

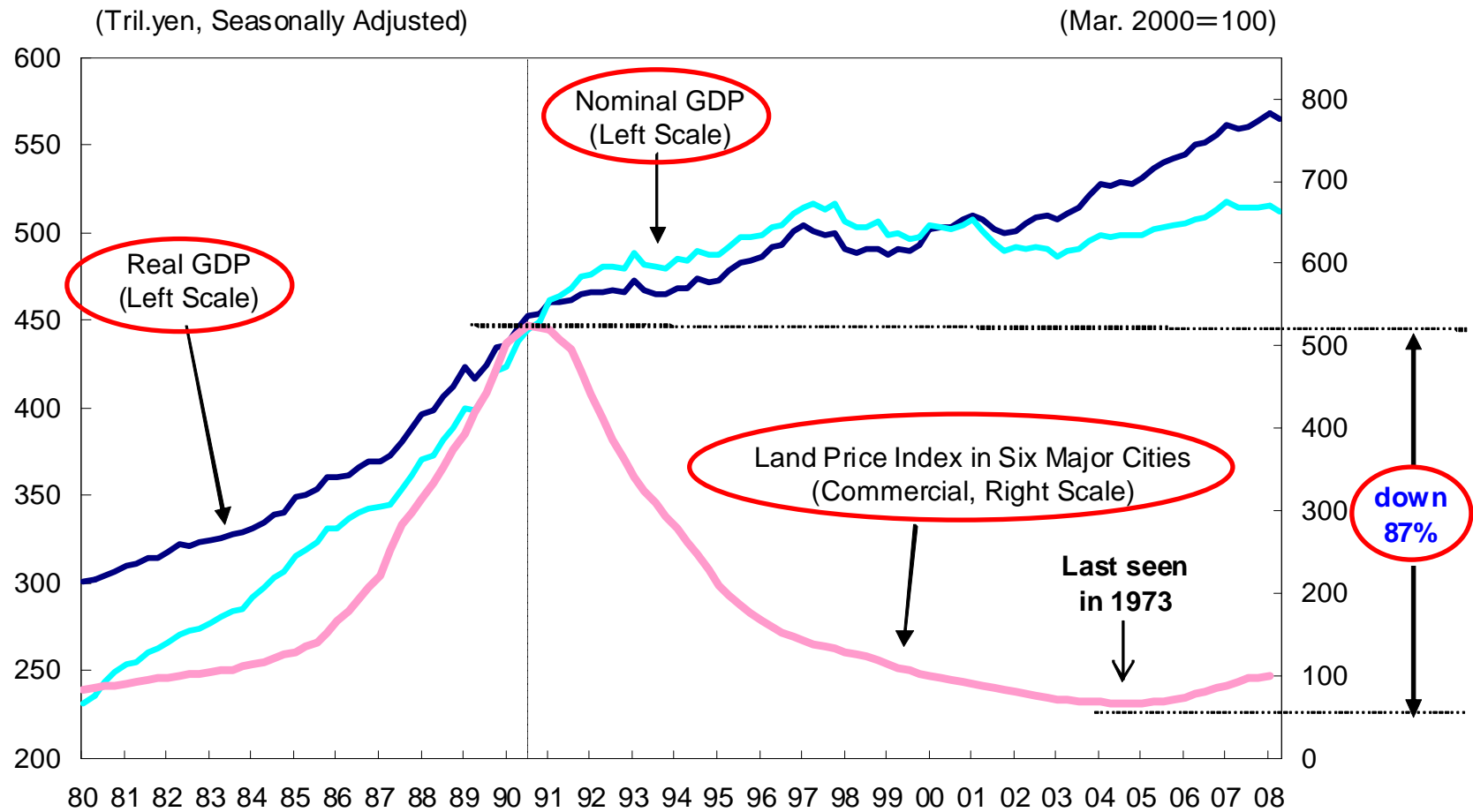
November 15, 2008

OVERCOMING THE CURRENT CRISIS

Taro Aso's proposals
for the short, mid- and long terms

Japan's Experience

—Japan's GDP Grew even after Massive Decline of Asset Prices and Private Sector Rushing to Pay Down Debt—



