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Statement by the Hon. **KIICHI MIYAZAWA**,
Governor of the Fund and the Bank for **JAPAN,**
at the Joint Annual Discussion

Statement by the Hon. Kiichi Miyazawa
Minister of Finance of Japan
at the Fifty-Third Joint Annual Discussion
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(Delivered by the Hon. Sadakazu Tanigaki, State Secretary of Finance)

Introduction

Mr. Chairman, fellow Governors, distinguished guests, ladies and gentlemen:

May I begin by saying what a pleasure it is for me to address the 53rd Annual Meetings of the World Bank Group and the International Monetary Fund.

Before moving to my remarks on policy, I would like to extend a warm welcome to the Republic of Palau, which has joined both the Fund and the Bank since last year's meeting.

State of the World Economy and Policy Coordination

Mr. Chairman:

Let me begin by reviewing the state of the global economy.

Today the world economy is faced with major risks and challenges. In Asia, a region that has experienced a period of great pain since last year, convincing signs of recovery are yet to appear.

In the meantime, another currency crisis started to unfold in Russia this past summer, triggering turbulence in the foreign exchange and financial markets elsewhere, such as the Latin-American economies.

The economic turmoil in emerging as well as transition economies since last year has indeed demonstrated the risk of a serious deflationary spiral of the entire world economy.

At home, the steep downturn of the Japanese economy became obvious last fall. Despite steady implementation of the latest economic policy package, the largest ever, and other measures, our economic situation is still extremely severe.

Considering this and also the current state of the world economy, the government of Japan is fully aware that it is imperative to put its economy on the path of recovery and steady growth. Our government will continue to make appropriate policy responses, including the implementation of a range of new measures put forth by the new administration.

With regard to foreign exchange, we are of the view that the excessively undervalued yen will do no good, not only to the Japanese economy but to the world economy as a whole. Let me make it clear that the government of Japan will not accept the excessively undervalued yen.

Aiming at the Rebirth of the International Financial System

Reviewing the IMF-World Bank system

For a little more than a year, Mr. Chairman, it has been at the top of our agenda to stabilize the markets in emerging economies that are exposed to dramatic capital movements on an international scale. As the core institutions for addressing such an issue, the International Monetary Fund and the World Bank Group have undoubtedly played a vital part in these global efforts.

However, with continued market turbulence in many parts of the world, the role and function of the two institutions which together have long served as one of the linchpins for the postwar world economy need to be re-examined.

The world today is vastly different from what its leaders, who gathered at Bretton Woods in 1944, anticipated. The whole idea of free trade and foreign exchange transaction under the fixed exchange rate regime was indeed instrumental in postwar restoration and progress of the world economy. What confronts us today, however, is a different reality. A reality in which markets can fall prey to large-scale capital movements that are abrupt and flowing across national boundaries.

Expanding the public-sector investments in developing countries by mobilizing public funds, which is one of our missions, has been dwarfed in the wake of the unstable yet increasingly large volume of private capital flows and continued poverty.

Over half a century after the historic conference at Bretton Woods, we all must recognize that the world economy has a totally new landscape. Thus, I believe it is time we returned to basics and reviewed the purpose of the Fund and the Bank, and it is time for the rebirth of the international financial system.

Abrupt capital movements on a large scale

Before reviewing what the Fund should be, however, I must point this out. I believe that economic management and development strategy that makes the most use of the market mechanism, which has long been promoted by the Fund, is still essentially valid. Ensuring greater exposure to a market mechanism, thus increasing economic efficiency, will continue to be a major policy priority for many of the developing and transition economies. As the basis of a market system, they must improve regulatory and accounting systems, maintain sound financial systems, and strengthen supervision of financial institutions for appropriate risk control.

However, given the fact that the latest turmoil in the monetary and financial markets in the emerging economies since last year is due in large part to the abrupt flows of short-term funds, we need to consider how to respond to the short-term or the speculative movements of capital.

Ever since December 1994, when the Mexican crisis began, we have been keenly aware of the risks associated with the modern market economy, where instant, large-scale capital movement can take place. That is why the Fund has initiated its effort to improve transparency to help markets make rational judgments, and has strengthened surveillance with the aim of helping prevent crises.

While such an effort is of course needed, it is far from sufficient. No matter how transparency is improved, and no matter how surveillance is strengthened, crises can still occur. To address the challenge, the Fund must face up to the reality that there are cases where the benefits of short-term capital movements can be surpassed by their risk and cost. I believe the Fund should then make further efforts in four areas.

