

April 3, 2009

**Speech by the Honourable Jim Flaherty, Minister of Finance,
to the Canada-United Kingdom Chamber of Commerce**

London, UK

It is good to be here for the third time since I became finance minister more than three years ago. This is a momentous time as we go through the synchronized global recession. I will speak a bit this morning about where we are in Canada and where we are globally, and about the meetings of the past day and a half. I can tell you that the results exceeded our expectations. The spirit of partnership in the G20 and the determination around the table augurs well for the weeks and months ahead.

The G20 leaders and the finance ministers are all firmly focused on tackling the global crisis, and the decisions that were taken reflect that focus. This focus began at the G7/G8 meetings in October in Washington. In October, the meeting on the Friday afternoon at the Treasury Department was not an ordinary meeting of G7 finance ministers. It was a meeting at which there was incredible focus. It was a meeting at which the usual communiqué was done away with and in which we agreed on five basic principles upon which we would proceed. We took it to the IMF, World Bank and G20 that evening and the next morning to the then President of the United States, George Bush. And then we took it to the IMF, to the Council of the Americas—the finance ministers from North America, Central America and South America—and we all agreed on those five principles.

The five principles upon which we agreed in October 2008 are the principles that continue to guide us in our discussions globally in the G7, G8, G20, IMF, World Bank and APEC.

The meeting this week built on those principles. We've made strides towards renewing global economic growth and preventing further crises. There are those who are advancing more grand schemes but we are focused on what we are facing now—that is, we need to fix the banks and we need the financial markets to function properly.

We talked last year about “liquid assets” and then they became “toxic assets.” Now, I'm told we're to call them “legacy assets.” It doesn't matter. They're bad debts. And we need to cleanse the banking system.

Secondly, we need to ensure that together governments, including the Government of Canada, provide adequate stimulus in our economies. That is important globally because stimulus builds on stimulus. We're a trading country. We're all trading countries who believe in free trade. We're against protectionism. The World Bank and IMF talked to us about having more than 2 per cent stimulus by the end of 2010. In Canada, with our partners in the provinces, we will have stimulus of in excess of 3 per cent of our GDP by the end of 2010.

Thirdly, we need to stand firmly against protectionism. And this is vitally important. If the 1930s teach us anything, it is to stand against protectionism. Protectionism does not protect us. In fact, it exposes us to a great deal of economic harm. We stand firmly against that. Not only do we say that, we act on it in Canada. In my budget in January, we are in fact taking away some tariffs on manufacturing. So it is important that we act in a

way that is consistent with what we believe—that is, we believe in free trade and we are against protectionism.

Fourthly, the financial crisis that began, or became evident, in August 2007 in the United States with the sub-prime mortgage crisis has moved from being a financial sector issue to being an issue in the real economies in the industrialized world, in the developed world, and then in the emerging economies and the lowest-income countries in the world.

So we made important strides in the last day and a half in terms of ensuring that there's adequate financing available through the International Monetary Fund for emerging economies that need access to credit, some of which is caused by repatriation of credit, and for the lowest-income countries, particularly through the World Bank, to ensure that those countries have the support they need from the stronger economies.

So Canada has done its part. We are in fact the lead contributor with respect to the lowest-income countries. This is important because this crisis has moved into all of the countries in the world.

Now on a happier note, let me talk about Canada's boring financial system. We're fortunate in Canada in several ways. All of our top 5 banks are now in the top 50 banks in the world, while in 1999 none of the Canadian banks were in the top 50. One bank is number 10 globally and 4 are in the top 10 in North America. And our life insurers are also doing well.

Why is this? Our banks have a relatively conservative investment philosophy. Also, governments in Canada permitted the top banks to acquire the investment banks, which they did back in the late 1980s and early 1990s. This is important because then they came under the regulatory umbrella of the Office of the Superintendent of Financial Institutions in Canada. We are relatively strict regulators with relatively high capitalization requirements.

I speak regularly, especially in recent months, with the Superintendent of Financial Institutions and the Governor of the Bank of Canada. We interact in a coordinated, collaborative way to ensure that our financial system does not have difficulties that we do not anticipate. This is important for our economic potential as well. Our challenges are not over but we've done a great deal to mitigate the effects of these difficult times.

