



International Monetary and Financial Committee

Eleventh Meeting
April 16, 2005

**Statement by HH.E. Sadakazu Tanigaki
Minister of Finance of Japan and Governor of the IMF for Japan**

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1. Global Economy and Financial Markets - Outlook, Risks, and Policy Responses

World Economy

I welcome the fact that global expansion, despite some moderation in late 2004, remains on track, supported by benign financial market conditions. I hope this growth will be sustained through policy efforts on the part of each member country.

Looking ahead, the key risks are persistence of or a further increase in high oil prices, as well as the abrupt tightening of financial markets and lingering geopolitical risks. In particular, the recent surge in oil prices with less price differential among various oil grades warrants close monitoring, because this might adversely affect production and balance of payments in oil-importing countries. Global imbalances, particularly the sustainability of the U.S. current account deficit, do not seem to present an imminent risk to the global economy at the moment. However, it cannot be denied that a further widening of the deficit might add uncertainty to the global economy in the long run. What is important for each country at this juncture would be to aim to achieve sustainable growth by addressing its respective challenges, such as fiscal consolidation in the United States, and continued structural reforms in Europe and Japan, in order to achieve sustainable growth over the longer term.

As globalization evolves and deepens the economic relationship among countries through trade and financial integrations, the impact of each country's economic situation on the regional and global economy tends to increase. Individual countries should take full advantage of the current favorable opportunity to strengthen their reform efforts to dispense with vulnerabilities and to implement sound economic policies. In this way, they should aim to achieve sustainable growth of their own economy, and thereby contribute to regional and global growth.

I welcome the robust growth achieved in 2004 by emerging market and developing countries, whose share in the global economy is increasing. Above all, as a member of the Asian countries, I am encouraged by the prospect that the Asian economy, including those countries that suffered from the recent earthquakes and the tsunami, is expected to grow more robustly than that of any other region. Also, I congratulate the sub-Saharan Africa region for achieving last year the highest economic performance in many years by implementing sound economic policies.

However, we need to be mindful of the possibility that if the current favorable financial conditions, underpinned by abundant liquidity and historically low interest rates, were to

be altered by a tightening of monetary conditions, we might observe a sharp reversal in financial flow and/or widened spreads, particularly in emerging market countries. Hence, these countries need to strengthen market confidence by implementing appropriate policies and further structural reforms from a medium-term perspective.

In this connection, the measures taken by the Argentine authorities during the process leading to their exchange offer for the bonds whose principal and interest payments had been suspended since the end of 2001, could establish an unfavorable precedent and raise a number of questions regarding sovereign debt restructuring. I would request that the authorities behave in a reasonable manner in the arena of international finance and engage in earnest discussions with the IMF. It is also necessary for the IMF to continue to consider how to respond to these developments in order to ensure discipline in international financial markets and to facilitate orderly sovereign debt restructuring.

Japanese Economy

The Japanese economy remains in a recovery phase led mainly by domestic private demand, without any recourse to fiscal stimulus. While real GDP growth paused in mid-2004 due to the reaction to the high growth in the latter half of FY2003 and the effects of global adjustment on IT-related goods, it has recently become positive once more. I am encouraged by the improvements made in the corporate sector, such as the increase in current corporate profits and business investments, which have positively spread to the household sector through increases in wages.

The progress made so far in structural reforms in both the public and private sectors has contributed significantly to the sustainability of the current economic recovery. Among other things, the negative legacies following the collapse of the “bubble economy” seem to have almost dissipated. In the financial sector, major banks have smoothly reduced the ratio of their nonperforming loans. The government has now completed its urgent policy agenda, as in responding to nonperforming loan problems, and has begun to place more emphasis on forward-looking measures, including efforts to create a “Financial Service Nation”, which gives people ready access to various financial instruments and services. In the corporate sector, any excess of employment, debts and equipment, which were regarded as constraints on growth, are about to be dissolved. The decline in land prices, which has put downward pressure on the Japanese economy through corporate balance sheet adjustments, has contracted. Stock prices have moved up steadily.

