and the understanding of international spillovers of domestic policies, the IMF should initiate thematic reports or Article IV reviews where the Fund engages multiple countries simultaneously to address similar challenges. Third, Article IV reviews could contain internal and external risk assessments, including a procedure to stress test projections and policy frameworks in the face of a large macroeconomic or financial shock. Finally, the IMF and the Financial Stability Board must better define their respective areas of jurisdiction in order to both avoid gaps and prevent overlap.

In this respect, a key lesson from the crisis is the threat posed by regulatory arbitrage—the incentive to structure financial activities in institutional forms and jurisdictions in a manner that reduces regulatory and capital requirements. As we have seen, global financial integration can provide important benefits in terms of efficient risk bearing and access to investment finance. Unfortunately, it can also be a source of systemic risk if financial problems in one country spill over to its neighbours. If we do not address this problem, we will have ignored a central lesson of the crisis. Part of our response, therefore, should be the recognition that, as members of the international community with a joint interest in the prudent stewardship of the global economy, we have obligations to

the system and to each other. Much work would be required to identify the precise nature of these obligations, but the starting point is agreement on minimum capital and liquidity buffers.

Simultaneously, there is a continued need for the IMF to provide targeted technical assistance to members to help them internalize the benefits of globalization through strong policy and regulatory frameworks. This includes an increased presence for the IMF in capital account issues, not as a referee for members' policies, but as a venue for collaboration, debate and technical assistance on stability promotion measures such as financial sector development.

If a crisis were to occur, however, the IMF needs the right framework to intervene effectively. It now has responsive and flexible tools to provide liquidity if situations such as the recent financial crisis arise, and the ability to ensure the right balance of lending and conditionality when crises of solvency emerge. The Flexible Credit Line (FCL) is one such successful tool. The credibility and effectiveness of the facility is due to its strict qualification criteria, and we should not pursue FCL modifications that could dilute its positive aspects. As we learn from the crisis, we must continue to ensure that the IMF's lending toolkit does not increase moral hazard in the global economy.

### *Resources*

Extraordinary resources were mobilized during the crisis in order to provide members and markets with confidence that the IMF was ready and able to act. Canada supported the Fund's regular and concessional lending programs with a temporary \$10-billion bilateral loan to the IMF as well as new commitments of \$800 million in loan resources, and \$40 million in subsidy resources, to the IMF's Poverty Reduction and Growth Trust (PRGT) to help low-income countries post-crisis and over the medium term. We encourage those who have not already done so to finalize their pledges to the PRGT to ensure it has sufficient resources to meet demand over the medium term.

We now need to look longer term. Since adequate and appropriate lending resources are critical to making the IMF credible, we believe that the IMF needs to have a quota increase that is in line with the lending role of the Fund and its status as a quota-based institution. The significant increase in the New Arrangements to Borrow must be considered when determining an appropriate quota increase, and fundamentally, we must prevent an overly enlarged Fund that would create moral hazard.

### *Governance*

Governance is the capstone piece of IMF reform that will tie all aspects together and ensure legitimacy, credibility and effectiveness at the IMF. This includes more clearly delineating the roles and responsibilities of the respective levels of governance to ensure accountability, transparency and efficiency in the Fund's operations and decision-making.

The ongoing quota and voice reform discussions are integral to the legitimacy of the Fund. We encourage all members to ratify the 2008 quota and voice agreement, and we hope to complete the next quota review by November 2010. We need to ensure that under-represented countries receive a quota allocation that represents their weight in the world economy, and we must implement the International Monetary and Financial Committee (IMFC)/G20 commitment to a shift in IMF quota share to dynamic emerging markets and developing countries of at least 5 per cent from over-represented countries to under-represented countries using the current quota formula as the basis. Over-represented members should be ready to give up share, and Canada will do its part.

Several aspects of corporate governance reform must be addressed. First, there has to be an appropriate balance between the independence of the IMF and oversight by Ministers. The optimal levels of independence and oversight will depend on the lending role, tools and resources of the Fund, and should be adapted based on the reforms of each of these, but we can start to make progress now.

Second, Fund effectiveness requires member countries to be engaged at the Fund so that they give considered guidance and in turn are suitably responsive to IMF priorities. IMF Governors should establish the strategic direction of the Fund, and the Executive Board and management should act based on this direction. The lines of accountability for each level of governance need to be clearer, including roles, responsibilities and reporting mechanisms. We need to strengthen the role of the IMFC to have IMFC members responsible for decisions on key issues, and we could consider the possibility of activating a Ministerial Council.

Third, we are encouraged that the IMF is reforming its senior management selection processes. Selecting senior management using an open, transparent and merit-based process—regardless of candidate nationality—will contribute to legitimacy.

## **Conclusion**

Through meaningful and thoughtful reform, the IMF will gain the legitimacy, credibility and effectiveness it needs. Legitimacy will arise when the Fund has voice and representation that reflects the economic realities of the 21<sup>st</sup> century, and when the Fund makes transparent decisions with clear accountability. The Fund's credibility rose throughout the crisis period as it showed it could intervene to help stabilize the global economy. Further credibility gains will occur by having the appropriate tools for surveillance and lending that enable the Fund to achieve its mandate, and by having a governance framework where the Fund is able to take decisions quickly to act on emerging crises. Effectiveness results from the links between all four facets of reform: an effective IMF requires the right resources and tools, and strategic and accountable governance that pursues stability in the global economy.