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

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I Introduction

Mr. Chairman and members of the Board of Governors:

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

First of all, I would like to welcome East Timor as a member of the IMF and the World Bank as of July 23.

This year commemorates the 50th anniversary of Japan's membership of these institutions. At the time of its accession, Japan was still in a postwar reconstruction period and was receiving a good deal of assistance from the World Bank and the IMF. This assistance contributed greatly to Japan's economic recovery. Once recovery was complete, Japan became a major financial contributor to the World Bank and the IMF. We hope to continue to maintain our close relationship with both institutions and contribute to them as much as possible.

II The World Economic Outlook

World Economy

Although the overall recovery trend of the world economy is expected to continue, the recent sharp fall in global equity markets, together with high oil prices, has caused some uncertainties, and we must be vigilant about what lies ahead.

The recent sharp fall in global equity markets reflects changes in investor sentiment in response to a recent series of corporate accounting scandals. Such a market environment poses a risk to the world economy. In order to restore market confidence, stricter accounting and auditing systems and better corporate governance are called for.

Amid heightened uncertainties in the world economy, the situation in Latin American countries is a source of particular concern. For this reason, we welcome and support the timely decision made by the IMF and the World Bank to provide financial assistance to Uruguay, Brazil, and other countries. To make this assistance effective, however, it will

be essential for these countries to practice sound economic policy management. We hope that these efforts will lead to an early restoration of market confidence and that their economies will return to a path of sustainable growth.

Japanese Economy

Although the Japanese economy remains in a difficult situation, there are signs of recovery, such as an increase in exports and the recovery of production. Although we cannot rule out the possibility that the uncertain prospects of the world economy could adversely affect final demand in Japan, we will decisively and expeditiously pursue fiscal expenditure reform, tax reform, the disposal of non-performing loans, and other structural reforms, with a view toward achieving sustainable growth led by domestic demand.

Specifically, we will pursue the following three policies in an integrated manner: (i) an “economic revitalization strategy” to restore competitiveness; (ii) “tax reform” to reinvigorate society; and (iii) accelerated fiscal expenditure reform, including enhancing the efficiency of fiscal expenditures, with the aim of achieving “small government worthy of bearing the costs.” Under the economic revitalization strategy, in order to achieve a vibrant society, we will actively implement deregulation while outsourcing the operations of public corporations to the private sector and promoting privatization wherever possible, thereby widening the scope of the private sector’s activities. With regard to tax reform, we will frontload tax reductions in order to revitalize the economy. In fleshing out the details of tax reform, we will maintain revenue neutrality on a multi-year basis so as to maintain fiscal discipline. We will intensify tax incentives for research and development as well as for investment. We will also reform the inheritance and gift taxes to promote the transfer of assets to future generations. In the area of fiscal expenditure reform, we will make every effort to reexamine all types of fiscal expenditure, prioritizing and streamlining public investments and establishing a sustainable social security system through public pension reform. In addition, in reallocating the budget, we will place more emphasis on the “Four New Priority Areas,” aimed at achieving a more vibrant society.

In addition to these structural reform efforts, resolution of the non-performing loan problem will be essential for establishing a vigorous and stable financial system. We will accelerate the disposal of non-performing loans based on a strict evaluation of assets, taking into account the outcome of the special inspections of major banks conducted by the Financial Services Agency. At the same time, after lifting the current blanket deposit protection system, we will take measures such as providing a type of deposit (“payment and settlement deposit”) that will be fully protected in the event of a failure of a financial institution, in order to ensure the stability of financial payment and settlement functions.

The Bank of Japan has recently embarked on studying a measure that would reduce the volatility risk stemming from financial institutions' shareholdings. It is expected that this measure will contribute to the stability of the financial system.

III Strengthening of the International Financial System

Crisis Prevention

Based on the experience of the Asian financial crisis, discussions have taken place in the IMF and other fora on how to strengthen the international financial system. Within the IMF, progress made includes the quota increase under the Eleventh General Review of Quotas in 1998, the establishment of the New Agreements to Borrow (NAB), and reform of lending facilities, including the introduction of the Supplemental Reserve Facility (SRF). However, since last year, there have been a number of cases that have required large-scale international financial assistance in Argentina, Brazil, and other Latin American countries. These crises point to the need for enhanced measures for crisis prevention and resolution.

Regarding crisis prevention, the strengthening of IMF surveillance is a matter of central focus. We expect that surveillance will be strengthened, focusing on its core areas of macroeconomic policy, capital movements, and the financial sector. Recently, the Financial Sector Assessment Program (FSAP) was introduced by the IMF to evaluate the soundness of countries' financial sectors. Japan announced last fall its intention to accept the FSAP, and the assessment process began in June. At the same time, the IMF's work on implementing international codes and standards is making progress, and a Report on Observance of Standards and Codes on Fiscal Transparency for Japan was published last year. We hope that many countries will follow us in accepting such international efforts with a view toward contributing to crisis prevention.