In order to convert these signs of recovery into sustainable growth, the government intends to pursue and accelerate its structural reform efforts that have been pursued vigorously so far. Deflationary pressures have been eased, but persist. Accordingly, the government and the Bank of Japan (BoJ) will continue to jointly pursue efforts to overcome deflation.

Regarding monetary policy, the BoJ continues to provide ample liquidity under its commitment to maintain the current quantitative easing framework until the year-on-year change in the consumer price index registers zero percent or higher on a sustainable

basis. To support the private sector's efforts to move forward, the BoJ will maintain the current accommodative monetary conditions.

Structural reform of the fiscal sector remains as the top priority policy issue, in view of the severe fiscal situation, with the highest gross government debt to GDP ratio among the major advanced economies. Steady progress in reforms on both the expenditure and revenue fronts, through the establishment of a sustainable social security system, tax system reform, and a thorough review of central and local government expenditure will be pursued with a view to achieving a surplus in the primary balance of the central and local governments in the early 2010s.

2. IMF's Strategic Direction

I welcome the intense discussions the Board has held on the IMF's strategic direction since last September. The issues discussed so far have been well documented in the Managing Director's report to this Committee. I look forward to further energetic discussions among the staff, management and the Board, with a view toward presenting, at the next Annual Meetings, a firm longer-term vision of which the members can be proud. In this regard, I hope that the Board will further strive to develop its medium-term strategy, taking into account its members' expectations. I believe that this strategy must not be supply-driven or self-serving.

The IMF is a cooperative financial institution whose purpose is to promote domestic and international monetary and financial stability. Therefore, we should keep in mind that its primary roles are to prevent monetary and financial crises through surveillance and policy advice, and to maintain confidence in the international monetary and financial system by providing, or standing ready to provide, necessary financing should a member be hit by a crisis.

If the IMF is perceived to be unable to provide this confidence, members would seek alternatives for "insurance" and the IMF might become irrelevant to them. In this connection, in order to avoid currency crises, Asian countries have been accumulating foreign reserves as "self insurance" against such crises, and promoting a "regional insurance" mechanism called the Chiang Mai Initiative, as a complement to the "global insurance" provided by the IMF. It should be noted here that these developments were triggered by the recognition that the IMF was not prepared to provide sufficient financing or confidence through "global insurance" in an appropriate and expeditious manner at the time of the Asian crisis.

Against this background, I am concerned that the IMF may lose its relevance in Asia. In order to play its role effectively, the IMF needs to strive to remain a relevant institution for its members and to be recognized as such by them. Since Asian countries have been increasing their relative importance in the world economy, Asia's support is essential in improving the mechanism for international cooperation to ensure international monetary and financial stability. Therefore, the IMF needs to listen to and understand the frustration and concerns Asian countries feel toward it and make serious efforts to

address these concerns. Unless the IMF responds effectively to the above, it could irrevocably lose relevance in Asia and ultimately in the world.

To my mind, Asia has the following concerns regarding the IMF:

First, there is the issue of whether Asia has a status in the IMF that is proportionate to its increasing relative importance in the world economy.

The distribution of quotas, which form the basis for calculating each member's voting power, should reflect the current realities and relative positions in the world economy of members' economies. It is also important to ensure an appropriate regional distribution of Board members and diversity of staff members. East Asian countries are seriously underrepresented in these respects. I believe that leaving this situation unresolved is problematic in the context of IMF governance. These issues are related to the very foundation of the IMF and are also crucial from the standpoint of accountability to its shareholders. Difficult as it is to build a consensus required for any move, serious and vigorous work should continue and a conclusion should be reached.

The current distribution of quotas is inappropriate, not only in terms of governance, but also in reflecting the economic size of members and the scale of their possible balance of payments need. Each member's quota determines the normal limits of its access to IMF resources. Given the current distribution of quotas, however, it is unfair to judge the relative scale of access based solely on the quota of the member concerned. I believe that a review of the distribution of quotas is an urgent issue that demands prompt action from this standpoint as well.

The second major concern Asian countries have is whether the IMF is making sufficient efforts to prevent, manage and resolve capital account crises.

