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

**Statement by the Honorable Toshihiko Fukui,
Governor of the Bank of Japan,
at the Joint Annual Discussion**

I Introduction

Mr. Chairman and members of the Board of Governors:

I am very pleased to have this opportunity today to address the 2003 World Bank-IMF Annual Meetings as Alternate Governor for Japan. I would like to express my gratitude to the government of the United Arab Emirates and the authorities of Dubai for hosting this year's Annual Meetings.

II The World Economic Outlook

The World Economy

I welcome the positive signs of recovery that are emerging in the world economy, and the resulting improvement in global equity markets. While due attention should continue to be paid to downside risks, such as a fall in the prices of goods and assets in some regions, I expect the world economy to continue to gradually recover in the second half of 2003, supported by policy efforts in many countries.

The Asian economy is expected to continue its strong growth thanks to the diminishing adverse impact of SARS as well as receding uncertainties surrounding the world economy. In order for Asian countries to maintain sustainable growth over the medium and long term, it is important for them to develop regional bond markets, with a view to better utilizing the region's high level of savings for long-term investments that is necessary for economic development. In this context, the Finance Ministers of ASEAN countries, China, Korea, and Japan (ASEAN + 3) agreed in August 2003 to intensify their efforts to develop regional bond markets.

With respect to emerging market economies, I am pleased to note the increasing market confidence as a result of appropriate policy management, particularly in Brazil. However, it is essential for these countries to press ahead with structural reform, including fiscal consolidation, in order to achieve sustainable economic development.

I welcome the IMF's approval on September 20th of a new arrangement with Argentina in the context of its medium-term economic program. However, Argentina

still faces many structural problems, which call for far-reaching reforms under the new IMF-supported program. It is also necessary for the Argentine authorities to proceed promptly with good-faith negotiations with a large number of external creditors under the principle of equitable treatment of all creditors.

The Japanese Economy

The Japanese economy is showing signs of recovery: stock prices are keeping a rising trend and there has been an improvement in corporate profits. According to recently released data, Japan's real GDP in the second quarter of 2003 grew by 3.9 percent in annualized terms, supported primarily by well-sustained private consumption and business investment. This was the sixth consecutive quarter of positive growth. In order to achieve sustainable growth, the government will continue to pursue structural reform in an integrated manner in such areas as regulation, the financial sector, taxation, and government expenditure.

With regard to fiscal policy, the government intends to maintain in its FY2004 Budget a restrained fiscal stance and to pursue greater prioritization and efficiency in budget allocation, taking into account Japan's difficult fiscal position. As for medium-term fiscal management, the government's goal is to achieve a primary surplus by the early 2010s through the realization of private demand-led sustainable growth and continued efforts to improve the fiscal balance. The government will also address comprehensive tax reform from a medium-term perspective, with the aim of re-invigorating society as well as the economy, and of regaining the confidence of the people.

As for the financial sector, under the "Program for Financial Revival" announced in October 2002, the government set a target of halving by end-March 2005 the major banks' nonperforming loan (NPL) ratio as of end-March 2002. Financial statements of major banks as of end-March 2003 show that progress in lowering ratio is well on track. The government has also taken rigorous measures to improve the quality of financial institutions' capital, including the bold and prompt injection of public funds into an institution whose capital adequacy ratio had fallen below the minimum regulatory requirement in order to pre-empt any financial crises. The Industrial Revitalization Corporation of Japan (IRCJ), which was established in April 2003 for the purpose of revitalizing Japan's corporate sector, is set to purchase financial institutions' loans to potentially viable firms. Recently, the IRCJ selected a few companies as the first batch of candidates to receive assistance.

The Bank of Japan (BoJ) has been providing ample liquidity to the markets under the policy framework of quantitative easing in order to help stabilize financial markets and to put an end to deflation expeditiously. Furthermore, the BoJ in July 2003 introduced a scheme whereby asset-backed securities would be purchased as part of

an effort to strengthen the transmission mechanism of monetary easing. The BoJ is firmly committed to maintaining its current policy stance until the consumer price index stably registers zero percent or above. The government, together with the BoJ, will make continued efforts to maintain the stability of the financial and capital markets as well as to overcome deflation.

III Strengthening the International Financial System

Despite the IMF's efforts in the area of crisis prevention, financial crises have occurred in a number of countries in recent years, highlighting the need to further strengthen the measures for crisis prevention and resolution.

