

**Statement by the Hon. SADAKAZU TANIGAKI,
Governor of the Fund and the Bank for Japan,
at the Joint Annual Discussion**

I Introduction

Mr. Chairman and my fellow Governors:

I am pleased to take this opportunity today to address the IMF-World Bank Annual Meetings as Governor for Japan.

At the outset, I would like to extend my heartfelt welcome to Mr. de Rato, who is attending his first Annual Meetings since assuming the position of the Managing Director of the IMF. I trust that Mr. de Rato will provide strong leadership in guiding the IMF to play a constant crucial role in the stability and growth of the world economy, in close cooperation with its member countries.

II Global Economy and Financial Markets - Outlook, Risks, and Policy Responses

World Economy

I welcome the continued recovery of the global economy at a faster pace and with more strength than expected, as more and more national economies become increasingly interrelated amid the evolving trend of globalization.

The current global recovery, initially driven by the United States and Asian countries, notably China, has now broadened its horizon to almost worldwide to include Latin America, the Middle East, Africa, and now Europe. It is hoped that the momentum of this recovery will continue.

While welcoming these developments, risks for the outlook remain. In addition to lingering geopolitical risks, uncertainties about the prospects for and the effects of rising oil prices, inflationary pressures, and the pace of rising interest rates clearly warrant continued vigilance. Against this backdrop, it is essential for each country to take advantage of the current favorable environment and to continue with a strong commitment their efforts to reduce remaining vulnerabilities, including structural reforms, so as to achieve sustainable growth.

The major challenges facing advanced economies are to pursue medium-term fiscal consolidation and social security reforms, and to implement structural reforms to increase

the flexibility of the economy, against the backdrop of an increasingly aging population. In emerging market economies, it is important to strengthen their resilience to shocks and to cement market confidence by continuing to implement structural reforms, including on the fiscal front, and to improve their financial and capital markets. With respect to Argentina, where the debt restructuring process is under way, I hope that the authorities will, following good-faith negotiations, reach agreement with external creditors on a comprehensive debt restructuring, thereby restoring the confidence of international markets.

Asian Economy

Owing to buoyant trade and investment, the Asian economy as a whole is projected to grow by 7.6 percent in 2004, higher than the world average. I applaud the fact that Asian countries have recovered successfully from the economic crises in the late 1990s and continue to increase their significance in the global economy. However, some concern has been expressed that increased capital inflows could induce overheating, which begs our attention because of the increasing impact of the Asian economy on the global economy. Meanwhile, appropriately sequenced liberalization of capital transactions and a move to an exchange rate regime with greater flexibility would contribute to stable economic growth in the long term.

In addition, regional cooperation in East Asia has made progress centering on trade, and the move to conclude free trade agreements (FTAs) has now gained considerable momentum as in other regions. Concurrently, East Asian countries have recently been promoting their cooperation on the monetary and financial fronts, as evidenced by active regional policy dialogues, establishing a network of financing arrangements among countries to provide short-term liquidity on demand, and nurturing efficient and liquid bond markets. All of these regional initiatives complementing the international trade, monetary, and financial systems, are open to the outside world, and Japan is actively contributing to these initiatives.

Japanese Economy

The Japanese government has made every effort to overcome prolonged deflation and revitalize the economy through reforms in the financial sector, as well as in regulatory, expenditure, and tax policies, and these efforts are gradually paying off. The impact of the improved profit situation in the corporate sector has increased business investments and has permeated the household sector through better labor market conditions and buoyant private consumption. The economic recovery led by domestic private demand is expected to continue.

Our government views the current recovery as a good opportunity to make further strides in structural reforms, which would lead to sustainable economic growth. We will pursue and accelerate vigorously structural reform efforts aimed at prompt resolution of major banks' nonperforming loan problems, a comprehensive review of the social security

system, reform of the fiscal relationship between central and local governments, and privatization of the postal service.

On fiscal policy, we are implementing fiscal consolidation, aiming at achieving a primary surplus in the early 2010s. Given the expected expenditure increase stemming from acceleration of the aging population, this reform should be well balanced, giving due consideration to both the expenditure and revenue fronts.

