International Monetary and Financial Committee

Fifteenth Meeting
April 14, 2007

Statement by Koji Omi
Minister of Finance Japan
On behalf of Japan

Statement by H.E. Koji Omi
Minister of Finance of Japan
and Governor of the IMF for Japan
at the Fifteenth Meeting of the International Monetary and Financial Committee
Washington, D.C., April 14, 2007

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

Global Economy

I would like to join others in welcoming the current robust growth of the global economy. Although some corrections were seen in financial markets around the world during late February and early March, these have not threatened the fundamentals; rather, they should be seen as a reflection of market participants' reevaluation of the risks posed. As we look ahead, we should remain vigilant against some downside risks, such as the extent of the economic impact of sub-prime loan problems in the United States, developments in oil prices, and increased inflationary pressures in some countries. However, I am confident that the global economy will firmly remain on a path of solid growth.

Japan's economy

I am delighted to report that Japan's economy is on a track of sustained recovery with price stability. The corporate sector has overcome the difficulties caused by the excesses in production capacity, employment, and debt. As a result, the corporate sector continues to perform solidly with improved profits and growing investments. Exports are also following a rising trend, as the global economy continues to expand. Additionally, although in a still moderate way, there are signs that private consumption is picking up. We now witness a willingness on the part of many companies to increase their number of regular employees. A further tightening of the labor market, against the backdrop of sustained recovery, is expected to lead to increases in wages with positive impacts on private consumption.

We believe that economic revitalization and fiscal consolidation are not only compatible with each other but also mutually enhancing. Together with structural reform efforts, Japan continues to aim at both economic growth and fiscal consolidation, and maintains sound and stable macroeconomic policy management without relying on unwarranted fiscal expansion. The government is making advances in fiscal consolidation within its FY 2007 budget, including the largest-ever reduction in the issuance of new government bonds. In this context, the government is committed to securing a primary surplus in the combined budgets of the central and local governments by 2011, which is a necessary first step toward achieving a stable decrease in the debt-to-GDP ratio by the mid-2010s. Furthermore, tax revenue increases will not be used to profligately increase expenditures; rather, we will focus on implementing planned cuts in expenditures.

Nonetheless, over the medium- to long term, the path to fiscal consolidation is far from being smooth. Some budgetary costs are projected to increase due to: expected increases in social security benefit payments, a rising share of government contributions to the national pension scheme, and measures to address the falling birth rate, which requires that Japan secure stable sources of revenue in parallel with thorough expenditure cuts. To that end, the government will make every effort with a view to drawing up the fundamental and integrated tax reform including consumption tax by around the end of Fiscal Year 2007, through substantive and concrete discussions after early autumn this year.

The Bank of Japan (BOJ) recently raised its target of the uncollateralized overnight call rate from around 0.25 percent –a rate which had been maintained since July 2005—to around 0.5 percent. Additionally, with regard to the future course of its monetary policy, the BOJ will gradually adjust the level of interest rates, in light of developments in economic activity and prices, while maintaining the accommodative financial conditions ensuing from very low interest rates for some time.

Global Imbalances

I welcome the Managing Director's briefing on the multilateral consultation on global imbalances. I agree that global imbalances do not pose an immediate risk to the world economy but, rather, pose a medium- to long-term risk. Global imbalances should be addressed primarily through a responsible implementation of sound macro-economic policies and effective structural reforms carried out by each participating member.

Indeed, global imbalances have accumulated over a long period of time, reflecting various factors including each member's domestic policies and investors' expectations regarding returns on foreign currency investments. In my view, trying to adjust such imbalances exclusively through changes in exchange rates would be counter-productive because certain adverse effects, such as excessive fluctuations in the markets resulting in the unexpected impact, including a sharp deterioration in macro-economic conditions, would far exceed any anticipated limited benefit. Therefore, Japan, for one, will continue to aim toward sustained growth, led by private demand, by taking measures to raise potential growth and simultaneously pursue fiscal consolidation. I believe that our efforts, together with those made by other member countries, will contribute to an orderly correction of global imbalances.

