



International Monetary and Financial Committee

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**Statement by the Honorable Toshihiko Fukui
Governor of the Bank of Japan
and Alternate Governor of the IMF for Japan**

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Governor of the Bank of Japan
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at the Fourteenth Meeting of the International Monetary and Financial Committee
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1. Global Economy and Financial Markets - Outlook, Risks, and Policy Responses

World Economy

I welcome the continuation of a broad-based expansion of the global economy, which has kept its highest pace in the last three decades. I am especially delighted that the Asian economies, including our host country, Singapore, have taken the lead in this growth. I expect this expansion to be sustained but concurrently we must all remain vigilant to the possible risk of rising inflationary expectations in some member countries, a further increase in already high oil prices against the background of ongoing geopolitical uncertainties, and a disorderly unwinding of global imbalances. Under these circumstances, each member should persist in striving vigorously to address its economic challenges and remaining vulnerabilities by taking advantage of the present favorable environment, while paying due attention to these risks.

In this connection, I commend the latest World Economic Outlook for analyzing the strong growth performance in Asia and identifying several key lessons drawn from the Asian experience over the past 60 years. Those lessons would be useful both for Asian countries themselves and for middle and low-income countries in other regions, who are expected to be the future leaders of the global economy. It is both timely and appropriate to consider the experiences and prospects for Asia during the meetings held in this region this year. Taking into consideration the strong growth in Asia during the past 30 years, the report concludes that a strong surge in productivity and a rapid accumulation of human and physical capital resources, fostered by the robust institutional and policy environment, have been the major sources for strong sustainable growth. At the same time, along with the self-help efforts of the Asian economies themselves and the private sectors' initiatives in the area of trade and foreign direct investment, I am also convinced that development assistance by the developed countries, including Japan, focusing on infrastructure development provided in a coherent manner, has been effective and instrumental in bringing about sustainable growth in Asia.

Japan's Economy

Japan's economy has finally recovered and is expected to continue its sustainable growth, primarily supported by domestic private demand. Our economy has stagnated for nearly ten years after the burst of the bubble economy, suffering from bad loans in the financial sector. Persistent efforts were made toward progress in structural reforms under the premise, "No growth without reform." With these efforts, the target for a reduction in bad loans has been achieved, the corporate sector has strengthened, the financial system has stabilized and economic resilience has increased. This has enabled us to enjoy a steady recovery led by domestic private demand without relying on fiscal stimulus. Looking ahead, strong performance in the corporate sector has been spreading to the household sector amid a benign labor market, and the economic recovery is expected to persist.

Improvements in our economic circumstances have given us the opportunity to accelerate structural reforms to raise productivity that would bolster the growth potential of our economy that faces the challenges of a declining population and intensified global competition. In this regard, fiscal consolidation is a top priority, given the current severe fiscal conditions. The government will continue its efforts in this direction and make sure that the consolidated primary deficit of the central and local governments turns from a deficit of 3.3 percent of GDP in FY2005 into a surplus in FY2011. Moreover, after achieving the target for the primary balance, fiscal consolidation efforts will continue with a view to generate primary surpluses so as to attain a stable reduction in the debt-to-GDP ratio for these governments.

On monetary policy, in July, the Bank of Japan raised its operating target for the policy interest rate for the first time in six years. The Bank intends to formulate future monetary policy by carefully assessing economic circumstances and prices, and will continue to underpin Japan's economy toward realizing sustainable growth under price stability by maintaining an accommodative monetary environment.

2. The IMF's Medium-Term Strategy

Following the sixtieth anniversary of the Bretton Woods Institutions, we are witnessing a growing momentum toward strategic reform of the IMF. Since its foundation, the IMF's fundamental objectives have been to stabilize the global economy and international monetary and financial systems. In order to continue its meaningful

contributions to international society, the IMF needs to further strengthen its efforts in improving its institutional capabilities and streamlining and prioritizing its operations in response to the dynamic development of the global economy. Moreover, reform of its governance structure has become a prerequisite for reforms in other areas.

