

THIRD APEC FINANCE MINISTERS MEETING

**Kyoto, Japan,
17 March 1996**

JOINT MINISTERIAL STATEMENT

1. We, the APEC Finance Ministers, met in Kyoto, Japan, to discuss broad economic challenges facing the region, including the pursuit of regional growth in the context of macroeconomic and financial stability. This is the third meeting since the APEC Economic Leaders called for our consultations at their meeting in 1993. The Economic Leaders urged a continuation of our consultations at their meeting in Osaka in November 1995. We are committed to doing our part to support the Leaders' goal of promoting the free flow of goods, services and capital in the region.
2. We exchanged views on four topics: current macroeconomic issues, financial and capital markets, mobilizing resources for infrastructure development, and the effects of exchange rate movements on trade and investment. The Managing Director of the International Monetary Fund (IMF) joined our discussion of macroeconomic issues. The IMF, the International Finance Corporation, the Asian Development Bank (ADB) and the APEC Financiers made valuable contributions in the preparatory process for our discussions.
3. As a result of our discussion, we made the Findings attached to this Statement and agreed on several initiatives in critical areas. The APEC Finance Ministers' Findings, Kyoto 1996, will broadly guide our voluntary efforts in pursuing key policy objectives of stable capital flows, domestic financial and capital market development, and mobilizing private resources for infrastructure development.

Current Macroeconomic Issues

4. The pace of economic growth in the APEC region continues to be stronger than that of other regions. Particularly noteworthy is the strong growth in most of the emerging economies in the region. Increases in intra-regional trade and foreign and domestic investment are both robust. Where there is potential overheating, policymakers need to respond appropriately by a mix of restrained macroeconomic policies. We believe that maintaining the good record of economies in the region for fiscal prudence should go hand in hand with the effective responses to social needs in our economies.
5. Under the circumstance of sustained growth, the trade volumes in the APEC region are estimated to have expanded significantly last year. The growth of intra-regional trade exceeded that of overall trade. Although there had been a large fluctuation in exchange rates which did not reflect economic fundamentals, the process of orderly reversal began in the summer last year. We welcome this development.
6. Capital flows into regional emerging markets have generally resumed in 1995, after market disturbances in the first part of the year. This fact indicates that continued strong economic performance backed by prudent macroeconomic policies was rewarded by favorable response of financial and capital markets. We renewed our common recognition of the significance of sound macroeconomic policies in contributing to stable capital flows and exchange rates, and ensuring sustainability of the dynamic development in the region.

Financial and Capital Markets

7. A key factor affecting recent international capital flows has been the progressive integration of emerging markets into the global financial and capital markets. Capital can be expected to continue to flow into emerging markets over the longer term and benefit these economies. We observed that, generally, capital flows to APEC economies have made a significant contribution to growth in these economies. Capital flows were primarily driven by sound domestic economic policies and favorable economic conditions.

8. At the same time, we recognized that there are clearly macroeconomic and financial risks, especially if flows reflect distorted incentives or unsustainable imbalances. We noted that vigorous efforts have been made in the international fora to properly address potential financial problems, following disturbances in global financial markets last year. We welcome the efforts of the IMF in establishing the Emergency Financing Mechanism which would strengthen the ability of the IMF to respond rapidly in support of members facing a crisis, as well as the on-going work to develop financing arrangements to double the amount currently available under the General Arrangements to Borrow (GAB). We also welcome that work will be going forward on the eleventh review of IMF quotas, including appropriate adjustments to take into account changes in the relative position of members' economies, to ensure that the IMF has sufficient ordinary resources for future operations.
9. Policies contributing to stable capital flows and fostering domestic financial and capital market development are of particular importance for us. In this context, we identified three broad policy priorities: 1) maintaining an appropriate macroeconomic policy mix; 2) promoting high savings rates and restraints on public sector borrowing as essential factors in good debt management; and 3) fostering further development and integration of capital markets to intermediate savings effectively and expand the array of investment options available to include some with longer maturities. If properly managed, market risks need not diminish the substantial benefits that come with increased access to international capital.
10. We recall that we urged last year that recommendations be developed on increasing the public availability of economic and financial information. We welcome the efforts currently underway in the IMF to develop a more demanding public disclosure standard for economies participating in international financial markets. We call for an endorsement on this issue to be made at the April Interim Committee and pledge our efforts to work toward early implementation of the standard.
11. We also endorse the objective of achieving prudential supervision and regulation of financial markets in conformity with the international standards and encourage the deepening of cooperation among regulators in the region concerning the development of regulatory principles and practice, and enhanced market surveillance. We intend to review these cooperative efforts at our next meeting.
12. We continue to recognize money laundering as a priority concern and one which could threaten legitimate institutions and economic policies. We endorse established international cooperative work and encourage adherence to international standards in the anti-money laundering field as well as on-going regional efforts including the one on the context of Financial Action Task Force toward enhanced cooperation in this area. We will be briefed regularly on the progress made toward improved international and regional cooperation.

