Statement by the Hon. Masaaki Shirakawa
Governor of Bank of Japan
Alternate Governor of the Fund and Bank for Japan
at the Joint Annual Discussion
Washington, D.C., October 13, 2008

I. Introduction

Mr. Chairman and fellow Governors:

It is my great privilege to have this opportunity today to address the IMF-World Bank Annual Meetings, representing the Government of Japan.

At the outset, I would like to express my sincere appreciation to Mr. Dominique Strauss-Kahn, Managing Director of the IMF, and to Mr. Robert B. Zoellick, President of the World Bank, for their excellent leadership at their respective institutions.

II. The World Economy and Global Financial Markets

The financial crisis that erupted in August 2007 appears to have become even more profound today. Credit quality concerns are broadening, as further declines in house prices and tighter lending conditions spread across countries, most notably in the United States and Europe. Financial firms face greater difficulties in raising capital to cover losses, while efforts to squeeze assets add to downward pressures on asset prices.

Recent developments in the U.S. financial industry have led to a considerable deterioration in market participants' sentiments. Although the decisive measures adopted by the U.S. authorities have prevented the global financial system from further disruption, significant uncertainty remains regarding the way forward. We, as policymakers who have the responsibility of dealing with global financial issues, should use the term "crisis" with utmost care, but it would be difficult to blame anyone for describing the current situation of the world economy as a "financial crisis."

Presumably not independent from the financial turmoil, commodity prices have demonstrated very volatile movements over the past year. The price of oil more than doubled between December 2006 and mid-July 2008, before easing in recent weeks, while, during the same period, food prices rose by over 50 percent.

Although commodity prices have recently leveled off, underlying inflation has risen, particularly in emerging and developing economies. The tightening of policy rates in some emerging economies is considered to have been behind the curve. Implementing policy responses to inflationary pressures from exogenous shocks will be quite challenging, given weaker growth prospects throughout the world.

Against this backdrop, the world economy is likely to display a marked slow down. Not only are advanced economies expected to go through a period of very sluggish growth for the remainder of 2008, but emerging and developing economies are also projected to continue to slow. Hence it would be advisable that we prepare against a “global recession.” We should also bear in mind that the global credit contraction arising from the present financial turmoil could increase the risk of squeezed private capital inflows to emerging economies.

Considering the situation I have just outlined, I believe that now it is a time when the resilience of the international financial system as a whole, as well as the policy responses of individual countries, requires thorough scrutiny.

We believe that Japan can contribute to the stability of world economy by pursuing to secure its own growth. On August 29, the government announced a package of measures to address the global surge in commodity prices, and a supplementary budget to implement these measures has just been passed by the Lower House of the Diet. Monetary policy continues its accommodative stance. In response to elevated strains in the global financial market, the Bank of Japan, with other central banks, has taken coordinated action to provide U.S. dollar liquidity, and it has supported interest rate cuts implemented by other major central banks. The Bank of Japan intends to carefully assess its outlook for economic activity and prices, while closely examining the likelihood of its projections as well as the upside and downside risks, and to implement its policies in a flexible manner.

Since the situation in the international financial markets has an enormous influence on the Japanese economy, we will very attentively watch global financial developments and put forth our utmost efforts to maintain the stability of the international financial system.

III. Expected Role of the Fund

Let me turn to the question of the Fund and expectations regarding its role. In the midst of concerns about the financial crisis and a global recession, recently, it has often been questioned whether the Fund properly fulfils expectations. We have some concerns that, in response to this criticism, the analytical and advisory capacity as well as the policy tools of the Fund might be scaled back, despite a genuine demand for them, from the international community.

I would like to offer some proposals regarding possible ways in which the Fund can fulfill its expected role.

First, the Fund can make an intellectual contribution to advanced economies affected by the financial crises. The Fund is well situated to accumulate the expertise of member countries on how to respond to financial crises. It is therefore important that the Fund build up and organize member countries' existing experiences and provide effective input to those countries currently fighting against a financial crisis. The Fund should also improve its ability and capacity to analyze financial market issues, and to accelerate its ongoing efforts toward enhancing integration between the analyses of financial markets and the macro-economy.