First, as has often been pointed out lately, capital account liberalization must be implemented with appropriate sequencing. Liberalization of direct investment and long-term capital flows, for example, must precede liberalization of short-term capital flows. What must also come first as a precondition is to have a sound and developed financial sector, responsible fiscal and monetary policies, and adequate depth of the national economy.

Second, monitoring of international movements of capital must be strengthened at both ends—creditors’ and debtors’. Particularly with large-scale, international institutional investors, such as hedge funds, we should perhaps consider requiring them, based on international coordination, to provide information on their investment behavior.

Third, in capital recipient countries, it is essential that the authorities fully recognize that their corporate as well as financial sectors are faced with risks that accompany foreign capital inflows, such as foreign exchange risk and the risk associated with maturity mismatch. To this end, the government in each recipient country must also enforce a prudential rule when and where it is needed.

Finally, we need to consider some effective measures to protect the emerging economies, which are faced with excessive inflows of short-term capital and capital flight, from the turmoil resulting from such abrupt capital movements.

Among the so-called capital controls, there are some that might lead to hampering useful capital inflows, such as direct investment, by eroding investor confidence. Some are either so discretionary or arbitrary that they might undermine the efficiency of the national economy. So, while taking all this into account, I request that the Fund make further study on what sort of measures should be taken.

Reconsideration of the Fund-supported adjustment programs

Economic adjustment programs, the core of the IMF system, also require a thorough review.

IMF-supported adjustment programs have played a significant role in promoting appropriate macroeconomic policies and structural reforms in each country, while underpinning the country's effort with financial assistance. But, we must not forget that the international environment in which the Fund operates has changed dramatically. While limited capital movements and fixed exchange rates were the norm when the institution was conceived, they are now giving way to free capital movements and flexible exchange rates.

For the Fund to better adapt to the new environment and make its programs even more significant, further improvement must be made on several accounts.

First, on a macroeconomic policy level, there are cases where the Fund's traditional prescription that combines fiscal balance improvements with tightening of monetary policy is not appropriate. I say this because in many cases nowadays a currency crisis or international payments difficulties does not stem from current account deficits, which used to be the cause initially anticipated in the Bretton Woods system: it derives from a change in confidence and the resulting rapid deterioration in capital accounts.

Asking a country with a fiscal surplus to tighten further, or asking a country to take a high interest rate policy for the sake of exchange rate protection, could end up with more negatives than positives—inviting a downturn in the economy, and further eroding confidence.

The second point is related to exchange rate regimes. As we have witnessed in recent events, maintenance of fixed exchange rates, on the one hand, can be taken as a government guarantee against exchange rate risk, thus leading to excessive inflows of short-term capital. On the other hand, a hasty shift to floating exchange rate regimes following the eruption of a crisis may only invite a free fall of the exchange rates. With these lessons in mind, a further effort must be made to identify appropriate exchange policies to be incorporated in IMF-supported programs.

Third, capital account flows must not be liberalized too quickly without fully taking into account the circumstances of each country. Recognizing that there can be a case that requires some measure to protect a country when the country is faced with abrupt capital movements, the Fund should think together with the local authorities as to how they might avoid taking unilateral measures which will undermine investor confidence, how they might avoid putting an unnecessary burden on the national economy, and how they might incorporate such measures into the IMF-supported adjustment programs.

Fourth, the way in which structural reform is being dealt with in IMF programs deserves further consideration, even if the reform itself is necessary. Take banking reform. When, for example, a country is not equipped with preconditions for reform such as a deposit insurance system, the Fund should perhaps be more considerate of the timing of implementation and its social impact. Likewise, the Fund should recognize that the modality of the market economy can be diverse, reflecting the history and culture of each country as well as its stage of economic development.

In this context, the Fund should perhaps reflect on the design of the past IMF-supported programs. The IMF may have damaged its own credibility when it demanded rather hastily program conditionality on structural measures that were neither necessary nor appropriate in the program design.

Finally, as we have witnessed in a recent series of crises in Asia in particular, the private sector now plays a central role on both the creditor’s and the debtor’s side. Hence, we must make even more sure that support from the public sector, such as the IMF, not be used as a bailout of the private sector.

From the viewpoint of preventing such a moral hazard, the Fund should consider the involvement of the private creditors in formulating an IMF-supported program, for example, by maintaining their exposure to that program country.