Sources: Cabinet Office, Japan Real Estate Institute

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(Summary)

International collaboration is necessary to overcome the current financial crisis.
Short term : Removal of the non-performing loans (NPLs), etc
Mid-term : Policies to improve the global imbalance, strengthening the function of International Monetary Fund (IMF), etc.
Long term : Maintaining the Stability of the dollar-based currency system, regional economic cooperation

Root cause of the problem

Ensuring the stability of financial and capital markets is the first priority of economic policy today. A major cause of the current financial crisis is the failure of supervision and regulation conducted by various individual governments to keep up with the innovation and globalization of financial products. We should not forget, however, that at the root of this problem lies the issue of global imbalances, i.e. that the deficit of the U.S., the key-currency country, is being financed by capital inflows from around the world.

International collaboration to prevent financial crises

It is evident that competition and capital flows based on free market principles shall continue to serve as the basis of growth. At present, capital flows have become so global that they could instantaneously take advantage of any differences that may exist among the regulations of different countries. In this situation, concerted actions to make the policy efforts of various countries converge in order to prevent the recurrence of financial crises has now become an unavoidable challenge.

1. Short-term policies to stabilize financial markets

- (a) Fair valuation, early disclosure of NPLs based on reliable standards, and removal of those loans from balance sheets

- (b) Capital injections into banks using public funds, while ensuring that a mechanism for providing sufficient credit is in place and limiting the extent of management responsibility
- (c) An integrated approach to the disposal of NPLs of financial institutions and the elimination of excessive debt among borrower companies
- (d) Supply of liquidity from central banks, in particular smooth and ample supply of US dollar liquidity, and development of an intra-regional dollar supply mechanism

2. Mid-term policies to prevent a financial crisis

(1) Improvement of the global imbalances issue

Policies to rein in consumption in countries with excessive levels of consumption and dependence on borrowing; transition to self-sustaining, domestic demand-led growth models in countries with heavy dependence on external demand.

(2) Reforms of the IFIs

- (a) Improving the IMF's role in monitoring movements in financial markets, or its early-warning functions to detect financial and economic crises at an early time.
- (b) I propose that the Fund's financial resources be doubled in order for the IMF to extend necessary assistance to emerging economies that are expected to continue their roles as drivers of global growth. Japan is prepared to lend a maximum of USD 100 billion to the IMF from its Foreign Exchange Fund Special Account, as an interim measure before a capital increase in the IMF takes place.
- (c) International developmental financial institutions should also play an active role. In particular, a general capital increase should be implemented at an early stage for the Asian Development Bank, which currently has limited room for new lending.
- (d) I propose a review of governance structures (quota shares and share of voting rights) of the IMF, the World Bank, as well as regulatory and supervisory international forum in order to reflect properly the economic realities of the world today.

(3) Others

- (a) The Financial Stability Forum (FSF), which is an assembly of the financial supervisory authorities, fiscal authorities and central bankers of various countries, should be given a clear status above those of sectoral standard-setting international institutions such as the Basel Committee. Its functions and joint work with the IMF should be reinforced, and it should be restructured to include the membership of emerging economies.
- (b) While work aiming to converge the accounting standards of various countries is being conducted with the International Accounting Standards Board at the center, government authorities, companies, investors and others should be involved in this work so that objectives and a fair set of standards are prepared expeditiously.
- (c) Rules which are self-imposed by rating agencies are being tightened, mainly through the International Organization of Securities Commissions (IOSCO). I propose that discussions be held with a view to giving legal authority to the authorities of various countries.
- (d) Nurturing local credit rating agencies in each region in addition to global agencies is also important for the development of regional bond markets.

3. The international monetary system over the long term

- (a) It has been raised whether or not the US dollar-based international monetary system will maintain stability into the future despite current changes in the U.S. global economic standing, and the fact that the U.S. is the world's largest debtor nation. However, we should be making efforts to support the dollar-based currency system, on which the current international economic and financial systems rely.
- (b) At the same time, it is important for each region to move forward with regional economic cooperation in the areas of both trade and finance. Regional cooperation, which is open to countries outside the region, complements globalism in a positive sense.