Crisis Prevention

In the area of crisis prevention, an important issue to be addressed is the strengthening of the IMF's surveillance together with the implementation of sound policies by each country to reduce external vulnerability. I welcome the progress being made by the IMF on various fronts, including the refinements of the framework for debt sustainability analysis, and hope further steps will be taken toward strengthening surveillance. The Financial Sector Assessment Program (FSAP) is well under way, with many member countries having already completed the assessments.

The Contingent Credit Line (CCL), which was set up as a facility for crisis prevention, is due to expire at the end of November 2003. However, the need for an effective framework to prevent contagion remains unchanged. I hope that the IMF's Board of Directors will discuss and come up with effective measures for crisis prevention before the CCL expires.

Crisis Resolution

For crisis resolution, it is essential to promptly restore the debt sustainability of a country in crisis through an appropriate combination of policy adjustment, official lending from the IMF and other international financial institutions, and private sector involvement (PSI), including debt restructuring as necessary.

With regard to PSI, I welcome the introduction of collective action clauses (CACs) by a number of emerging market economies, including Brazil, South Africa, and Korea, following Mexico's lead. I also welcome the Uruguayan government's successful debt exchange using CACs in the Japanese market. I hope that other countries will follow suit in introducing effective CACs in their sovereign bond issues under foreign jurisdiction. With regard to a Code of Conduct for crisis resolution, I hope that interested parties will make further progress in the discussion of its various elements.

On the IMF's quota, it is essential that the IMF maintain a sufficient level of financial resources for effective crisis resolution. Changes in the world economy and financial markets can be abrupt and hard to predict. The IMF should therefore continue to examine quota issues and be prepared to act promptly whenever the need for a general quota increase arises. In the review of quotas, we should bear in mind that the distribution of quotas should reflect the current realities of the world economy as well as the relative position of member countries' economies.

IV Development Issues

Now, I would like to address development issues. Economic growth is certainly an essential factor to achieve sustainable poverty reduction. In this context, I welcome the fact that the developing countries have demonstrated growth that outpaces the world economy on the whole.

Recent developments leading to the achievement of the Millennium Development Goals (MDGs)

It is important for the international community to cooperate closely in aiming to achieve the Millennium Development Goals (MDGs). To move toward the goals steadily, each developing country is expected to localize the MDGs according to the circumstance it faces and then to formulate its own Poverty Reduction Strategy Paper (PRSP) designed to achieve the localized goals. As developing countries vary on many fronts, such as poverty profile, fiscal situation, and administrative capacity, it is essential for each developing country to localize the MDGs by identifying the development strategy it needs and prioritizing policies to implement it under that strategy. In this context, Japan welcomes a steady increase in the number of countries that have completed the PRSP process.

Looking at recent PRSPs, one can observe that more and more PRSPs are putting emphasis on growth-oriented policies, with the recognition that growth is essential for poverty reduction. Particularly, we welcome the fact that the World Bank has recently affirmed its commitment to infrastructure dimension. In this context, I would like to request the Bank to analyze the transmission mechanism among infrastructure, economic growth and poverty reduction. The Bank would then feed back the results of such an analysis to its future operations. I would also like to request the Bank further collaborate with the private sector in order to make more sustainable operations in areas related to infrastructure, taking account of lessons learned from the past experiences.

As the PRSP process moved up along its phases from formulation to implementation, several issues have emerged. For example, many PRSPs simply list diverse policies without prioritizing them. Some other PRSPs seem to set too ambitious goals. To address these issues, it is necessary to firmly cost out each policy in the PRSPs and incorporate them into the annual budget and the Medium-Term Expenditures Framework (MTEF), while at the same time keep the whole spectrum within the

framework of macro-economic balance and public debt sustainability. Developing countries are required to build their capacity in such areas as fiscal and public expenditure management and the World Bank is expected to strengthen support to help such efforts. Once a realistic PRSP has been formulated, the donor community including the IMF and the World Bank is expected to jointly support the PRSP by aligning its assistance with the PRSP.

To enhance the effectiveness of PRSP approach in the future, it is essential to monitor how developing countries and the donor community are playing the roles they have committed to, and to feed back its results to future PRSPs. When conducting evaluations, it is necessary to distinguish the evaluation of policies from that of the results. Japan welcomes the fact that policy evaluation now holds a central place in the internationally agreed monitoring framework.