Regarding monetary policy, the Bank of Japan (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. This aggressive monetary easing has given further impetus to private investment and expenditure as economic recovery unfolds. To support the private sector's efforts to move forward, the BoJ will maintain the current accommodative monetary conditions.

While persistent deflationary pressure has eased, overcoming deflation remains high on the policy agenda. Therefore, the government and the BoJ will continue to join together to ensure overcoming deflation during FY2005 and FY2006, periods defined as the "Concentrated Consolidation Period."

III IMF Surveillance and Crisis Prevention and Resolution

While ensuring international financial stability and preventing crises first call for countries' efforts to strengthen their policies and institutions with a view to reducing external vulnerabilities, IMF surveillance is expected to play an even more important role against the backdrop of increased interdependence among countries and a vast increase in international capital flows amid globalization. In this regard, I welcome the progress made by the IMF, including refinement of the framework for debt sustainability analysis and strengthened analysis of the financial sector. Overall, I believe that the current surveillance framework, including its organizational structure, is effective, and that the next step for the IMF at this stage should be to steadily implement measures to strengthen the existing framework.

The Policy Monitoring Arrangement (PMA), which was recently discussed at the IMF Board, could be worth considering as an instrument to serve the member countries, if any, that have no need for IMF resources but that seek close IMF engagement in promoting sound economic policies, or to obtain the IMF's external signaling on the strength of these policies. I expect the IMF to examine thoroughly whether the demand for such a mechanism actually exists among members, and whether the chosen IMF signaling would actually meet the needs of multilateral and official bilateral creditors or donors. In doing so, it is critical to distinguish clearly between the new mechanism and the existing instruments in order to avoid overlap with various existing IMF instruments,

and to ensure that introduction of a new instrument would not hinder members' access to IMF resources via existing arrangements.

In this connection, I believe that precautionary arrangements would be an effective and practical means for member countries with sound policies to cope with potential capital account crises stemming from sudden changes in capital flows. Therefore, I hope that the IMF will continue its work on adapting precautionary arrangements for crisis prevention purposes, regardless of whether a PMA is introduced.

Regarding crisis resolution, I welcome the introduction of collective action clauses (CACs) begun last year by many countries issuing their international sovereign bonds in the New York market where there had been no such market standard. I hope to see other countries follow suit by introducing CACs in their bond issues under foreign jurisdictions. I also hope that further progress will be made in reaching agreement on developing a Code of Conduct, following further discussions among various related parties, such as debtor countries and the private sector.

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 credibility. Changes in the world economy and financial markets can be abrupt and difficult to predict. The IMF, therefore, should continue to examine quota issues and be prepared to act promptly whenever the need for a general quota increase arises. In the review of quotas, their distribution should reflect the current realities of the world economy as well as the relative positions of member countries' economies. With regard to the issue of enhancing voice and participation of developing countries in the IMF and the World Bank, I believe that the discussions on this matter have to be closely coordinated between the two institutions.

IV Issues in Development

This year marks the 50th anniversary of Japan's Official Development Assistance (ODA). Next year, there will be the UN mid-term review of progress in meeting the Millennium Development Goals (MDGs) by 2015. Even in Asia, where progress in poverty reduction has been remarkable, most part of this progress has been achieved through high economic growth in China and India, while a number of challenges remain in other Asian countries. The sub-Saharan African region will have to overcome more difficult challenges.

Investment Climate and Infrastructure Development

The key to poverty reduction is sustainable economic growth. As seen in China, India, and Vietnam, high economic growth and poverty reduction are closely correlated.

“Getting a job” is regarded the top priority as a means for the poor to break out of poverty. To achieve this sustainable growth, improvement in the investment climate and infrastructure development are of particular importance.

Improvement in the investment climate is essential to secure stable inflows of foreign direct investment and to foster small and medium enterprises (SMEs). In this regard, strengthening the financial sector is an indispensable part. In November, we will co-host with the World Bank and other organizations the Tokyo International Conference on African Development (TICAD), Asia-Africa Trade and Investment Conference. At this conference we plan to deepen our discussions on the region’s development through promotion of trade and private investment in Africa, as well as private-sector business exchanges between Asia and Africa.