Mobilizing Resources for Infrastructure Development

13. Dynamic economic development will continue in the region in the medium term and generate huge demand for infrastructure development. There is a compelling need to mobilize private resources and to achieve coordination of public and private resources for infrastructure development. We noted that the public sector has increasingly assumed a role as facilitator, whereas the private sector has assumed a more prominent role in provision of infrastructure services. Private resources often have the advantage of increased efficiency. We concluded that it is desirable to mobilize private resources in fields where the market mechanism can better achieve efficient provision and operation of infrastructure.
14. To this end, the development of financing techniques which channel private savings to investment in infrastructure is critically important. Particularly noteworthy is the need to deepen and broaden domestic capital markets, in order to improve the mobilization of domestic savings and better accommodate huge infrastructure investment requirements in the APEC region.
15. Prudent macroeconomic management and, in many cases, regulatory and institutional changes are also necessary to attract private investment in infrastructure development. The International Financial Institutions (IFIs) are expected to play a vital role in catalyzing sectoral reforms

and private investment. We recognize that the IFIs should be provided with necessary support and adequate resources to enable them to fulfill their roles.

Effects of Exchange Rate Movement on Trade and Investment

16. Short-run nominal exchange rates are affected by such a wide range of factors that it is extremely difficult to find one model that adequately explains their movements. In the longer-run, however, it is possible to discern trends. In particular, nominal exchange rates tend to move broadly in parallel with ratios of national price levels. Given that this relationship does not always hold in the short-run, real exchange rates can deviate from their long-run trends.
17. We observed that in general, there are two types of deviations from long-term trend: volatility, or a temporary deviation of real rates from trends that is quickly reversed; and a deviation that tends to persist over months or years. While volatility is, more or less, a feature of asset market prices, persistent deviation, on the other hand, is more likely associated with policy-induced imbalances (misalignment) or medium-run changes of terms of trade. In this regard, it should be noted that it is very difficult to identify ex-ante whether a particular currency movement should be characterized as either temporary or persistent.
18. We noted the finding of various studies that the weight of evidence points to a relatively small direct effect of short-term exchange rate volatility on trade. In contrast, medium-term deviations in the real exchange rate do have significant effects on trade. Increased foreign direct investment inflows may follow a depreciation if the new level of exchange rate is viewed as sustainable.
19. We stress that in order to address real exchange rate misalignment, the key role for policymakers is to put in place sound macroeconomic policies. Such policies need to control inflation and address both internal and external balances in accordance with the macroeconomic needs of each economy. Prudent macroeconomic policies will benefit not only the adopting economy but all other APEC economies through improved stability in economic and financial inter-relationships.
20. In this connection, we express our support for the IMF's efforts towards enhancing multilateral surveillance and welcome the on-going initiatives for enhancing cooperation among monetary authorities in the APEC region.

Other Issues

21. Tax issues are important in the context of the development of international trade and investment within the APEC region. In this regard, we support the Australian initiative to hold a symposium on international business taxation issues in cooperation with the OECD. Further progress in concluding bilateral tax treaties in the region will also facilitate trade and investment linkages.
22. We remain resolved to contribute to the overall APEC effort to pursue trade and investment liberalization and facilitation. In particular, as many of us have responsibility for customs matters, we welcome the tangible achievements of harmonizing and simplifying customs procedures included in the Osaka Action Agenda. We encourage our customs authorities to continue their efforts through steadily implementing their action program, with appropriate technical assistance.

Future Meetings and Activities

23. In order to advance our discussion, we ask the Working Group, in conjunction with its work on macroeconomic and exchange rate issues, to undertake a regional effort to share experiences on policies, reforms, liberalizing measures, and other actions which will be taken in line with the APEC Finance Ministers' Findings, Kyoto 1996 to promote financial and capital market development and facilitate private financing for infrastructure development. This sharing of experience will help us to identify the most successful policies and strategies. We call on the ADB to continue to provide useful input to support this effort.
24. We also commission the Working Group to develop a framework for establishing a computerized communication network among our Finance Ministries to facilitate the improved information sharing about macroeconomic and financial developments and policies.

25. The report by the APEC Financiers added valuable insights to our deliberation on the issues of public information disclosure and infrastructure development. We encourage them to continue their efforts.
26. We express our appreciation for the hospitality extended by Japan. We look forward to meeting again next year in the Philippines and hope to continue our consultations on macroeconomic issues, financial and capital markets, mobilizing resources for infrastructure development, and exchange rate movements.
27. Finally, we will report to the APEC Economic Leaders again on the activities of the APEC Finance Ministers Meeting, on the occasion of their next meeting this year in the Philippines.

