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**WORLD BANK GROUP**

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INTERNATIONAL FINANCE CORPORATION  
INTERNATIONAL DEVELOPMENT ASSOCIATION  
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Statement by the Hon. **MASARU HAYAMI**,  
Alternate Governor of the Bank and the Fund for **JAPAN**,  
at the Joint Annual Discussion

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**1. Introduction**

Mr. Chairman and members of the Boards of Governors:

I am very happy to have this opportunity today to address the World Bank-IMF Meeting as Alternate Governor for Japan.

First of all, I sincerely welcome the reappointment of Mr. Wolfensohn as President of the World Bank. Since his appointment in 1995, Mr. Wolfensohn has been taking the lead on bold reforms of the institution and strategy in the World Bank, and has been tackling many challenges, such as the response to the Asian crisis. I am confident that Mr. Wolfensohn will play, in his next term, a more and more important role in addressing various development issues that the Bank Group will face.

**2. The Post-Crisis World Economy**

Mr. Chairman, as I look back to our meeting last year, I am reminded of the grave sense of uncertainty and tension that gripped the international financial markets at that time. The negative impact of the Russian crisis that had erupted in August was spreading to Brazil and other Latin American countries, as well as to Asia's emerging market economies, which were just beginning to regain their footing after the previous year's crisis. The United States was shocked by the near collapse of Long Term Capital Management (LTCM), while in Japan, major banks were in dire difficulty. But what a difference a year can make. The Brazilian crisis has been brought under control through the assistance program led by the IMF, the United States has successfully calmed the market through a number of interest-rate cuts, and Japan has taken the necessary actions to strengthen its financial sector. These and other efforts by the international community have helped shake off the uncertainty in the international financial markets and reestablish a sense of stability in the world economy. It is particularly noteworthy that positive growth has been projected this year for almost all of the Asian emerging economies that were in crisis two years ago Korea, Indonesia, Malaysia, the Philippines, and Thailand. Their growth is expected to accelerate next year, with the region enjoying a conspicuous upturn in economic activity.

Let me now turn to the Japanese economy. For the first time in nearly two years, we have experienced positive growth of real GDP in two consecutive quarters. The worst is now over, and economic activity is improving somewhat. The positive signs that we are beginning to see are the result of assiduous efforts with regard to macroeconomic and structural policy. Since last summer, the government has made economic recovery its

main priority, while recognizing the eventual need to implement fiscal structural reform. We have also tackled the problems of the financial sector by recapitalizing banks with public funds on condition that they implement far-reaching restructuring plans. The financial sector is now regaining the confidence of the markets, and financial institutions are making dramatic moves that will facilitate the reform of this sector. We will continue to monitor carefully developments in the economy and to concentrate our efforts on the implementation of various measures to strengthen the foundations for recovery.

### **3. The Need for Global Response**

As I mentioned, conditions in the international financial markets have improved significantly in the past year. However, we must consider preventive measures for the future, as we cannot completely avoid the risk of crisis, and be prepared to implement them swiftly when a crisis erupts. We have discussed the relevant issues from various perspectives, and now two years after the Asian crisis, a consensus has been established on a number of important matters. Based on this consensus, the IMF Executive Board is currently discussing various reform measures and moving toward their implementation. We must remember that no single reform measure can act as a panacea for reinforcing the international monetary system. All parties should be required to implement their share of reforms: emerging market economies, which are exposed to the risk of currency crises; private investors who are investing in these countries; developed countries, which are responsible for instituting prudential regulations covering their investors; and the IMF and other international financial institutions. I would like to present Japan's thinking on various points pertaining to these reforms.