We welcome that the IMF and the World Bank will further explore the issue of fiscal space for infrastructure projects to properly treat these expenditures within developing countries’ budgets, recognizing that infrastructure projects could generate further return. With regard to public-private partnerships, it is essential that developing countries establish adequate regulatory frameworks. Although we experienced a number of difficulties at the operational level to promote these partnerships, we have to make our best efforts to overcome them. It is necessary to deepen our discussion on the delivery of infrastructure services, financing for these services, and promotion of discussions among policy makers, operators, and users. In this context, we welcome the work of the World Bank Group to explore new tools of support on this issue, such as support at the sub-sovereign level and by local currency-denominated loans.

Financing Modalities

In order to increase aid flows for development, various financing modalities, such as the International Finance Facility and global taxes, are currently being considered. However, these instruments require careful examination on various issues such as the institutional or political feasibility for each country, the additional administrative cost to introducing the new mechanism, overlap with existing international organizations, and future drastic decrease in aid flows after aid funds are frontloaded. Thus, we are afraid that delving into this matter and having further discussions might not reach productive outcomes.

Instead, we should focus our efforts to reach agreements on replenishment negotiations for the existing international organizations as scheduled. In this regard, we welcome the successful conclusion of AsDF9 in May of this year. The ongoing negotiations on IDA14 and AfDF10 are extremely important, and we encourage donor countries to make serious efforts to finish these negotiations by the end of this year.

Debt Sustainability in Low-Income Countries

To avoid further debt distress, we believe that it is important to sufficiently analyze low-income countries' debt sustainability and utilize the results to consider each debt holder's future support, including the IMF and the World Bank, and to promote the formulation of appropriate borrowing strategies by these countries. In this regard, to effectively operationalize the framework for debt sustainability analysis, which is jointly elaborated by the IMF and the World Bank, we call for prompt deliberation on specific indicators for policies and institutional environment and debt burden thresholds and look forward to taking an active part in such a deliberation. However, we have to be prudent in debt reduction beyond the Heavily Indebted Poor Countries (HIPC) Initiative and an increase in the volume of grants for the following reasons. First, the multilateral development banks (MDBs) are established as lending institutions. Second, further debt reduction and the increased grant might cause moral hazard in low-income countries.

Iraq

Reconstruction and restoration of security in Iraq are extremely important for its people, and also for peace and stability of the international community, including the Middle East and Japan. Later this month, Tokyo will host the third donor meeting of the International Reconstruction Fund Facility for Iraq. As host, Japan will make utmost efforts to steadily implement the assistance that it has already committed. We welcome that the IMF Board approved credit under the emergency post-conflict assistance (EPCA) for Iraq last week, and look forward to an early project implementation through the World Bank-administered trust fund. Japan will also expedite consultations on the Iraqi debt issue with the other countries concerned so that we can reach a conclusion in the Paris Club by the end of this year.

V Measures Against the Financing of Terrorism

While three years have passed since the tragic events of September 11, 2001, recent terrorist attacks in several countries remind us that the threat of terrorism remains serious. It is, therefore, paramount for the international community to continue its efforts to combat the financing of terrorism.

In this regard, it is important for member countries to steadily implement the international standard for anti-money laundering and combating the financing of terrorism (AML/CFT). Japan will continue to provide technical assistance in this area, based on the needs of recipient countries.

VI Conclusion

This year coincides with the 60th anniversary of the agreement on the establishment of the IMF and the World Bank. In those 60 years, the world economy has changed dramatically, as witnessed by the end of the fixed exchange rate regime and the rise of emerging market economies. In response to these drastic changes, both these institutions need to articulate their respective roles and to review their policies vigorously in various areas, including crisis prevention, crisis resolution and support to low-income countries. While it is essential for the IMF and the World Bank to help low-income countries progress toward the MDGs, they must contribute to this cause in a sustainable manner based on economic rationality, without losing their perspectives as financial institutions.

I would like to conclude my remarks by extending my best wishes to each of these institutions in their successful pursuit of policy efforts in a challenging world.