The new mission of the World Bank

Now to the World Bank. Traditionally, its mission has been to provide developing countries that could not readily raise funds in the market, with the long-term capital necessary for their economic development.

However, as the flow of private capital from industrial countries to a number of Asian and Latin-American countries expanded in the 1990s, the focus of the World Bank operations also shifted from development assistance through infrastructure provision to other areas, such as education, insurance, population, and the environment.

The economic turmoil triggered by the Asian currency crisis last year has made it all the more difficult for us to help developing countries achieve economic growth and to reduce poverty. For the countries in East Asia, this meant a major turnaround. For the twenty years that preceded the crisis, these countries enjoyed high and steady economic growth, accomplished fairer distribution of wealth, and succeeded in reducing poverty. Now, their economic performance has started plummeting, the unemployment rate has kept climbing, prices have risen, and public spending has dropped. All this means a serious impact on the people, particularly those in poverty.

Take Indonesia, where the poverty rate had dropped to 11 percent of the total population, or 22.5 million in number, by 1996. The economic crisis has affected the lives of people, first in urban areas and then in rural areas. As a result, the number of people who live in poverty now is said to be 3.5 times as many as two years ago.

Against such a backdrop, reformulating the Bank's mission and the way it provides assistance is now one of the most urgent tasks.

In the event of a crisis driven by abrupt and large-scale capital movements, it should be a significant mission of the Bank, I believe, to work with the Fund to stabilize the market through prompt supply of funds, as it did for Korea late last year.

In such a case, close collaboration with the Fund is of course essential. But, since the World Bank Group is equipped with functions of its own to raise funds from the market and to guarantee private capital mobilization, I request that the Bank consider a new scheme of assistance that will capitalize on these functions.

Furthermore, to address a range of new problems associated with a crisis, the Bank must promote social stability and the fight against poverty by implementing appropriate structural programs.

For that, it is essential for the Bank to collaborate with the Fund in dealing with structural problems in the financial and corporate sectors. Alongside this, it is even more essential for the Bank to secure basic social spending, for example, on education and hygiene, and to protect the most vulnerable group in society, thus contributing to social stability.

The social investment project which the Bank has recently approved for Thailand is an exemplary case, and Japan stands ready to support such an effort by the Bank in various ways.

In dealing with poverty and other emerging social problems, the role of the International Development Association (IDA) is extremely important. I would like to make a strong request that IDA address these issues in the Asian region in a prompt and proactive manner, and reflect it in its Twelfth Replenishment.

Even when we ourselves are in the midst of a crisis, we must not forget our support for countries in great distress, such as the heavily indebted poor countries and the post-conflict countries. For its part, Japan will continue to support such efforts of the World Bank and other international financial institutions.

Role of the Fund and the Bank and the responsibility of the international community

For the international economic community faced with mounting problems and challenges, the roles of the IMF and its sister institution, the World Bank, are absolutely vital, and can never be replaced by others. Thus, to make further improvements in their functions is, I believe, the responsibility of the international community as a whole.

While I welcome the reform effort of these institutions to strengthen their coordination and to increase transparency, a fundamental review of the IMF-World Bank system, including the points I have made earlier, is necessary in order to breathe new life into the international financial system.

I would also like to take this opportunity to emphasize that a strengthened financial footing of the Fund is indispensable for it to continue to provide countries in difficulties with appropriate financial assistance and to be able to perform its role as the core institution of the international financial system.

Thus, I would like to urge those countries that have yet to notify their consent to the ratification of the New Arrangements to Borrow (NAB) as well as the quota increase under the Eleventh General Review, to act promptly on these issues.

A New Scheme to Support the Asian Currency Crisis and Internationalization of the Yen

Announcement of the new scheme

Mr. Chairman:

May I draw your attention to our response to the Asian currency crisis that started to unfold in Thailand in July of last year.

To address the problem under the international framework of the IMF, the World Bank, the Asian Development Bank, and the countries concerned, Japan has committed to the largest bilateral support, and has steadily implemented it. As a result, exchange rates are more or less stabilized in these countries, and one might say that many of them, if not all, have gone through the immediate impact of the crisis. Turning to real economies, however, these countries are still faced with difficulties: corporate performance that is dramatically deteriorating, an unemployment rate that keeps climbing, and prices that continue to increase.