In September of last year, there was no suggestion by any economist that our economy would go into recession. It did go into recession in the last quarter of the year. When we see the numbers for the first quarter of this year, they will confirm that it is in recession. How does one describe this? Something like one of my colleagues, a finance minister, said the other day: "In November, the ball rolled off the table and it hasn't hit the floor yet."

So where are we in this recession? Well, the most accurate description I've heard is that we are closer to the bottom, and I think that is fairly descriptive of how I see things.

So what did we do in Canada? In October, we were in an election campaign and so it's unusual for a government to do this, but we did move forward because we had to guarantee the international debt of our banks, which we did, and also to provide capital to our banks by purchasing CMHC mortgages, which are insured mortgages by the Government of Canada. We did that precipitously during the election campaign. We did it so that our banks would not be at a competitive disadvantage internationally because of the intervention of other governments with respect to their banking systems.

Having said that, we have not had to put any taxpayers' money into our financial system in Canada, nor do I anticipate that we'll be obliged to do so. We did this year in our budget bill after the January 27 budget, which provides the Minister of Finance with the authority to do that if necessary. But that was done in a prophylactic way because I had a sense over the course of the past 18 months or so of what the Americans have had to do, and to some extent the UK and other countries, in terms of their financial system.

So we want to ensure in Canada that we have all the tools at our disposal that we might need to use were things to get dramatically worse, which we do not anticipate. Our economy did contract in the last quarter of last year. But the contractions in other places have been substantially more significant. As you know, in the last quarter, GDP contracted by 5 per cent in France and by 12 per cent in Japan; our economy contracted by 3.4 per cent.

So what do we do as we move forward? We did a very broad consultation in Canada in the months of December and January. We listened to the Canadian people. This is not a time for ideology. This is a time for ensuring that countries do what they need to do. And that's why we took the steps that we did in the January 27 budget in Canada.

We did several key things. One is reduce taxes again to provide a stimulus to the Canadian economy. I am very pleased that the provinces in Canada have followed our exhortation since 2006 to reduce their corporate taxes, especially in the budget of the province of Ontario last Thursday.

We will have overall in Canada, and in 80 per cent of the Canadian economy now, by 2013 a combined federal-provincial corporate tax rate of 25 per cent—15 per cent federal tax, we brought it down from more than 22 per cent when we took office in 2006, and get the provinces down to about 10 per cent. This is a great opportunity globally to brand Canada as a low-tax jurisdiction.

We're harmonizing our federal goods and services tax with provincial taxes. Last week in its budget, the Ontario government took a major step forward when it announced a recent agreement with us to reduce their tax and to harmonize it overall. What does it mean? It's a stimulus of \$5 billion in the Ontario economy this year.

Lower corporate taxes and harmonized sales taxes across the country are very important in the middle and longer term for the Canadian economy. Because of the leadership of the

Government of Ontario, the remaining four provinces that are not harmonized in terms of a VAT will seek to do so. So that's important in the longer term for our country and for a rational system. It also means that administrative savings for businesses carrying on business in the province of Ontario will be about \$500 million each year.

So this is a remarkable time. It shows that there's some good that comes out of crises and focusing the mind and making sure that we take actions that are well placed during a difficult time.

How does the world view Canada? The IMF says Canada is better placed than many countries to weather the global financial turbulence and worldwide recession, thanks to sound policy management and proactive steps to maintain economic and financial stability.

Critics used to call us boring. As I said, boring has its benefits these days. I was pleased to see BBC economist Stephanie Flanders give Canada the best-prepared award. She said that by most key measures, the Canadians are coming out of this crisis in a league of their own. She compliments our financial system's strength and soundness. She also compliments our fiscal position and the fact that it has allowed us to contribute significant stimulus to the economy. She said: "The most impressive thing of all about Canada's position is that you are probably reading about it for the first time. Canadians are so sensible they even have the sense not to brag, in case things turn out badly for them after all."

