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Statement by H.E. Sadakazu Tanigaki
Minister of Finance, Japan

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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 continued expansion of the global economy and expect its momentum to be sustained well into the future. At the same time, we need to remain vigilant to the possible risks of persistence of or a further increase in high oil prices, the effects on emerging market economies' financing of reduced liquidity and changes in capital flows reflecting interest rate reversals, as well as the avian flu pandemic. Under these circumstances, each member country should continue to strive vigorously to address its remaining vulnerabilities by taking advantage of the still benign environment.

While global imbalances, particularly the US current account deficit, are not likely to pose any imminent threat to the global economy, a further widening of these imbalances could add uncertainty to the global economy in the longer run. Against this background, advanced countries should vigorously implement a widely supported policy package in the form of fiscal consolidation and structural reforms. At the same time, emerging Asia should expand consumption and increase investment by improving the functioning of its financial markets, and oil-producing countries should make efficient use of additional revenue stemming from higher oil prices. I do not deny that exchange rate flexibility in emerging Asia could play a certain role in the course of reducing imbalances, but I believe what is paramount now for each member country and region is to implement steadily the policy measures needed to strengthen its respective economic fundamentals, which would contribute to resolving global imbalances in a smooth and orderly manner while maintaining sustainable growth. In this regard, the IMF is being called on to present concrete medium-term policies for each country and region, so that it can play not only the role of a guardian of the international monetary system who continuously sends warning signals, but also of a reliable guide who can chart a credible path for the international community, including by offering alternative policies.

A successful outcome of the Doha Round, which aims to maintain and strengthen the WTO-centered multilateral trade system, remains critical to supporting sustainable global growth over time. Discussions are currently underway to come to agreement on common modalities on various measures, including specific tariff cuts, and Japan will continue to take a proactive stance in these efforts.

Japan's Economy

Japan's economy continues to recover amid a mild deflationary phase. Structural reforms have increased the resilience of the economy through a strengthened corporate sector and financial system stability, and have brought about a steady recovery led by domestic private demand without relying on fiscal stimulus. Looking ahead, improvement in the corporate sector has been spreading to the household sector amid a benign employment and income environment, and this economic recovery supported by domestic private demand is expected to continue into the years ahead.

Japan faces the challenges of a declining population and intensified global competition, and structural reforms should be accelerated to raise productivity that would bolster growth potential. At the same time, fiscal consolidation is a top priority, given the severe fiscal conditions. The government will continue its utmost efforts to achieve a primary fiscal surplus for the combined central and local governments in the early 2010s.

The Bank of Japan ended its quantitative easing policy last month and changed its operating target from the outstanding balance of current accounts at the Bank to the uncollateralized overnight call rate, and encouraged the rate to remain at effectively zero percent. The Bank will continue to underpin Japan's economy toward realizing sustainable growth under price stability by maintaining an accommodative monetary environment.

2. Implementation of the IMF's Medium-Term Strategy

On the strategic review of the IMF, I welcome the intensive discussions that have taken place in various fora since the publication of the Managing Director's report last September, including the discussions at the G-20 Workshop on Reform of Bretton Woods Institutions held in Tokyo last February. Clearly, we have now reached the stage of implementing the medium-term strategy rather than discussing what direction it should take. I appreciate and support the Managing Director's strong leadership in presenting us with his *Report on Implementing the Fund's Medium-Term Strategy*, which exemplifies his proactive stance toward implementing the reform of this institution.

In order to continue to function as the key international financial institution, I believe it is critical for the IMF to strive continuously to remain an institution that is (i) well streamlined and focused on its objectives and core mandates, namely, ensuring stability of the world economy and the international monetary and financial systems, (ii) capable of addressing new challenges faced by the world economy, including globalization, (iii) relevant to the international community in terms of responding to the needs of member countries in an effective manner, and (iv) has legitimacy in the sense that the will and responsibilities of all member countries are represented fairly. From these standpoints, I support the thrust of the Managing Director's report, and look forward to further work at the Executive Board in the coming months to make progress in agreeing on concrete measures to be implemented.

In this respect, I would like to offer my views on the four issues that I believe are of particular importance.

Review of IMF Quotas and Governance

The first issue is the review of quota distribution and of the IMF's governance structure. In view of significant changes in the world economy that have taken place over many years, including the remarkable growth of emerging market economies, the IMF needs to update its governance structure so that it better reflects the current realities of the world economy. This is essential for maintaining the legitimacy of the IMF in the international community. In this regard, many emerging market economies, including those in Asia, are markedly underrepresented in terms of the distribution of quotas, compared to their current economic strength and relative positions in the global economy. We need to listen to their views seriously and put in place the necessary measures to address their concerns in a prompt manner.

The discussions on quota reform have gained global momentum. An emerging view broadly shared among the members recognizes the critical importance of making progress on quota reform by the forthcoming Annual Meetings in Singapore. In order to keep this momentum and to bring about tangible reform of IMF quotas and governance, it is essential to agree on a "sequenced approach," in which measures that need to be taken urgently are implemented first, while committing to address other crucial issues at later stages. More specifically, I strongly support the view that, by the Singapore Meetings, we reach concrete agreement on ad hoc quota increases for significantly underrepresented members selected by appropriate criteria as the first step toward credible quota reform. At the same time, we should firmly agree to tackle the issues of the size and composition of the Executive Board, an increase in the number of basic votes, and the review of the quota formulas, all of which will require extensive discussions within a longer-term framework.