In this regard, I am glad to observe achievements which reaffirms concrete steps toward substantive implementation of the IMF's Medium Term Strategy (MTS), especially in the areas of governance and surveillance. I would like to express my sincere appreciation for the strong leadership shown by the Managing Director Rodrigo de Rato, who has emphasized the importance of quota and voice reform in the MTS and made strenuous efforts to reach agreement on this issue at the Board before the Annual Meetings. I would also like to express my thanks to those member countries that share a common interest in pursuing this reform, which will benefit the entire membership and the global economy as a whole.

At this opportunity, I would like to comment on the following three issues that are of particular importance regarding the implementation of the MTS.

Quotas and Voice Reform

First, on governance reform, especially on the quota and voice issue. Reform of the IMF's governance structure is needed to enable it to reflect the dynamic changes taking place in the world economy, including the rapid growth of the emerging market economies. Reform in this area is indispensable for the IMF to maintain its legitimacy, relevancy and credibility in the international community. Under the current quota distribution, many emerging market economies, including those in Asia, are significantly underrepresented in relation to their economic strength. Since economic and financial stabilization in emerging market economies, which are experiencing rapid growth and facing various challenges, are expected to be the core activities of the IMF in the coming years, the IMF's relevancy in these countries could become questionable unless the IMF listens to their voices and prepares itself to take necessary and appropriate measures.

Quota reform is a strategically important issue with global implications to improve the governance structure of the IMF, enabling it to play an effective role in the global economy. At the same time, in Asia, where so many emerging market economies are growing rapidly, quota reform has its own meaning in regaining and strengthening the

IMF's relevance and credibility in this region during the post-crisis years.

As the momentum for strategic reform of the IMF gained its strength, Japan, along with other members who share the view that there is an urgency in addressing this issue, promoted the idea of granting ad hoc quota increases for member countries whose quota shares are significantly underrepresented. I am happy to note that, following extensive discussions at the IMF Board and elsewhere, a broad consensus has emerged to place this idea at the core of the total package of quota and voice reform. I am confident that a historical milestone will be achieved here in Singapore by adopting the proposed resolution to implement this reform package. I urge my fellow Governors who have yet to vote for the draft resolution to do so immediately, thereby proving to the world at large that the IMF is a trustworthy institution that can reform itself.

The draft resolution is truly epoch-making. It clearly states its objectives and the specified timeframe for the steps to be taken to implement this reform. The IMF management, the Executive Board, and all member countries should endeavor to cooperate in carrying out this reform within the specified period. Japan supports this resolution wholeheartedly and emphasizes the following points:

- i) The Executive Board should begin discussions on a new quota formula soon after the Annual Meetings in Singapore and report progress made to the next IMFC meeting. The new quota formula should properly reflect members' relative positions in the world economy, and I believe that GDP should have significantly larger weight than in the current formula.
- ii) Based on a new formula, significant second stage ad hoc quota increases should be granted to a large number of underrepresented countries, with the aim of achieving meaningful adjustments in the quota share to properly reflect members' relative positions in the world economy, when the quota reform is finally completed. In order to ensure the voices of low-income countries in the IMF's decision-making process, the Board needs to discuss the issue of increases in basic votes concurrently with the second ad hoc increases. As for the increase in the basic votes, Japan supports an increase that is significantly more than the doubling of the current votes.
- iii) Agreements on both the second stage ad hoc increases and increases in the basic votes should be reached by the 2007 Annual Meetings, and no later than those in 2008. With this timetable in mind, the Board should initiate its discussions on these issues as soon as possible.

The workload over the coming two years is expected to be formidable, based on our past experiences. Nevertheless, I firmly believe that the membership as a whole should strive to make every effort with a cooperative spirit to advance this issue as its responsibility, with a view to ensuring the legitimacy of the IMF, which will benefit all. I sincerely hope that each member will share this recognition and participate in the discussions on this reform with constructive and cooperative spirits.