Crisis Resolution

In formulating lending programs, it is essential for the IMF to set necessary and appropriate conditionality in extending assistance to policy adjustments of borrowing countries. We welcome the recent adoption by the IMF's Executive Board of the new guidelines on conditionality, which emphasize the importance of the ownership of the borrowing countries and of keeping conditionality to a minimum. The IMF should continue to analyze how much this change in its conditionality policy contributes to improvements in program design and performance and, if necessary, continue to study the possibility of further improvements in the guidelines.

In resolving crises, private sector involvement (PSI), including sovereign debt restructuring, has sometimes been called for. In order to secure an orderly debt restructuring process, some legal frameworks have been proposed to clarify the debt restructuring procedures. For example, Ms. Krueger, the IMF's First Deputy Managing Director, proposed in November 2001 a majority-based decision-making process based on a statutory framework such as a treaty. This proposal is now being discussed at the IMF and in other fora. Such a statutory approach is ambitious and requires further continuous examination. Also being studied is a contractual approach, which calls for majority-rule provisions. We hope that both bond-issuing countries and market participants will recognize the importance of such provisions and that they will be introduced widely. It is particularly important that such market practices should be commonly used in markets like New York, where a large amount of international sovereign debt is issued.

Recently, access to IMF resources beyond the normal limits has been granted frequently as part of the response to the financial crises in Argentina, Uruguay, Brazil, and other countries. But given the limited availability of the IMF's resources, we need to adopt appropriate lending rules to restrict lending beyond normal access limits to truly exceptional cases. Furthermore, in approving exceptional access, the IMF will need to base its policy advice on realistic scenarios under which the economy would return to a sustainable growth path in the medium term, as well as conduct in-depth analysis on debt sustainability.

Quota Review

Intensive discussion has been taking place under the Twelfth General Review of Quotas before its deadline of end-January 2003. Given the significant increase in abrupt movements of capital across borders in the global economy, it is imperative that the IMF maintain a sufficient level of resources to prepare for future crises. Particularly following the recent large-scale financial assistance to Latin American countries, the IMF's usable resources are at very low level, and we hope for an immediate decision on a quota increase. In the process of the quota review, reallocation of quotas should also be examined, in view of the fact that current quota shares do not properly reflect changes in the global economic environment.

IV Issues in Development

Over the past year we have had important discussions to promote development, growth, and poverty reduction in developing countries at various fora, including the International Conference on Financing for Development held in Monterrey, Mexico, in March and the recent World Summit on Sustainable Development in Johannesburg, South Africa.

We welcome the series of replenishment agreements reached during the last three months, that is, the thirteenth replenishment of the International Development Association (IDA-13), the third replenishment of the Global Environment Facility (GEF-3), and the ninth replenishment of the African Development Fund (AfDF-9). We hope the new funds made available by these replenishments will be used in an effective manner to realize sustainable development in developing countries.

Development Effectiveness

It is encouraging that discussions held since the Monterrey Conference have yielded substantial progress toward more effective aid. We have learned from past experience that aid can be used efficiently and effectively, and can contribute to growth and poverty reduction when sound policies and institutions, as well as good governance are ensured in recipient countries. Therefore, in countries unequipped with these preconditions, priority should be given to establishing an effective public sector, characterized by such features as accountable and transparent budget execution and tax collection, as well as fair and impartial public service.

From this point of view, we intend to actively extend our support in these areas through our trust funds at the World Bank. That is, we plan to expand the functions of the Policy and Human Resource Development (PHRD) Fund and the Japan Social Development Fund (JSDF), to strengthen support for institutional and capacity building in core areas such as public expenditure management and financial auditing. Recognizing the particular need to train middle-class public servants in these areas, Japan, in cooperation with the World Bank and the Asian Development Bank, plans to enhance capacity building assistance, including support for localized public-sector training programs.

Another important way to increase the effectiveness of development assistance is to properly evaluate the results of assistance provided and to heed the lessons learned from these evaluation results. In this regard, we welcome the ongoing efforts of the World Bank and regional development banks toward better measuring, monitoring, and managing for development results. In making further efforts toward operationalization, it will be necessary to build effective frameworks, including benchmarks that are tailored to country-specific conditions and transparent to donors.

