

**Statement by H.E. Sadakazu Tanigaki
Governor of the Bank and Fund for Japan
at the Joint Annual Discussion
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1. Introduction

Mr. Chairman and my fellow Governors:

Let me begin my remarks with a sincere welcome to Mr. Wolfowitz, who is here for the first time after assuming the position of President of the World Bank. I hope that, under his strong leadership, the World Bank will continue to be effective, efficient and relevant to the economic development of developing countries.

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

World Economy

I welcome the continued expansion of the global economy in an increasingly integrated world. I hope to see this momentum sustained, while I note that oil price developments remain a major risk that warrants vigilance over time. In this regard, I would like to underscore the importance of closely monitoring developments in Asian countries that have high oil dependency and are increasingly gaining significance in the world economy.

While global imbalances, particularly the sustainability of the U.S. current account deficit, do not appear to present an imminent risk to the global economy, a further widening of that deficit might add uncertainty to the global economy in the longer run. Against this background, advanced countries should vigorously implement structural reforms, including fiscal consolidation, in order to strengthen a foundation conducive to long-term growth. At the same time, emerging market and developing countries should further enhance their efforts toward resilience against shocks.

I welcome the recent steps taken by China and Malaysia toward increased flexibility in their foreign exchange regimes. These reforms should increase the latitude of economic policies and enhance the flexibility of their economies to absorb shocks, thereby contributing to the growth and stability of the global economy.

In order to further strengthen the WTO-centered multilateral trade system, each country should make decisive strides toward the success of the Hong Kong Ministerial Conference in December.

Japan's Economy

Japan's economy has steadily strengthened its foundation through structural reforms, as seen in the substantial decline in major banks' nonperforming loan ratios. Improvement in the corporate sector has been spreading to the household sector, and the economic recovery supported by domestic private demand is expected to continue.

Continuous efforts to accelerate and strengthen structural reforms are called for to raise productivity, which is needed to respond to the unprecedented rapid pace of aging of our population, and to meet the growing challenges of globalization. In particular, fiscal consolidation remains the top priority on the government's policy agenda, and steady implementation of fiscal structural reform efforts will continue, with a view toward achieving a primary surplus for the combined central and local governments in the early 2010s.

Regarding monetary policy, the Bank of Japan will maintain its quantitative easing policy in accordance with the current commitment based on the consumer price index and will support the private sector's activities from the monetary front.

3. The Strategic Direction of the IMF

Since a Strategic Review of International Financial Institutions (IFIs) was proposed last year on the occasion of the 60th anniversary of the Bretton Woods Institutions, the IMF's future direction has been discussed in various fora. I applaud the Managing Director's leadership in presenting us with a succinct and well-balanced report on the IMF's medium-term strategy. "Globalization," which is proposed as the organizing principle of the IMF's medium-term strategy, has brought about enormous and rapid changes in the world economy. In order to appropriately cope with those new changes, and to continue to function as one of the key IFIs, it is important for the IMF to focus its discussions on the roles it truly has to play, and to undertake necessary reforms in an effective manner. In this context, I believe the following three issues are of particular importance.

Prevention and Resolution of International Financial Crises

The first issue is the prevention and resolution of international financial crises. Globalization has provided both opportunities and challenges to every country in the world, and supporting members' efforts to respond to its challenges has become one of the major roles of the IMF.

The experience of financial crises since the 1990s has taught us how important it is in a globalized economy to prevent capital account crises, and to appropriately manage and resolve them once they have occurred. In recent years, increased access to expanding international capital flows is being observed in three large emerging regions, namely Latin America, Central and Eastern Europe, and Asia. Ample international funds are currently flowing smoothly, thanks to unprecedented low interest rates. However, this benign environment could be reversed at any time. Therefore, it is important to adapt the IMF's precautionary arrangements to a preventive framework that would enable member countries with sound policies to cope more effectively with possible capital account crises. I strongly encourage resumption of the discussions on precautionary arrangements with exceptional access, so that the IMF could respond effectively and efficiently to massive financing needs should a capital account crisis occur for any member country.

In view of the increasing importance of capital flows in the current environment, there is a growing need to deepen our understanding of capital movements and to enrich the analysis of the financial sector and capital markets. In order to better fulfill this function, it is paramount for the IMF to review its work in this area, including its organizational structure.

Review of IMF Governance

The second issue is the review of the IMF's governance. Over the past 60 years, thanks to the free trade regime and the international financial order that have been sustained by GATT/WTO and the Bretton Woods institutions, many member countries have realized sustainable economic growth and advanced their level of development. These countries are now expected to play increasingly important roles in the global economy. These emerging economies, which used to be beneficiaries of financing from the Bretton Woods institutions, are now expected to play a more active role and assume greater responsibilities in the global community, including the role of providers of funds. For these countries to play this larger role, their will and responsibilities need to be better reflected in the decision-making process of our institutions. Hence, a review of IMF governance has become one of the urgent problems that needs to be addressed.