APEC Finance Ministers' Findings, Kyoto 1996

The following Findings are relevant common points, which emerged after deliberations on the three key policy issues of stable capital flows, domestic financial and capital market development, and mobilizing private resources for infrastructure development. The Findings are intended to broadly guide each APEC member's voluntary efforts to strengthen its economic and financial conditions.

Financial and Capital Markets

Policies Contributing to Stable Capital Flows

- 1) Capital inflows supported by sound economic policies along with financial and capital market development have contributed significantly to overall regional economic growth.
- 2) There are macroeconomic and financial risks associated with large and abnormal capital inflows, especially if these flows reflect distorted incentives or unsustainable imbalances.
- 3) If properly managed, such risks need not diminish the substantial benefits that come with increased access to international capital in any significant way.
- 4) It is important that every effort be made to ensure that sound economic conditions prevail. A set of economic conditions which each APEC member economy would aspire to achieve or maintain includes: non-inflationary growth, fiscal prudence, sustainable external balance and appropriately valued exchange rate, and deep and broad financial and capital markets.
- 5) Managing the macroeconomic effects of large capital inflows requires flexible implementation of appropriate and feasible mix of several policy options: including intervention with sterilization, other forms of monetary control, fiscal restraint, and suitable exchange rate regime.
- 6) High savings rates and restraints on public sector borrowing have been critical factors in successful debt management in much of the region.
- 7) Further capital market development must be a priority to intermediate these domestic savings effectively and to expand the array of investment options available to both domestic and foreign investors, including assets with longer maturities.
- 8) Effective prudential regulation and supervision can play an important role in promoting business behavior which avoids putting banks' balance sheets at risk, for example, during periods of large and abnormal capital inflows.
- 9) The regional experience with capital controls is too diverse to provide definitive assessment. But in any case, controls impose economic costs, and should not be viewed as a substitute for sound macroeconomic policies, strong prudential regulation and supervision, and an active effort to promote capital market development. Limiting the duration of controls and acceleration of liberalization efforts are generally desirable.

Policies Fostering Domestic Financial and Capital Market Development

- 1) Active and healthy financial and capital markets need to be developed for further advancement of APEC economies. Toward this end, market-oriented policies which promote domestic savings and expand domestic investor base should be pursued.
- 2) In determining how to promote the development of domestic markets, policymakers can benefit from communication with the private sector and with officials from other APEC economies.

- 3) The International Financial Institutions (IFIs) including the International Finance Corporation and the Asian Development Bank have been actively involved in capital market development in developing economies in the region. They can continue to play an important role in fostering sound growth of capital markets of the APEC region.
- 4) Policymakers should consider: establishing a legal and regulatory framework which fosters disclosure and competition based on market conditions, and clearly defines the roles of various institutions; taking actions which promote both the demand for, and supply of, assets for investment, especially institutional investment; educating the public about savings options and necessary points for consideration; and enabling expertise and developing human resources.
- 5) Regulatory and supervisory policies should be pursued to ensure fairness, efficiency and investor protection in the markets. Liberalization and prudential regulations complement one another.

Mobilizing Resources for Infrastructure Development

- 1) There is a compelling need to mobilize private resources. The public sector has increasingly assumed a role as facilitator, whereas the private sector has assumed a more prominent role in provision of infrastructure services.
- 2) In exploring areas where the private sector could play further role, such factors need to be considered: technological advances, advancements in knowledge and experience, sensitivity to the potential macroeconomic consequences of public financing, and the efficiency and dynamism of the private sector.
- 3) Private resources often have the advantage of increased efficiency. It is desirable to mobilize private resources in fields where the market mechanism can better achieve efficient provision and operation of infrastructure.
- 4) The development of financing techniques which channel private savings to investment in infrastructure is critically important.
- 5) Particularly noteworthy is the need to deepen and broaden domestic capital markets, in order to improve the mobilization of domestic savings and better accommodate huge infrastructure investment requirements in the APEC region.
- 6) Prudent macroeconomic management and, in many cases, regulatory and institutional changes are necessary to attract private investments in infrastructure development.
- 7) The authorities of recipient economies have a responsibility for improving the domestic business environment through, inter alia, improving infrastructure planning and coordination, establishing simplified and more transparent procedures for private sector participation, privatizing or restructuring state-owned firms, promoting domestic financial markets, and providing the appropriate regulatory and legal frameworks. An improved business environment will facilitate promotion of private sector investments including foreign direct investments.
- 8) The IFIs are expected to play a vital role in catalyzing sectoral reforms and private investment by providing technical assistance to host economies, and through complementary financing schemes and guarantee facilities. The IFIs should be provided with necessary support and adequate resources to enable them to fulfill their roles.