2. Implementation of the IMF's Medium-Term Strategy

As globalization progresses, the international society faces greater challenges, including: how to maintain peace and security, how to protect the environment, and how to conserve natural resources. The challenges also include how to deal with increasing international capital flows, along with the acceleration of the flow of information, and how to simultaneously achieve growth and stability. Only countries who adopt pro-active reforms to meet these challenges will be able to seize opportunities for further advancement. This same reality applies to the IMF as well.

Therefore, I very much welcome the willingness shown by the IMF to undergo further reforms under the leadership of the Managing Director, and the support provided by its entire membership. Indeed, this is a golden opportunity that we should not let pass. It is therefore important to keep up the momentum toward the common aim of maintaining the IMF's legitimacy, relevancy, and credibility within the international community, and that both management and the Executive Board continue their efforts to overcome differences of opinion and interests.

I would like to take this opportunity to comment on the following three issues that, I believe, are of particular importance regarding the implementation of the IMF's Medium Term Strategy (MTS).

IMF Quotas and Voice

First, on governance reform, especially on the quota and voice issue. While discussions on the quota reform are being held at the IMF Board and other fora, I recognize that differences in members' views still remain. I believe it is extremely important that members reach a consensus on a concrete reform package as soon as possible, based on the principles agreed in Singapore, namely: i) the new quota formula should enable the alignment of members' quotas to their relative positions in the world economy, and ii) the voice of low-income countries should be protected, at a minimum, by increasing basic votes. In this light, I would like to emphasize the following points:

(1) Each member should recall the shared view that the quota reform is not to be seen as a zero sum game, but rather as a change that will strengthen IMF governance and benefit all members. In this regard, I am particularly concerned about recent discussions that focused too much on the changes of quota share among different groups of countries, such as advanced countries, emerging market countries, and developing countries, thereby creating unnecessary tension among different groups of members. In my view, the new formula should be principle-based, and it should not be over-burdened by expecting it to play the role of making certain adjustments based on political judgments.

(2) Each member should also reflect on the fact that the principle agreed in Singapore was to secure governance structure so that a member's quota share would reflect its relative position in the global economy. In order to achieve this goal, it is my belief that the size of the second ad hoc quota increase should be significant in order to achieve a meaningful adjustment in the quota share of all members that are largely under-represented.

(3) As an important part of this governance reform, it is imperative to enhance the voice of low income countries by increasing the basic votes to secure broader support. Given that the ratio of basic votes to the total voting power has decreased substantially since the establishment of the IMF, we agree with a significant increase of basic votes, depending on the size of the second-stage quota increase. Ultimately, we might even consider restoring the significance of basic votes in aggregate votes.

Adaptation of the IMF Surveillance Framework

Second, on IMF surveillance, I welcome the progress made in modernizing the framework of the Fund's surveillance, including the review of the 1977 Decision on Surveillance Over Exchange Rate Policies and the introduction of a remit to set and clarify objectives and priorities of surveillance. I urge management and staff to make further efforts to foster consensus at the Board.

I would like to emphasize that, in the end, this new framework must contribute to an improvement in the quality of surveillance. In this light, surveillance should look at the consistency among a whole range of policies covering both external and domestic areas. For instance, external imbalances and spill-over effects are important issues that require discussions encompassing broad aspects and not just exchange rates. I am also concerned that the concept of equilibrium exchange rates, which is supposed to equilibrate trade balances, may be losing relevance in the context of efforts to maintain external stability in today's world, where exchange rates are largely influenced by capital flows. As such, I have serious doubts about the appropriateness of using equilibrium exchange rates, which are derived from theoretical exercises, to determine the appropriate level of exchange rates for members or to make judgments about members' exchange rate policies. Furthermore, I am skeptical about the case made for using the concept of equilibrium exchange rates in the new surveillance framework.