The truth is we have a lot to brag about. In many parts of the world, governments have been forced to intervene and bail out banks and other financial institutions. We have not been obliged to do that in Canada. We have not seen any bank failures or anything close to that.

We have not had to inject equity in our banks. In fact, our top five banks have been able to raise equity this year and in the last quarter of last year. Over a year and a half into the global liquidity crisis, Canada's banks and other financial institutions remain sound, well capitalized and less leveraged than their international peers. This is a tangible result of a rigorous regulatory regime.

We have substantial capital requirements for our financial institutions. They are above minimum international standards and they are higher than in other jurisdictions. In fact, heading into this crisis, Canadian banks maintained healthy capital buffers above what was required by our regulator. Canada also has a cap on leverage.

The number one issue is fixing the banks internationally and making sure that we have a flow of credit. This is imperative in order for the real economies to begin to recover.

Capital-to-asset ratios in Canadian banks are in the high teens compared to ratios in the 30s for US investment banks and the 40s and 50s for many European banks. In the aftermath of the financial crisis, we are now witnessing global banks trying to reach those

Canadian capitalization levels. So it's a global race to get boring like the Canadian banking system.

Past practice is paying off for us. I thank the people who are in this room, many of whom are involved with Canadian banks or work with the Canadian banks. We have a close working relationship with the Canadian banks, and I certainly do with the CEOs in Canada. This is important in terms of ensuring that we do not engage in practices collaboratively that are negative for the Canadian people and that we're fully aware of what is transpiring.

The positive state of the Canadian banking system was highlighted by President Obama on February 19 when he pointed to Canada as a model for the way forward. So has the World Economic Forum, which has described the Canadian financial system as the most sound in the world. The IMF describes it as a system displaying remarkable stability amidst global turbulence.

But we are not an island. We are a relatively small trading country. So how do we deal with this crisis?

First of all, in the budget we lowered taxes. We also created the Extraordinary Financing Framework of up to \$200 billion to make sure that there is adequate credit available for small, medium-sized and big business. And we are working in tandem with the Government of the United States and the Government of Ontario on problems relating to the North American auto sector and the Detroit Three.

The number one issue that I heard when I consulted across Canada through the month of December, the Christmas period and into January with small business people, Canadians from every walk of life and my Economic Advisory Council, which represents some of the larger businesses in Canada, was access to financing. We're not over that hurdle yet. But in the budget we created the Extraordinary Financing Framework to make sure that we can address these issues.

I will announce next week the advisory group that's going to keep me informed about gaps in our financing network. We're employing our Crown corporations—Export Development Canada as well as the Business Development Bank of Canada for the smaller businesses. We're employing the power we have to put equity into those Crown organizations to ensure that we have adequate credit across the country.

This is being done collaboratively with the Canadian banking system. I'm meeting with the CEOs sequentially now to ensure that they understand exactly what we're trying to accomplish here, which is to make sure that we do not have gaps in our system and that creditworthy entities in Canada will be able to obtain credit. And we will use our Crown corporations to accomplish that, in cooperation with our banks, to ensure access to credit.

And further to the agreement reached at the G20 leaders meeting in Washington in November, we ensured adequate stimulus in our economy. Our stimulus in the Canadian

economy by the end of 2010, in cooperation with the provinces, will be in excess of 3 per cent. What the IMF had mandated—we agreed to this—was at least 2 per cent. This is important. It's important in Europe as well. There's some debate, as you know, about the amount of stimulus in Europe.

We understand in Canada the inclusion of the automatic stimulators that happen in the economies in Europe, and they happen in our economy as well in terms of employment insurance. And these are substantial when they kick in because of increasing unemployment.

There is agreement among the G20 countries that we are all taking adequate stimulus steps. This is very important because, as I said earlier, stimulus builds on stimulus as we deal with trading economies.

In our budget, we provided permanent tax relief, substantial stimulus. In the last day and half, some have called for more stimulus spending. I respectfully would suggest that we let the stimulus spending that we're doing enter our economies. Our fiscal year started two days ago in Canada, on April 1, and I look forward to very substantial stimulus entering our economy in the next 90 days. Our Parliament was cooperative in terms of getting our stimulus package passed, and our public servants have been quite responsive to the sense of urgency that we face.