#### *(1) Issues for the Emerging Market Economies--Responses of Capital Recipients*

The massive inflow of foreign capital into the emerging market economies creates opportunities for accelerated economic growth in these countries. However, at the same time, it entails potential risks. In order to minimize these risks, it is essential for individual governments to pursue sound macroeconomic and structural policies. The Asian crisis has also impressed upon us the importance of reinforcing the financial system by instituting appropriate prudential regulations and strengthening the existing supervisory arrangements. In this context, we must not forget that when steps are being taken toward capital liberalization, it will be even more important than before to closely monitor private sector liabilities, including those of the financial sector. It is also necessary to improve debt management and liquidity management for countries as a whole. This issue is currently being considered by the IMF and the World Bank, and we look forward to seeing the results of these deliberations.

On the question of what type of exchange rate regime should be adopted by emerging market economies, we must remember that numerous crises have been caused by misguided efforts to maintain a de facto fixed exchange rate pegged to a single currency.

Based on extensive past experience, the IMF should provide appropriate advice on this matter through the programs it supports and its surveillance activities.

Issues related to capital liberalization and restrictions on capital flows are of vital importance and require continued examination. In the course of recent IMF discussions, we have seen growing support for the view that, if combined with appropriate measures such as a more flexible exchange-rate system, restrictions on capital inflow can suppress the inflow of speculative short-term capital. Malaysia's recent use of restrictions on capital outflow was effective in drawing a line of defense against speculative attacks and stabilizing the foreign exchange market. We expect further discussions on the usefulness of restrictions on capital flows from a practical point of view. Possible effects include the reinforcement of appropriate macroeconomic policies and strengthening of the financial sector in some cases, especially the supplementing of prudential regulations.

*(2) Issues for Private Investors and the Developed Countries—Response of Capital Providers*

To maintain stability in the international monetary system, improved risk management is needed on the part of investors. A particularly important issue, which is currently being discussed in the Financial Stability Forum, is the question of hedge funds and other highly leveraged institutions (HLIs). A consensus has been reached on the need to expand the scope of disclosure for all market participants, including HLIs, and to institute more thorough risk management by counterparties to transactions. As an initial step, it is important to translate this consensus into concrete action. At the same time, we believe that it is also necessary to further examine the following types of defensive actions by the emerging market economies. When there is a possibility of market manipulation, measures may be taken, such as requiring HLIs to report on their activities in the interest of maintaining market integrity. The use of nonstandard interventions like those recently made by the Hong Kong SAR and Malaysian authorities--which are different from traditional policy responses, namely, intervention in foreign exchange market or the adjustment of interest rates--may be necessary in special circumstances.

Even more important on the investor side is to increase private-sector involvement in order to both prevent crises and help resolve those that do occur. The continued use of public funds to bail out private investors is not viable and invites moral hazard. We now have an international consensus that private creditors, including bond holders, must be asked to cooperate appropriately. However, it is true that the actual implementation of such a cooperative approach entails numerous difficulties. There are certain matters that must be borne in mind in promoting greater private-sector involvement. It must be clarified that the objective is to promote appropriate burden-sharing and cooperation between public-sector and private-sector creditors. From this perspective, measures should be taken to promote dialogue with the private sector concerning conditions in borrowing countries and to improve ways and means to encourage private-sector involvement. Moreover, a framework should be developed for cooperative action for individual country cases. It is important that the IMF lead the way in discussing specific

measures in this area, and that the entire international community cooperate toward achieving appropriate private-sector involvement.

### *(3) IMF Reform*

As the central institution in the international financial system, the IMF should strengthen its functions of providing assistance to countries in crisis--subject to proper terms and conditions--and providing appropriate policy advice to member countries. A decision has been reached to re-institute the IMF's Interim Committee as a standing committee to be renamed the "International Monetary and Financial Committee." We urge the new Committee to work toward enhancing the functions of the IMF and to play an important role in the international community's engagement in problems related to international finance. In this connection, I would also like to mention the G-7's proposal for the first meeting of a new mechanism for informal dialogue, which would include the emerging market economies, to be convened at the end of this year. We hope that this forum will play a constructive role in reinforcing the international monetary system.