Asian countries are expected to continue their remarkable growth, but at the same time, it is important for them to be well prepared for unforeseen contingencies. Their expectations from the IMF can be great in this respect. Preventing crises first calls for members' own efforts to strengthen their policies and institutions, and IMF surveillance plays an important role in promoting these efforts. In addition, however, a continuous review of IMF facilities is needed in order to ensure that the IMF is well equipped to provide sufficient financial support in an appropriate and expeditious manner in the event of a capital account crisis.

From this standpoint, it is essential for the IMF to continue discussions on whether there is room for improvement in precautionary arrangements. As many members have used precautionary arrangements, it would seem practical to make them an effective preventive framework which could be used by countries with sound policies in order to cope better with potential capital account crises stemming from sudden changes in capital flows or contagion. The current exceptional access framework, under which exceptional access can be granted only after a crisis arises, should be amended to recognize explicitly that exceptional access could be allowed as well under precautionary arrangements. This

is essential from the standpoint of preventing crises, because it is often necessary to maintain market confidence by demonstrating that a substantial amount of financing would be made available in the event of a capital account crisis, reflecting the potentially large financing need under these circumstances.

Furthermore, in order to play its expected role in crisis prevention and resolution effectively, it is essential for the IMF to maintain a sufficient level of financial resources, thereby underpinning market confidence. Changes in the world economy and financial markets can be abrupt and difficult to predict. The IMF, therefore, should continue to examine the appropriateness of the total amount of quotas and be prepared to act promptly whenever demand on IMF resources shows signs of an increase.

3. IMF's Support for Low-Income Members

In reviewing the role of the IMF in assisting low-income members, as pointed out in the context of the IMF's strategic directions, it is important to consider the role its members are expecting of it, and the areas in which the IMF has its strength or its comparative advantage.

I believe that, while low-income countries themselves are primarily responsible for reducing poverty and fostering growth in their efforts to achieve the Millennium Development Goals, the IMF should support these efforts by making full use of its tools, i.e., surveillance, technical assistance and financial assistance. At the same time, the IMF's assistance should focus on its core areas of expertise, such as macroeconomic frameworks and institution building in the fiscal, monetary and financial sectors.

From a global perspective, the international community needs to extend financial assistance to low-income countries with an appropriate mix of grant and loan financing. In this context, the IMF's mission is to maximize its financial support for low-income countries' efforts through concessional lending under the Poverty Reduction and Growth Facility (PRGF). Accordingly, with a view to making the PRGF more attractive to low-income countries, I have proposed that the PRGF be strengthened in its lending capacity and concessionality.

At the same time, the IMF is not a multilateral development bank or a development agency; therefore, in addition to financial assistance, policy advice through surveillance and technical assistance will continue to play an important role in the IMF's support of low-income countries. I believe that a Policy Monitoring Arrangement (PMA) focused on low-income countries deserves further consideration as one of the IMF's potential tools to address the needs both of the low-income members that have neither balance of payments difficulties nor the intention to request financial assistance, and of donors who assist these countries. I look forward to further discussions by the Board on the modalities of a PMA that focuses on low-income countries.

In providing further debt relief to low-income countries, international financial institutions should adopt a case-by-case approach based on debt sustainability analysis,

rather than an across-the-board approach, with a view to ensuring sustainable development by promoting private sector development and nurturing a credit culture. I have proposed that debt be lowered to a sustainable level based on the existing rules and, in addition, that further debt reduction be granted for countries with sound policies and robust institutions, in order to allow these countries to use loan financing by creating room for future borrowing. Therefore, I firmly oppose a uniform 100 percent debt reduction. Such an approach would result in reducing debt beyond the level necessary to maintain debt sustainability, and create moral hazard on the part of the debtor countries concerned.

Last but not least, I should like to extend my deepest condolence and sympathy for the victims of the recent earthquakes and the tsunami. The government of Japan has decided to make a financial contribution in the amount of US\$ 2.5 million to the subsidy sub-account established in January 2005 to alleviate the burden of interest payments by countries using the Emergency Assistance for Natural Disasters facility. Our government is prepared to support the IMF's activities in assisting low-income countries' own efforts for development, based on its characteristics as a financial institution and in the area of its expertise.