Second, there is room for intensifying the Fund's engagement with international financial crises. Addressing global financial crises, and helping member countries cope with those crises, both lie at the heart of the Fund's *raison d'etre* as an international institution. When emerging economies and smaller countries that host large financial institutions implement such measures as providing capital to financial institutions and deposit guarantees, to ensure the stability of financial systems in the midst of a crisis, these countries are likely to encounter difficulties in financing their budgetary needs. The Fund should be responsible for providing financial assistance in such cases, and should seriously consider how to fulfill this responsibility. It does need to convey to the market the Fund's determined commitment to tackle against spreading financial stresses, and thus, have a positive impact on restoring confidence. If the Fund requires additional resources, Japan stands ready to supplement needed funds.

Third, the Fund needs to prepare for reduced access to private capital by both emerging and developing economies. As international intermediation falters as a result of the global credit crunch, such a situation may arise as thinner private capital inflows to emerging and developing economies leads some countries to face balance of payment difficulties.
The Fund should vigorously examine how effectively it can fulfill its role and consider possible regimes of international cooperation for those countries.

Fourth, technical assistance is the Fund's area of unique competence. Indeed, from a mid- to longer-term perspective, capacity building of developing countries in the macroeconomic policy field is critical toward achieving economic growth and stability. Japan, for its part, has been expanding its financial contributions to the Fund's technical assistance programs through the Administered Account for Selected Fund Activities—Japan, and will continue to extend its support for Fund operations in this area. We believe that it is indispensable that technical assistance programs be mutually beneficial and offer a tangible outcome for both recipients and donors. To this end, particular importance is attached to achieving an objective ex-post evaluation, with specific attention toward ensuring accountability to taxpayers in donor countries.

IV. Development Issues and the World Bank

A global tightening of credit triggered by the subprime mortgage crisis could lead to shrinking private capital flows to developing countries, thus putting at risk the mobilization of resources necessary for infrastructure investments that support economic growth, indispensable for poverty reduction as well as for the provision of social safety nets. We expect the Bank to actively contemplate how the Bank, and Regional Development Banks, could compensate for the decline in private capital flows that have been the primary funding source for developing countries, and what kind of catalytic roles the World Bank Group could play in bolstering withered private capital flows.

At such a critical juncture, on October 1st, the “new JICA” was launched by merging the JICA and the overseas economic cooperation operation of the JBIC. This marks a creation of one of the largest bilateral aid agencies equipped with providing all three aid modalities: technical cooperation, grants, and ODA loans. Facing the risk of shrinking financial flows to developing countries, Japan expects that the Bank and the “new JICA” will make their aid more effective and efficient and produce robust results by means of an exchange of best practices and know-how, and its close coordination and cooperation. In fact, at this year’s TICAD IV, good cooperation was already established in the broad area of aid for Africa. Also, in the global efforts to tackle the pressing food and climate change issues confronting the international community, Japan would like to strengthen even further its cooperation with the Bank.

Regarding governance reform at the Bank, we welcome the proposed comprehensive package that envisages a phased implementation of reform measures. The steady implementation of the measures in the package is critical to the success of the reform.

V. Conclusion

The world economy is experiencing a period of rapid change. Developments in the financial markets of one country are almost instantaneously transmitted to the financial market of other countries. Moreover, the factors that influence financial markets are increasing their tendency to affect the real economy through a so-called “negative feedback loop.” In such a world, no country can maintain its prosperity without thoughtfully considering the health of the global economic system. Today, we hear many observations indicating that the Fund and the Bank need to be fundamentally reformed or that they should do much more to cope with the current new environment. These observations, however, can be interpreted as proof of continued high expectations for the two Bretton Woods institutions. Japan hopes that the Fund and the Bank will live up to those high expectations by fully utilizing their splendid human resources.