It is important to recognize that the current distribution of IMF quotas represents another form of unsustainable global imbalance. Many emerging market economies, including those in Asia, are markedly underrepresented in terms of their current economic strength and relative positions in the global economy. A quota distribution that does not reflect a country's current economic size and the scale of its balance of payments needs results in distortions and unfairness in determining countries' access limit to IMF resources. A more balanced quota distribution is also important from the viewpoint of ensuring a better regional balance in the composition of the Executive Board. Japan, as a member of Asian countries, maintains a strong interest in these points.

Since the issue of quotas is crucial in order to secure the IMF's political legitimacy, discussions on this issue should be undertaken in a prompt manner. Japan strongly supports the views expressed in the medium-term strategy that the resolution of the quota issue is beneficial to every IMF member. I fervently hope that a broad consensus on the principles of how to redistribute quotas can be reached in time for the next Annual Meetings.

The Role of the IMF in low-income countries

The third issue is the IMF's role in low-income countries. In these countries, capacity building in the area of fiscal and monetary policies, the financial sector, and debt management is essential to garner, manage and utilize increased aid inflows in an effective manner, while maintaining macroeconomic stability. The IMF's support in the areas of its core expertise is expected to play a complementary role vis-à-vis the longer-term support to structural reforms extended by multilateral development banks, such as the World Bank. I welcome the progress being made by the IMF on enhancing its toolkit to support low-income countries. I will watch closely with great interest what roles the Policy Support Instrument and a second window under the Poverty Reduction and Growth Facility for sudden exogenous shocks will be able to play.

The Role of the IMF in Asia

Next, I would like to offer our views on the role of the IMF in Asia. In parallel with the rapid growth in the region, significant progress has been made in regional cooperation, including financial cooperation, in Asia. Nevertheless, the IMF should continue to play an important role in this region, including by establishing a new relationship that is not limited to conventional financial support.

Japan has been actively promoting regional financial cooperation, mainly through the ASEAN+3 Finance Ministers' process, including efforts to strengthen regional economic surveillance and policy dialogue, to promote the Chiang Mai Initiative (CMI), and to make progress in the Asian Bond Markets Initiative (ABMI). These initiatives aim at preventing and resolving financial crises, and are expected to serve as a regional self-help and support mechanism against crises and to supplement the existing global insurance provided by the IMF.

More recently, the ASEAN+3 Finance Ministers agreed in May 2005, on (i) measures to strengthen the CMI (known as the "CMI Second Stage") such as integration and enhancement of the regional economic surveillance into the CMI framework and a significant increase in the size of swaps, (ii) initiation of discussions on the CMI's future, including transformation of the current network of bilateral swap arrangements into a single financial arrangement, and (iii) adoption of the ABMI Roadmap that features an exploration of the possible issuance of an Asian currency-basket. Clearly, regional financial cooperation in East Asia has been elevated to the next level.

In the current globalized economy, sharing the lessons of one region with another is becoming increasingly important. The IMF is expected to play a pivotal role in this exercise, by analyzing and discussing desirable monetary and exchange rate regimes in this region through its surveillance function, and by establishing preventive frameworks to deal with rapid capital movements.

The swiftly evolving developments in Asia require the IMF to maintain continuous dialogue with Asian member countries, deepen mutual understanding, and pursue its expected roles in the region. In this regard, the useful and encouraging discussion that took place at the "High-Level Seminar on Asian Financial Integration", co-hosted by the IMF and the Monetary Authority of Singapore in that country earlier this month, has nourished our hope for the future relationship between the IMF and Asia. I hope this dialogue will gather further momentum in the period ahead.

4. Current Status of Development Issues

Next, I would like to state my thoughts on development issues. Five years have passed since the Millennium Development Goals (MDGs) were agreed upon, and both developed and developing countries have further reinforced their efforts on the development agenda. Japan is determined to make the most of efforts to progress toward the MDGs and has thus committed to increase ODA volume by US\$10 billion in aggregate over the next five years. Japan also intends to double ODA to Africa in the next three years, where progress toward the MDGs is at risk, and has announced its action plan to implement the Paris Declaration to improve aid effectiveness. To make steady progress toward the MDGs, I believe the following three points are particularly important.

First, we need to support developing countries in achieving sustainable growth. Sustainable economic growth is imperative to achieving poverty reduction. From this viewpoint, I appreciate that the World Bank attaches great importance to improvement of the investment climate and infrastructure development. With regard to infrastructure development in particular, we need to give more priority to addressing the emerging challenges we are facing, such as relevant institutional reforms, improvement in service

quality, and environmental impact, rather than focusing on lending volume. Continuous dialogue with stakeholders is also necessary.