The so-called sequenced approach has already gained broad support in various fora, including the G-20, the ASEM and the ASEAN+3. In view of the growing support for this approach, I firmly believe it is only natural that the IMFC gives a clear mandate today for the Managing Director to submit a concrete proposal on ad hoc increases in line with the direction presented in his report in time for the Singapore meetings. I call on my fellow IMFC members to express strong support for this proposal.

The IMF's role in emerging market economies

The second issue is the IMF's role in emerging market economies. These economies have achieved remarkable growth by reaping the benefits of globalization and increased international capital flows. Nevertheless, they remain vulnerable to the volatility in capital flows. The IMF needs to adapt to this evolution and strengthen its work on emerging market economies, especially on preventing, managing, and resolving international financial crises. This is critical in maintaining the IMF's relevance in these economies, as well as in the entire international community.

Toward this end, the IMF needs to deepen its understanding of financial sectors, capital markets, and capital flows. I therefore welcome the Managing Director's call for greater

focus on financial and capital market issues in macroeconomic analyses of emerging market economies. In particular, I expect the IMF to enhance its analysis of the vulnerabilities of domestic financial sectors, the flow of international capital to these economies through markets, and the implications of domestic liquidity on real economies.

That being said, one needs to keep in mind that capital account crises will never be fully predictable, even with serious efforts made by emerging market economies themselves and the strengthened surveillance by the IMF. This recognition is all the more important at benign times like the present, when there is no ongoing crisis. It continues to be essential for the IMF to improve its financial instruments and to put in place an effective precautionary framework to cope with capital account crises, both *ex ante* and *ex post*. It is both legitimate and appropriate for the IMF to express its commitment to provide, as needed, sufficient emergency financing to countries that still have some vulnerabilities despite their sound economic policies, in order to help them maintain market confidence. In a globalized world with a large scale of volatile capital flows, this function must be seen as one of the core areas of the work of the IMF, which is the institution established to enhance stability of the international monetary system. I therefore strongly support the Managing Director's proposal for establishing a new instrument for contingent financing, and look forward to further discussions on this proposal at the Executive Board.

In this connection, I welcome the Managing Director's explicit support for regional efforts in crisis prevention and resolution. In East Asia, significant progress has been made in strengthening regional financial cooperation, including under the Chiang Mai Initiative, which is a regional framework that supplements and complements the IMF's global financing arrangements. It is important for the IMF to continue to work together with these regional efforts.

Surveillance

The third issue is IMF surveillance. As globalization and demographic changes provide opportunities and challenges to the world, the IMF is expected to make unrelenting efforts to enhance the effectiveness of one of its core functions—surveillance, by utilizing its wisdom and analytical capacity as well as its comparative advantage of having a universal membership.

In this regard, I support the direction taken by the Managing Director in his report to strengthen analyses of financial and capital market developments and their macroeconomic implications, and to place emphasis on more focused discussions and policy dialogue with country authorities in bilateral surveillance. It is important to strive further to improve the quality of surveillance by strengthening the analysis of the impact of systemically important countries' economies on the regional and global economies and by expanding cross-country analyses.

While the report proposes to place greater emphasis on exchange rate surveillance of member countries, this direction needs to be pursued with care. I believe it appropriate to enhance

surveillance on exchange rate policies as one element of a comprehensive policy dialogue with a view to ensuring consistency between exchange rate policies and other macroeconomic and structural policies. Surveillance should avoid focusing narrowly on an analysis of a specific exchange rate regime or on a quantitative assessment of a specific level of exchange rates based on numerical indicators derived from certain models. Rather, the IMF should endeavor to present fresh and objective viewpoints and policy advice, which would enable integration of the analysis of the developments in capital flows and market sentiments, both of which could have significant bearing on exchange rate movements, with the analysis of developments in the real economy.

The IMF's support to Low-Income Countries

The fourth and final issue is the IMF's support to low-income countries. The IMF can and should play important roles in supporting low-income countries in the areas of its core expertise, such as macroeconomic stability. At the same time, it should be recognized that the role the IMF can play in promoting sound development in these countries is limited, since it is not a development agency. Hence, establishing a clearer division of labor and effective collaboration with the World Bank and other agencies is called for. This is particularly true at this juncture, as the importance of the IMF providing effective policy advice and technical assistance in analyzing and managing the macroeconomic impact of an expected rise in aid flows has increased. The IMF, together with the World Bank, is also expected to contribute to the global effort to support low-income countries by presenting robust and objective debt sustainability analyses and by strengthening the monitoring of transparency in public expenditure management and of implementation of anti-corruption measures in these countries.

I welcome the rapid progress made since our last meeting in putting in place various measures to strengthen the IMF's support to low-income countries. The establishment of the Exogenous Shocks Facility and the Policy Support Instrument has enabled the IMF to address low-income countries' diverse needs for its support in a more flexible manner. In order to assist these efforts, Japan has already committed to make a financial contribution in the amount of SDR 20 million to the PRGF-ESF Subsidy Account to subsidize shocks financing by the IMF.

Moreover, the Multilateral Debt Relief Initiative took effect last January, extending 100 percent debt relief to the first 19 qualified countries. I hope these countries and other eligible countries that intend to avail themselves of the initiative make effective use of the resources freed up by debt relief and accelerate their efforts to achieve macroeconomic stability, tackle structural problems, and reduce poverty. To ensure that debt prospects improved by debt relief will not deteriorate again through new borrowing, the IMF is expected to strengthen debt monitoring under the joint Bank-Fund low-income country debt sustainability framework.