Yet, the Asian strengths are still there. Even the latest currency crisis has failed to shatter their strong fundamentals, such as high savings rates, abundant human resources, priority in education, or their firm commitment to economic development. So, once they have overcome the difficulties that now exist, I believe the Asian countries will be back on the road again to the further growth and well-being of the people

We all must help these countries overcome economic difficulties and, in doing so, contribute to the stability of the international financial and capital markets.

In this context, I would like to present a new scheme of financial assistance totaling some 30 billion US dollars to be provided as Japan's bilateral support. Under the scheme, as I will detail in a minute, 15 billion US dollars will be provided as mid- to long-term financial assistance for the recovery of the real economy of these Asian countries; another 15 billion US dollars will be reserved as provision against short-term capital needs that might emerge in the course of promoting economic reform.

Mid- to long-term financial assistance for Asian countries

For the Asian countries affected by the currency crisis, capital needs are enormous. They need capital for corporate debt restructuring in the private sector. They need capital to make their financial systems stable. They need capital for the socially vulnerable. They need capital for a stimulus package. They need capital to address a credit crunch.

In response to such mid- and long-term capital needs, Japan will provide assistance to facilitate fund-raising by these Asian countries. At the same time, we will see to it that the Tokyo market is put to better use and that the reflux of our capital is promoted.

Specifically, the first thing we plan to do is to provide the Asian countries with assistance in the form of EXIM Bank loans and yen credit.

Guarantee functions must then be fully drawn upon in order to facilitate fund-raising by the Asian countries in international financial and capital markets. For that, the guarantee functions of our Export-Import Bank will be utilized. I request, at the same time, that the World Bank and the Asian Development Bank provide aggressive guarantees for the Asian countries' borrowing as well as fund-raising through bond issue. It is hoped that in the long run the establishment of an international guarantee institution with a prime focus on Asian countries will be seriously considered.

Japan will also establish an Asian currency crisis support facility. By providing an interest subsidy, for example, the facility will allow borrowers to raise funds at a smaller cost. This facility will feature a framework which is open to the other countries in Asia, so should any country agree with this cause, and wish to take part, that would be most welcome.

Further, in collaboration with the World Bank and the Asian Development Bank, Japan will endeavor to provide financial assistance for these Asian countries. In response to the capital needs, in particular, for corporate debt restructuring in the private sector and for stabilizing financial systems, I request that the World Bank and the Asian Development Bank provide the maximum possible assistance. In that event, Japan will join their effort by providing cofinancing.

Finally, on technical assistance. To help the Asian countries implement comprehensive measures for corporate debt restructuring in the private sector and for stabilizing financial institutions, I request that the World Bank and the Asian Development Bank provide the needed technical assistance by fully drawing upon the Japan Special Fund at each institution.

For its part, Japan stands ready to provide technical assistance, according to the circumstances of each country.

Short-term financial assistance for Asian countries

Should a need arise for short-term capital in the Asian countries to facilitate trade financing during the process of steady implementation of economic reform, Japan will have short-term capital ready for the need. This will include a method of increasing the recipient country's foreign exchange reserve by using swap transactions.

Collaboration with multilateral development banks and other countries

To implement all these measures, Japan intends to collaborate closely with multilateral development banks and other countries, particularly the countries in the Asia- Pacific region.

Internationalization of the yen

As has been often pointed out, overdependence on the US dollar was obviously one of the causes of the currency crisis that erupted in Asia last year, and this has led many countries in the region to look to the yen to play a greater role.

Recognizing this, the government of Japan is now considering from a broader perspective some specific measures to improve the environment for the yen to be used more actively by market participants in the region and beyond.

Three months from now the euro will be introduced. A greater role for the Japanese yen, as an international currency together with the US dollar and the euro, should contribute to the stability of the international monetary system.

Conclusion

Mr. Chairman:

Faced with major risks and challenges, the world economy is now at a turning point. It is about time we made a new step forward to build a new system in response to the new reality, while fully drawing upon the wisdom the international financial community has accumulated over the years.

Like my fellow Governors, I will play my part in aiming at the rebirth of the Bretton Woods institutions.

In my statement, I made it clear that Japan is determined to make further contributions to its neighbors.

In the future, too, Japan will continue to join hands with all the countries that are represented here today, and in particular with the Fund and the Bank, to find our way out of the difficulties that lie ahead, and to regain growth momentum for the world economy.

Thank you.