Second, we need to strengthen our focus on each country's different circumstances, while securing ownership of developing countries. Donors should align their assistance with the priority that is embodied in the developing country's own development strategy, such as the Poverty Reduction Strategy Paper (PRSP). For that purpose, the PRSP needs to be more specifically linked with the Mid-Term Expenditure Framework (MTEF) and budget process in developing countries, and needs to clearly prioritize their policies.

Third, it is important to provide additional resources commensurate with the improvement of developing countries' absorptive capacity. We should also recognize that it takes some time for capacity building efforts to produce their expected outcomes and for these outcomes to become truly owned by developing countries.

Last but not least, it is crucial to deepen the academic dialogue in the development field in order to implement development effectiveness. From this point of view, Japan will host the Annual Bank Conference on Development Economics (ABCDE) next spring for the first time in East Asia. ABCDE intends to make an essential contribution to development policies and provide opportunities to discuss interdisciplinary development.

Supporting Africa

There is no doubt that in Africa, where progress toward the MDGs is at risk, developing countries must strive to construct stable governments and economies and to strengthen governance, while developed countries must certainly make further efforts to assist these efforts by developing countries. Japan has committed to double ODA to Africa in the next three years. And I welcome the Bank's Africa Action Plan that focuses on capacity building and growth.

Japan also believes that to reduce poverty through sustained growth, we should deliver aid in such a way that it leads to wealth creation through private sector development. We have to bear in mind the notion that it is more important for countries to grab hold of a fishing rod than to be given fish. From this viewpoint, Japan plans to provide the following support to Africa.

First, we will provide more than US\$1 billion assistance over the next five years to implement the Enhanced Private-Sector Assistance for Africa (EPSA for Africa), which is a comprehensive initiative with the African Development Bank to promote private sector growth in Africa. To expedite the delivery of EPSA in the future, support from other donors is indispensable. I hope that all countries concerned will share the purpose of this initiative and participate.

Second, we will initially contribute US\$2 million to the Private Enterprise Partnership for Africa (PEP-Africa), the initiative IFC took this year to promote private sector development in Africa.

Third, we intend to make an initial contribution of US\$ 1 million to launch a new facility at MIGA. This new facility intends to promote private investment in Africa, by supporting small- and medium-sized enterprises that meet MIGA's environmental and social standards.

Fourth, as a major donor in the agricultural sector, we will reinforce our support toward achievement of the Green Revolution and better livelihood in rural areas, through development and diffusion of NERICA (New Rice for Africa), education, and infrastructure build-up. As about 70 percent of Africa's population lives in rural areas, agricultural development and improvement of rural livelihood is imperative for socio-economic stability. We expect that African countries will strengthen their efforts in the agricultural sector in accordance with the "Declaration on Agriculture and Food Security in Africa," and hope that donors will reinforce support for their efforts.

Debt relief

On debt relief for Heavily Indebted Poor Countries (HIPC), I am pleased that the G-8 debt cancellation proposal, in which Japan participated, is being discussed at this year's Annual Meetings. It aims to provide debt relief to HIPCs that have reached the completion point, leading to 100 percent cancellation of their debt owed to the IMF, IDA, and the African Development Fund (AfDF). I hope that this proposal will be implemented with the support of other members.

The G-8 debt cancellation proposal does not stand alone in addressing the issue of debt sustainability in low-income countries. Progress has recently been made on this issue, as IDA has launched a new "traffic light" system from the beginning of the IDA 14 period. The enhanced HIPC Initiative, to which Japan has made the largest contribution as an official bilateral creditor, continues to be effective, while we have to maintain our efforts to encourage non Paris Club and private creditors to participate in the Initiative.

As financial institutions, the World Bank and the IMF must fully take into account the importance of fostering a credit culture in the medium- and long-term perspective in order to achieve sustainable growth in low-income countries and prevent moral hazards associated with uncontrolled expansion of debt relief. In addition, so as to ensure that debt relief would further accelerate low-income countries' efforts to achieve economic growth and poverty reduction and that all the resources provided are used for those goals, I expect the World Bank and the IMF to report to us on improvements on transparency and the drive against corruption in all areas.

5. Conclusion

Since the establishment of the World Bank and the IMF sixty years ago, the world economy has changed dramatically. In response to these drastic changes, both institutions need to articulate their respective roles and to vigorously review their core activities, including crisis prevention, crisis resolution, and support to low-income countries. I would like to conclude my remarks by extending my best wishes to both of these institutions on the successful reviews of their work.