Assistance to Policy and Human Resource Development

To enhance aid effectiveness, both the developing countries and the international community as a whole should make their own endeavors. While the former is requested to establish a prudent institutional capacity and policy environment, the latter should extend assistance to developing countries in this respect. Japan is committed to continuously making active contributions in such areas as consolidation of institutional capacity and policy environment, and capacity building of the public sector. I have the pleasure to announce here that Japan is currently preparing for the establishment of a Global Distance Learning (GDL) Center in Tokyo. To be connected with the other GDL centers in the Asia Pacific Region via satellite, the new facility should be able to provide such interactive services as remote training and policy dialogues. Japan will continue working with the World Bank to inaugurate the Center in the spring of next year.

Reconstruction Assistance to Iraq, Afghanistan, and Sri Lanka

Regarding countries suffering from conflicts, it is essential to promote human security as well as to extend assistance in development dimension such as consolidating peace and building basic foundations.

Stability and reconstruction of Iraq is important. As a member of the international community, Japan pledged a total of USD 100 million in humanitarian assistance, and to date has already extended or decided to extend some USD 86 million of assistance. One of the key challenges that lie ahead is to make the October international donors conference in Madrid a success. Japan is also committed to make efforts in this direction. The situation in Afghanistan also deserves the attention of the international community. In this sense, it was high time that the Afghanistan Development Forum was held here in Dubai. As host to the International Conference on Reconstruction Assistance to Afghanistan in January 2002, Japan will continue to be actively engaged in supporting Afghanistan through the “DDR process” (the process of disarmament,

demobilization and reintegration of the former combatants), “Ogata Initiative” (a comprehensive development plan for priority regions in Afghanistan), and assistance to reconstruct roads. Consolidating peace in Sri Lanka is also essential. For its part, Japan hosted the Tokyo Conference on Reconstruction and Development of Sri Lanka this past June. At the Conference, Japan expressed its intention to extend assistance of up to USD 1 billion for the coming three years, subject to the evolution of the peace process in the country.

The 3rd Tokyo International Conference on African Development (TICAD III)

Japan has been promoting the TICAD process since 1993. As such, its assistance to African countries has been articulated based upon the spirit of the process, which is to enhance both Africa’s ownership and partnership of the international community. This spirit, is echoed in the “New Partnership for Africa’s Development” (NEPAD). I have the pleasure to note that the third meeting of TICAD will be held in Tokyo next week, at the juncture of the 10th year since the process was inaugurated. I hope that an active discussion will take place to further consolidate and enlarge the partnership of the international community towards NEPAD.

ODA Charter

Next, I would like to inform you that the Japanese Government has recently revised its “ODA Charter”. In the new Charter, strengthening partnerships and collaborating with international organizations are placed as one of the key principles, and poverty reduction is held up as one of the priority goals. Japan intends to continue supporting the PRSPs based upon the principles set out in the Charter. Furthermore, the new Charter stipulates that Japan will enhance policy dialogues with developing countries, paying due attention to their institutional environment and policy capacity, while also reflecting the results of ex-post assessments of development assistance to future ODA policy. We hope that these attempts will lead to further enhancement of aid effectiveness.

There is no change in the importance given to the comparability of development and environmental dimensions in the new ODA Charter. In this respect, the Japan Bank for International Cooperation (JBIC) will put into place its new Environmental Guidelines effective this October. The new Guidelines will introduce, among others, a procedure allowing the complainant to place formal objections. Japan International Cooperation Agency (JICA), for its part, is currently working to revise its guidelines for environmental and social safeguards before the end of this fiscal year. I strongly hope that many countries will follow their lead in order to achieve more sustainable development of the international community, especially in developing countries.

V Measures Against the Financing of Terrorism

The threat of terrorism remains serious. It is therefore important for the international community to strengthen measures to combat the financing of terrorism. From this standpoint, I welcome the revision of the 40 recommendations of the Financial Action Task Force (FATF). The revised recommendations have set a new international standard in the fight against money laundering and terrorist financing. I also welcome the substantial progress in the assessments of member countries' compliance with the AML/CFT (anti-money laundering and combating the financing of terrorism) standard in the context of a 12-month pilot program by the IMF and the World Bank.

Based on the results of these assessments, technical assistance should be provided to help countries implement the AML/CFT measures. Japan will continue to contribute to such assistance based on the needs of recipient countries.

VI Conclusion

More than six years have passed since the outbreak of the Asian financial crisis. I welcome the progress that the World Bank and the IMF have made towards improving various aspects of their work. In spite of such efforts, however, countries in different regions have experienced economic crises. I would therefore like to conclude my remarks by expressing my sincere hope that the World Bank and the IMF will further strengthen their efforts toward crisis prevention and resolution.