The multilateral consultation, which was initiated last year as a new framework to strengthen surveillance, has played a useful role in deepening our mutual understanding of the policies implemented by the participating members. In order to further strengthen the effectiveness of surveillance, I believe that it is also useful to deepen the analysis from a regional perspective, focusing on the main policy issues in the region, intra-regional linkages, and the implications to global surveillance identified in both the World Economic Outlook (WEO) and the Global Financial Stability Report (GFSR). Indeed, the regional work plan of area departments could contribute to this effort, as proposed in the Managing Director's Report on Implementing the IMF's Medium-Term Strategy.

Role of the IMF in Emerging Market Economies

Third, on a new instrument for crisis prevention in emerging market economies. Based on our experience during the Asian financial crisis, a new liquidity instrument that will help emerging economies forestall capital crises resulting from the outflow of short-term capital is called for.

In this respect, I welcome the progress made in the Board's discussion of a new instrument proposal for emerging economies. In my view, it is imperative that this discussion advance, keeping in mind the factors that led to the failure of the Contingency Credit Line, and keeping it appealing enough for potential user countries to view it as a useful tool even in the current global market with its abundant liquidity. In this light, I would like to emphasize the following points:

(1) The qualification criteria should be simple and transparent, using quantitative indicators as much as possible, so that potential users can reasonably guess their possible qualification

to a Reserve Augmentation Line (RAL). It is often perceived that there is not much demand for a new instrument, but I believe that this low demand is partly due to the uncertainty surrounding the eligibility criteria. In this context, it would be useful to adopt criteria which will qualify, for example, more than half of emerging market members, based on the information available from past Article IV reports. By allowing the automatic front-loaded drawing of up to 500 percent of quota for these eligible members, a clear message on the merits of having a RAL could be conveyed to emerging market members.

(2) Predictability regarding the monitoring process should also be ensured by using quantitative indicators, to the extent possible, while leaving some room for flexibility to take into account specific circumstances. The Board should conduct a semi-annual review of the track record for the qualified members, and safeguard the Fund's resources, while establishing simple and transparent guidelines to ensure the predictability of the availability of continuous access to Fund resources.

(3) Charges and commitment fees for the RAL should be constructed so as to provide easy access to members. In my view, the current proposal to apply high charges and commitment fees for the RAL, following those of the SRF, would not quite appeal to members.

Role of the IMF in Low-Income Countries

The IMF plays an important role in supporting low-income countries' economic growth, and poverty reduction in the area of its core expertise, such as macroeconomic stability. However, the IMF is not a development agency. In this regard, the IMF should collaborate effectively with development agencies, such as the World Bank, closely cooperating to complement each other's work. Although it is desirable to clearly divide the roles of the IMF and the World Bank, there is no single answer as to how to accomplish this. Therefore, we must focus on the most important objective, that is, to provide effective support for low income countries. For this purpose, it is crucial that the IMF and the World Bank engage in further discussions. In particular, the recommendations made by the External Review Committee on IMF-World Bank Collaboration may be useful in this process.

Sustainable Financing of the IMF

The stability of the international financial market has recently led to a reduction in IMF lending as well as an increase in the early repayment of loans from members. With this background, the IMF has been experiencing a rapid drop in its credit outstanding and this trend will likely continue over the medium-term. Consequently, the IMF's current financing model, which relies primarily on interest income derived from lending to fund the whole range of its activities, needs to be restructured urgently.

I welcome the report by the Committee of Eminent Persons recommending a new set of revenue measures, on which the Board has initiated its discussions. Japan is willing to actively participate in the forthcoming discussion of the recommendations made by the report. At the same time, however, I should point out that the IMF must live up to the advice it often gives to member countries with fiscal deficits, and therefore needs to aim toward greater restraint in its expenditures, even beyond the current plan outlined in the medium-term budget. To achieve this goal, it should make further efforts to, for example, pursue the streamlining of its operations and organization as well as enhance its efficiency.