Sustainable Development

We welcome the successful conclusion of the World Summit on Sustainable Development (WSSD) in Johannesburg. At the WSSD meeting, Prime Minister Koizumi emphasized the importance of human resource development, including that in the education and health sectors. Specifically, Japan plans to provide assistance of about \$2 billion over the next five years for education in low-income countries. We are also reinforcing our ongoing efforts to combat infectious and parasitic diseases, our aim being to allocate a total of \$3 billion over a five-year period that began in FY 2000. In addition, we plan to enhance our support in social development sectors, including education and health, through the Japan Social Development Fund at the World Bank in close cooperation with the Bank's CDD-type projects.

It is also encouraging that the importance of the issue of water, which is essential for life, was highly recognized at the WSSD meeting. We are planning to convene the Third World Water Forum and its international ministerial meeting next March. We hope that representatives from many countries will participate in these meetings.

Having said that, I would also like to emphasize that, in addition to the efforts put forth in areas such as education and health, private-led economic growth is essential for sustained poverty reduction. In this regard, we should not underestimate the importance of providing assistance for physical infrastructure that promotes private sector activities. Another important challenge is to assist developing countries so that they can benefit from international trade.

Moreover, we highly appreciate the concept behind the NEPAD (New Partnership for Africa's Development), an initiative for sustainable development emerging from developing countries in Africa, in that the initiative has been drawn up by African countries with their ownership and it clearly recognizes the importance of growth. Japan will further strengthen support for Africa through TICAD III (The Third Tokyo International Conference on African Development) in October next year.

Enhanced HIPC Initiative and PRSP Approach

In order for heavily indebted poor countries (HIPC) to advance toward sustainable development, it will be necessary to support these countries in implementing appropriate policies. For this purpose, effective implementation of the Enhanced HIPC Initiative continues to be an important challenge.

Under the framework of the Enhanced HIPC Initiative, twenty-six countries have reached their decision points so far, and 6 have reached their completion points. Japan has committed \$4.8 billion in total, or one-fourth of the G-8 contributions to the Enhanced HIPC Initiative, to these 26 countries. Debt relief under the Enhanced HIPC Initiative should be regarded as a good opportunity to help the poorest countries attain sustainable development, and this Initiative should continue to be implemented steadily.

However, debt relief is not a panacea for poverty reduction or economic development. Poor countries must make policy efforts in order to achieve sustainable growth and diversification of their exports. The Poverty Reduction Strategy Paper (PRSP), a development strategy worked out with the ownership of these countries, should be a central vehicle for such efforts. Japan supports countries in preparing and implementing PRSPs, including through our contribution to the multi-donor Poverty Reduction Strategies Trust Fund at the World Bank.

Assistance for Reconstruction in Afghanistan

Turning to regional issues, assistance for reconstruction in Afghanistan continues to be an important challenge in the aftermath of the events on September 11, 2001. To achieve stability and reconstruction in a country that had seen conflict for more than two decades, unified support from the international community is essential. In this regard, we hope the World Bank will continue to play a key role in the international support for reconstruction in Afghanistan, in cooperation with other development partners, including the Asian Development Bank and other international organizations, bilateral donors, and NGOs. As a responsible member of the international community, Japan will steadily implement support of up to \$500 million over a two-and-a-half-year period, including through the Japan Social Development Fund (JSDF) at the World Bank, as pledged at the International Conference for Afghanistan Reconstruction held in Tokyo in January.

V Measures Against the Financing of Terrorism

One year has passed since the tragic events of September 11. Various measures to fight against terrorism have been taken by the international community. We welcome the progress made by the IMF and the World Bank toward the inception of the assessments using the comprehensive AML/CFT (anti-money laundering and combating the financing of terrorism) methodology covering the FATF40+8 recommendations. Once this assessment begins, non-FATF member countries will be encouraged to accept it.

Japan has made far-reaching efforts to freeze the assets of terrorists and those who provide them financial support, reflecting the importance that it attaches to combating the financing of terrorism. To that end, Japan has been taking a series of measures blocking

the assets of those who support terrorists, including joint actions on the part of the G-7 countries. By June, a set of laws to combat the financing of terrorism, which was required to domestically implement the International Convention for Suppression of the Financing of Terrorism, was approved by the Japanese Diet, and thus the Government formally accepted the Convention. In order to fight terrorism, it is essential for all countries and relevant international organizations to continue to cooperate in taking all measures necessary to combat the financing of terrorism.

VI Conclusion

Lastly, I would like touch upon the modalities of the Annual Meetings. This year's abbreviated annual meetings provide a good opportunity to review the modalities of the annual meetings and we should consider ways that will enable us to have more substantive discussions. The IMF-World Bank Annual Meetings offer a valuable opportunity for economic policy leaders of member countries to convene in one place. It is therefore important to continue to consider the means to achieve more fruitful outcomes within the limited time available.