There is no point in spending \$10 billion, \$20 billion in 2010. We need to spend it now. The stimulus is needed in our economy now, as it is in the other economies. The unemployment pressure is now. So we need to act now. That's not that easy to do with a large bureaucracy, so one has to impress upon them the need to act now. I am confident in the Canadian government that we have that support that we need in terms of getting the money out the door in the next 90 days.

We have the authority now through Parliament to spend 90 per cent of our stimulus dollars in the next six months, most of which we can spend in the next 90 days. It's not glamorous. It's for things like repairing bridges, roads, and university and college buildings. It doesn't require environmental assessments, thank goodness, because that would delay things substantially. But it is employing people, it is providing stimulus to the economy, and that's precisely what I heard from Canadians that we need to do.

Another challenge, which is a challenge for many of us in the G20, is: What do we do about running deficits and how do we exit from deficits? What's the exit strategy for governments? This is important because running large deficits is inflationary eventually and has currency consequences as well.

In our budget this year, we anticipated deficits going forward three or four years, but mainly this year and next year. But the spending will end. It is a use-it-or-lose-it proposition for the provinces, the municipalities and the private sector. This is essential.

I got into politics because I was so upset in the 1970s and the 1980s at the spending habits of Canadian governments, of deficit upon deficit upon deficit, creating large public debt to the point where more than a third of Canadian tax dollars that were sent to Ottawa each year were being used to pay interest on the public debt. And we do not want to go back to that place.

So the rule that I put in the budget this year is this: that as we come out of this recession, every dollar that we have in surplus will be used first of all to pay off the deficits that we will incur in this year, next year and probably into the next fiscal year. We have to do that in order to ensure that we do not go back into deficit after deficit spending. And the other rule is that when we get through the two years of stimulus spending, this fiscal year and the next fiscal year, that we stop and that we do not continue it as any part of program spending.

All of this is in recognition of the extraordinary times that we are in, requiring extraordinary steps which we took in this year's budget and which we will continue with over the course of this year and next year in Canada.

The events of the last six months are extraordinary. The importance of coordinated stimulus internationally is very important. The importance of staying away from protectionist actions is very important; this is a big lesson from the 1930s. In terms of regulation of our financial institutions, Canada was the co-chair of Working Group 1 for the Financial Stability Forum. The report, which was delivered to the G20 ministers, was accepted and was published yesterday. This is important in terms of financial regulation of all systemically important institutions and of all systematically important activities.

This is a system-wide approach to financial regulation, strengthening international regulatory standards, increasing transparency, and ensuring that all financial markets, products and players are appropriately regulated and subject to the oversight needed to prevent future financial calamities.

So we've done the regulatory side. We'll have to persist in that. The G20 leaders are going to meet again in the autumn. The Financial Stability Forum, which will now be called the Financial Stability Board, will be doing the international financial standards setting. The IMF will be doing its financial assessments of governments and financial systems, as they've done in the past throughout the world with the support of the G20.

This is important in order to restore confidence in the banking systems internationally. We will get through this. We have been through recessions before. In September 1981 in Canada, the prime rate was 22.5 per cent. And then we had the recession in the early 1990s. Most people in Canada came from other places, including the United Kingdom. Most of them came on boats. Most of them came with nothing, many of whom died because of disease while they were travelling to Canada. We commemorate that in various places in Canada.

Relatively speaking, this is a mild economic recession. These are relatively mild challenges for us. We will come out of this strongly. Fiscally, Canada and the Canadian governments, including the provinces, are in strong fiscal positions, having run surpluses for a time.

We are able to withstand this. We are taking the necessary steps so that Canada, in a monetary and fiscal policy sense, will accelerate out of this recession as we move forward. So I say to you with a degree of confidence that I think is warranted that the Canadian situation is strong, that our fiscal and monetary situations are both strong and that we are taking the necessary steps to move out of this recession. As we do so we'll see the Canadian economy accelerate, and I look forward to coming back next year or so and being able to talk in a very, very happy way about the recovery of the Canadian economy, and I hope the economy throughout the G20.

Thank you very much.