Strengthen surveillance

Second, on IMF surveillance. Globalization has brought both opportunities and challenges to all nations. Bilateral, regional and multilateral surveillance are the fundamental functions of the IMF, with its deep knowledge and analytical ability in the area of macroeconomics. The IMF is expected to continue to make every effort to strengthen its ability, as well as streamline and prioritize its activities in this area in order to improve its effectiveness in surveillance. In this regard, I welcome the new initiatives proposed in the MTS and the discussions at the Board on clarifying the objectives and priorities of surveillance for the coming few years in the context of introducing a “remit” as suggested in the last IMFC Communiqué. At the same time, I believe that reviewing past surveillance experiences would be useful in identifying possible areas for improvement to enhance the quality of IMF surveillance.

I also welcome another new surveillance framework, namely the multilateral consultation, and intend to actively participate in the discussions on this topic. I expect that frank, constructive and interactive discussions on global imbalance will deepen our mutual understanding on this issue and enable us to learn how policy efforts can reduce the risk of disorderly unwinding. At the same time, efforts should be made not to hasten the discussions, which could lead to focusing too narrowly on specific issues or specific countries, thereby sending incorrect signals to the market. Rather, the emphasis should be placed on maintaining consistent policies taken by the participating countries/area.

Improvement in the effectiveness of surveillance on exchange rate policies is also being pursued by reviewing the IMF’s practices and its analytical capabilities, and by reviewing the 1977 Decision on surveillance over exchange rate policies. Almost 30 years have passed since that decision was adopted, and it is time to consider whether IMF surveillance has kept pace with the changes in the international economic environment and analytical tools, and whether any new changes are warranted. Against this background, Japan is ready to support continuing discussions on a possible revision

to the decision in order to improve the effectiveness of surveillance. The Board should discuss this issue from the viewpoint of securing a consistency between exchange rate policies and other domestic economic policies, and not in the narrow context of attributing the global imbalance to a specific country's or regions' exchange rate policies.

Further, since the inception of the IMF, the volume of global financial transactions that are not related to trade transactions has enlarged enormously. It is often said that the amount of foreign currency transactions overwhelms the volume of trade transactions by more than 40-50 times. As a leading international financial institution, the IMF should deepen its knowledge on international capital movements as well as financial and capital markets in order to enhance the quality of policy dialogue in this area. In particular, the IMF should examine with fresh eyes the emerging market economies and assess the vulnerabilities of the domestic financial sector, the borrowing activities of international private capital markets, and the liquidity level of domestic financial markets. Finally, in addition to bilateral and multilateral surveillance, I also encourage the IMF to promote regional surveillance, which could pay special attention to the unique developments and characteristics of certain regions, such as Asia.

To follow up on all of these issues, I call on the Executive Board to report concrete progress made in this area to the next IMFC meeting.

Providing Crisis Prevention for Emerging Markets

Third, on a new instrument for crisis prevention in emerging market economies. These countries have been growing rapidly, enjoying the benefits of globalization and increases in international capital flows. At the same time, they remain vulnerable to the rapid changes in these flows. The IMF needs to increase its credibility in these upcoming economies by broadening its toolkit so as to prevent capital account crises triggered by a large and rapid reversal of international capital flows, and also to respond appropriately and quickly to a crisis that has actually occurred.

In this context, I welcome the Board discussion on the well-balanced proposal on a new liquidity instrument for market access countries. This discussion should be advanced keeping in mind the factors that led to the failure of the Contingent Credit Line, which was established for a similar purpose but was never utilized. It is important to make progress in this area in order to keep and enhance the IMF's relevancy in the emerging market economies. I urge the Executive Board to expedite the discussions on this issue

after the Annual Meetings and report further concrete progress to the next IMFC meeting.

In this regard, I am happy to report that, here in Asia, progress is being made to strengthen crisis prevention and mitigation efforts on a regional basis. To be specific, the ASEAN+3 Finance Ministers agreed in their May meeting to strengthen the Chiang Mai Initiative (CMI) and to pursue further study on various possible options toward an advanced framework of a regional liquidity support arrangement (Post CMI). Having said that, I would like to emphasize that such a regional framework is designed to be complementary to the IMF's global facilities for crisis prevention and does not at all negate the need for a crisis prevention framework for the IMF itself.