Finally, I should like to touch briefly upon some recent improvements in IMF procedures. We welcome the higher level of transparency achieved through the publication of IMF staff papers. This year has also seen IMF surveillance and research activities undergo external evaluation, yielding a number of positive recommendations. Let me reiterate a point made in this external evaluation process: IMF surveillance and programs should remain focused on the core areas of fiscal and monetary policies, exchange rate regimes, the financial sector and capital movements, and problems directly related to these core areas.

## **4. Regional Responses--The Manila Framework and the New Miyazawa Initiative**

Today's international financial crises are both global and regional in nature: global in the sense that they are rooted in characteristics of an international financial system, regional in that, once started, they tend to spread very rapidly within specific regions. Therefore, intra-regional cooperation among countries with close ties has proved particularly effective in coping with such crises. For example, in the case of the Asian crisis, Japan hosted a meeting of countries in the region to rescue Thailand, and the participating countries complemented the IMF's global action with a speedy and large-scale regional response. Based on the experience of the Thai currency crisis, the Manila Framework was created, and it has functioned effectively in complementing the actions of the IMF in terms of both surveillance and financing.

In addition to this, last October, Japan launched the New Miyazawa Initiative, which includes a \$30 billion financial support package for the affected Asian countries. The urgent capital needs of each Asian country were met through funding via the New Miyazawa Initiative and other public assistance, and the economies in the region are

bottoming out. It is now essential to mobilize domestic and foreign private sector funds to achieve a full-scale, vigorous recovery in these economies. With this purpose in mind, Japan announced the "Resource Mobilization Plan for Asia (Second Stage of the New Miyazawa Initiative)" on May 15, 1999 at the APEC Meeting of Finance Ministers. As part of this program, in line with the scheduled establishment of the Japan Bank for International Cooperation in October, we have enacted the necessary legislation to allow it to guarantee public-sector bonds issued by the Asian countries. Japan has also contributed about \$3 billion for the creation of the Asian Development Bank's "Asian Currency Crisis Support Facility" which is to be used to provide guarantees for raising of funds from the markets and for interest subsidies.

Recently, Japan called on various countries in the region to participate in cooperative efforts for the establishment and development of bond markets throughout the Asian region, and discussions are already under way. We will also increase our efforts to provide technical and personnel assistance for the establishment of a stable financial system in the region. I would like to reiterate that Japan is committed to implementing this initiative while maintaining close cooperation with related countries and international institutions.

## **5. Issues in Development**

### *(1) The World Bank's Response to Crises*

During the past two years, the central issue in the area of development has also been how to respond to the crises in the emerging market economies. The World Bank and other multilateral development banks (MDBs) have responded to the crises by providing a wide range of assistance, which was beyond their traditional functions. At the outset of the crises, by utilizing their fund-raising functions from the markets, together with the IMF, they supplied funds expeditiously to the affected countries, and prevented the entire loss of the fruits of development for years. The New Miyazawa Initiative, Japan's bilateral assistance that responds to the sharp economic downturn, has been also implemented in close coordination with the World Bank and the Asian Development Bank.

The World Bank's swift and effective response to the crises should be highly appreciated now. Such a response was made possible by the World Bank's flexible management and financial soundness, and we must spare no effort in restoring and maintaining the World Bank's risk-bearing capacity.

As a recent example of such a swift response by the World Bank, I would like to point out the World Bank's announcement of its assistance to aid in the aftermath of the Marmara earthquake within 36 hours. As a country that has also suffered from earthquakes, Japan expresses its deepest sympathies to the victims of the earthquake in Turkey and will extend reconstruction support. At the same time, we fervently hope that as the core of the international community's assistance, the World Bank will contribute to

the reconstruction in Turkey by providing timely and large-scale loans. Another important challenge is assistance for reconstruction and development from the recent turmoil and destruction in East Timor. We expect the World Bank to lead the reconstruction process, and Japan intends to play an important part for its reconstruction and development.

