

**Statement by the Honorable Toshihiko Fukui  
Governor of the Bank of Japan  
and Alternate Governor of the IMF for Japan  
at Twelfth Meeting of the International Monetary and Financial Committee  
Washington, D.C., September 24, 2005**

## **1. 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.

## **2. IMF Objectives and Medium-Term Strategy**

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.

### **Historical Mission of the IMF and the Evolution of Globalization**

Reflecting upon the role the IMF should play 60 years after its founding, one would note that the IMF has a historical mission that has remained unchanged throughout this period, while there are also roles that need to be adapted to constantly changing circumstances. Needless to say, the IMF was established based on the lessons we learned from the retaliatory duties and competitive devaluation of exchange rates, which had induced the emergence of economic blocs and protectionism and eventually led to World War II. The purposes of the IMF as stipulated in Article I of the Articles of Agreement, namely, promoting international monetary cooperation and exchange rate stability, helping each member to correct maladjustments in its balance of payments by making its resources temporarily available, and thereby contributing to international monetary and financial stability and to the development of the global economy, remain unchanged as the IMF's historical mission.

At the same time, "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. The wave of globalization, which gained momentum with the end of the Cold War and the IT revolution, has resulted in the rise of emerging economies, sharp increases in international trade and capital flows, as well as outbreaks and contagion of capital account crises. 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.

In this context, the core function to be played by the IMF continues to be its bilateral, regional and multilateral surveillance, which utilizes its wisdom and analytical capacity. Therefore, unrelenting efforts toward its improvement are necessary. I welcome the proposals made in the medium-term strategy to enhance the effectiveness of IMF

surveillance through greater selectivity in the coverage of bilateral surveillance tailored to each country's circumstances, and by strengthening policy dialogue with country authorities.

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.

In resolving these crises, it is important to restore promptly the debt sustainability of crisis-ridden countries through a combination of appropriate measures, including policy adjustments of the countries concerned, official support from the IMF and other institutions, support based on regional cooperative frameworks, as well as private sector involvement in sovereign debt restructuring as necessary. In this regard, I welcome the diffusion of private sector involvement in crisis resolution as witnessed by the increasing number of sovereign bonds issued with collective action clauses.

### **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. For well-balanced growth of the global economy, poverty reduction and sustainable growth of low-income countries has become all the more important at the current juncture. In order to achieve these policy objectives, it is essential for low-income countries to effectively manage and utilize increasing aid inflows based on international commitments, while maintaining macroeconomic stability. To this end, institution- and capacity-building in the areas of fiscal and monetary policies, the financial sector, and debt management, is essential. The IMF should deliver support by focusing on areas of its core expertise, in line with the Poverty Reduction Strategy approach.

In delivering actual support, the IMF should take into account what member countries are expecting it to do, and flexibly respond to country-specific circumstances with an appropriate combination of surveillance, technical assistance and financial assistance. In this regard, I welcome the progress being made in the IMF's work on enhancing its toolkit to support low-income countries, including introduction of the Policy Support Instrument for those countries that do not need the IMF's financial assistance, and of a second window under the Poverty Reduction and Growth Facility (PRGF) to assist countries dealing with sudden exogenous shocks.

In providing financial assistance, the PRGF continues to play an important role as an instrument that provides utmost support to low-income countries' reform efforts. In this respect, I am of the view that the PRGF should be adequately funded based on solid projections of its future demand.

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. I hope that this proposal will be implemented with the support of other members. 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.

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.

### **3. The Role of the IMF in Asia**

Finally, 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, along with the accumulation of foreign reserves that serves as self insurance.

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. In addition to the ASEAN+3 processes, the Executives’ Meeting of East Asia and Pacific Central Banks (EMEAP) process has launched the “Asian Bond Fund 2”, which aims at investing a part of foreign reserves in sovereign and quasi-sovereign local currency-dominated bonds. 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.