In a number of Asian countries, signs of recovery from the crisis are now discernible in economic dimension, although with regard to the social dimension the situation is still serious particularly in the poor and vulnerable groups. Those who had received the smallest fruits of economic growth are now being left behind. Moreover, this is not unique to directly crisis-hit countries, but also to those affected indirectly.

We call on the World Bank to challenge the new poverty generated by the crises as one of its top agenda items and to further strengthen its assistance in areas such as health, sanitation, education, and employment, underpinned by high standards of governance. In close coordination with MDBs, Japan will identify its support to meet these urgent needs by making new contributions to the World Bank and the Asian Development Bank.

### *(2) The Enhanced HIPC Initiative*

Assistance to heavily indebted poor countries (HIPCs) represents another vital area in combating poverty. I welcome that the enhanced framework of the Initiative for “broader, deeper and faster” debt relief was recently endorsed. Under the enhanced Initiative, Japan will provide the largest-scale bilateral ODA debt relief. The enhanced Initiative is now expected to be implemented speedily.

In the implementation of the enhanced HIPC Initiative, it is necessary to identify financial resources to meet the increasing cost to international organizations. Maximizing the use of their internal resources should come first and then, bilateral contribution on the basis of the principle of fair burden sharing. I welcome the agreement on a financing plan that will permit the enhanced HIPC framework to be launched and the delivery of debt relief to begin for countries requiring retroactive relief and those expected to reach their decision points over the near term. I would like to express my appreciation for the efforts made by the managements of the World Bank and the IMF.

It is also important to clearly identify the Initiative as an integral part of the World Bank’s poverty-reduction strategies and to ensure a link between debt relief and poverty reduction. It is essential to secure developing country governments’ ownership and participation of civil society during implementation. We should fully recognize the necessity of tailoring assistance to reflect each country’s poverty situations, available resources from debt relief, and implementation capacity.

### *(3) A New Vision for the Asian Economies*

It has been only six years since the World Bank published its highly acclaimed “East Asian Miracle”, in which it analyzed the high growth of the Asian emerging market economies during the 1980s and presented the growth potential and policy issues in the region. The recent crisis in the region was not only an economic crisis, but also a challenge to our vision of the Asian economies. From this viewpoint, it would be meaningful for the World Bank as a “knowledge bank” to comprehensively analyze the unprecedented recent economic turmoil, to show its long- and medium-term prospects and the road to overcome poverty, and to indicate a direction on policy management for the region. I would like to propose that the World Bank undertake a comprehensive research project under a title such as “Toward a New East Asia–Revisiting Its Miracle”, and hereby announce that Japan will support this project.

## **6. Conclusion**

Throughout the twentieth century, and particularly during the first half of the century, the global society repeatedly suffered the calamities of war and serious economic dislocation. However, when we look back at this century in its entirety from our current vantage point, we realize that this was a century in which mankind sought to liberate itself from the shackles of poverty, and growing numbers of people were in fact able to do so. It goes without saying that the IMF and the World Bank have made extremely important contributions to the stability and development of the world economy during the second half of the century.

Mr. Chairman, as we stand on the threshold of the twenty-first century, we have been made to witness and to realize that our globally integrated international financial system has a shadow side of putting national economies at risk of grave crisis through sudden and massive reversals in capital flows. Yet, in crisis, we have observed how the countries of the world, including those directly affected by the crisis, in earnest consultation with the IMF and the World Bank, have been drawn together as a single international society to work toward the prevention and resolution of future crises. Herein lies our hope for the twenty-first century. Let us remember that we have overcome numerous difficult problems during the twentieth century. In the process, we have been able to develop a firm foundation for international cooperation and coordination, and have learned to bring together and share our knowledge and our wisdom. If we continue to apply these valuable global assets to the challenges and issues that lie ahead, I am certain that we will be able to overcome the problems of the twenty-first century as well.

Thank you.