

NLI RESEARCH INSTITUTE 10TH ANNIVERSARY SYMPOSIUM

October 13, 1998

Imperial Hotel, Tokyo

THEME: Japan's Role in the International Community

MODERATOR (Inoue, NLI Research Institute):

Ladies and gentlemen, I would like to open the NLI Research Institute Symposium. My name is Inoue of NLI Research Institute, and I will be acting as the moderator, and your kind cooperation will be very much appreciated.

Before opening the substantive part of the symposium, I would like to ask Mr. Masada, President of our Institute, to extend his greetings.

PRESIDENT FUMIO MASADA (NLI Research Institute):

Good afternoon, ladies and gentlemen. I am Masada of NLI Research Institute.

Thank you, indeed, very much for taking time to participate in this symposium. We are delighted to see so many of you having decided to join us here today.

Our Research Institute was established to commemorate the centennial of the foundation of Nippon Life, and we are pleased to be able to commemorate or celebrate

our tenth anniversary. We owe this tenth anniversary to the generous support extended by you over the years, and availing myself of this opportunity I would like to express my sincere gratitude to you for your support and guidance over the years.

Currently we have some ninety research fellows in our institute. The institute has grown rather substantially, and the Research Institute is engaged in various active activities putting forward recommendations in different spheres. The outcome of daily research has even published through the NLI Research Institute Report or NLI Research Institute Bulletins and other regular publications, and some are reported through monograms, books or through web site on the Internet.

This year, since we are celebrating the tenth anniversary, we have compiled the compendium of research entitled Perspectives on Social Security in the 21st Century, focusing on the social security matters which are attracting a lot of attention because of the aging of the society.

Furthermore, our Chairman Mr. Hosomi also authored a book entitled Wake Up, Japan, and both of these books have been distributed to you today, and I would appreciate it if you spare some of your time to read through these two books at your leisure.

Today's symposium has the theme "Japan's Role in the International Community". This is actually the eleventh symposium organized by our institute. We had the pleasure of having Dr. Henry Kissinger for our first symposium, and we are delighted to see that we have been able to hold this eleventh symposium.

We have the good fortune of our having our keynote speaker today, Mr. Bill Emmott, the Chief Editor of The Economist of London, and he will be delivering the keynote address titled "Japan's Attractiveness and International Harmony" or "Japan Amidst the Gathering Storm".

He is the author of *The Sun Also Sets*, which was published in 1989, and he foresaw what we are experiencing today earlier on, and I'm sure we will be able to benefit from a very informative keynote address underpinned by his extensive experience and piercing insight.

As panelists we have Professor Yoshiaki Abe of the Institute of Asia-Pacific Studies at Waseda University; Mr. Glen Fukushima, President of ACCJ; and, furthermore, another figure who is well known to you through Japanese newspaper reporting, that is Dr. Eisuke Sakakibara, Vice Minister for International Affairs of the Ministry of Finance, and our Chairman Mr. Hosomi will be acting as the Coordinator for this symposium.

Japan has been thrown into a very serious situation. Can Japan be resuscitated as an attractive country? What kind of role can Japan play for the sake of the Asian economies while keeping harmony with the international community? From diverse perspectives, from political, economic and cultural, I'm sure we'll benefit from in depth discussion amongst panel members.

With these brief remarks of appreciation as well as request for your continued generous support for our Research Institute going forward, I would like to conclude my greetings representing the organizer today. Thank you very much for your attention and for your attendance.

MODERATOR: Thank you, Mr. Masada. Now we would like to move into the substantive part of the symposium. The theme is "Japan's Role in the International Community" and "Japan's Attractiveness and International Harmony."

Today's symposium is in two parts, keynote address and panel discussion. I believe distributed to you is a question sheet. If you have any questions addressing either the keynote speaker or panel members, since the Secretariat staff will be passing by you, please hand them to them.

First, it's a pleasure for me to introduce Mr. Bill Emmott, the Chief Editor of The Economist of London. I'm sure you are fully aware of his personal history but, nonetheless, let me briefly introduce him to you.

Mr. Bill Emmott was born in London, UK, graduated from Magdalen College, Oxford, and in 1980 he joined The Economist of London. After his service in the Brussels Bureau as well as the London Office in charge of economics, he became chief of the Tokyo Bureau.

In 1986 he returned to London where he took up the charge of the finance sector, and having served as editor for the business department of The Economist in 1993 he became Chief Editor of The Economist.

Now, may I introduce Mr. Bill Emmott to you.

KEYNOTE ADDRESS BY MR. BILL EMMOTT, EDITOR, THE ECONOMIST

Good afternoon, ladies and gentlemen, and thank you very much for giving so much time from your busy schedules to come here to listen to me and to the panel discussion, and thank you also for being so tolerant of me speaking in English during this afternoon's symposium.

It is a great honor to be invited by NLI Research Institute, and especially by my old friend Hosomi-san, to address this prestigious gathering. I have been discussing Japan's economic situation with Hosomi-san regularly for more than twelve years now, always with great benefit, certainly to my own knowledge and understanding, and I am delighted to again have an opportunity to continue our discussion.

It is a cliché, or a commonplace, to say that so many things have changed over those twelve years. One of the biggest changes, and one of the changes that is most often commented upon these days, is the change in the image held abroad, and in Japan itself, about Japan and, in particular, about its economy.

Twelve years ago this image of Japan was dominated by admiration on the part of some outsiders. That admiration was also affected by envy, and sometimes even by fear, but, above all, Japan was admired. It was becoming an economic superpower. The normal refrain went: It would only be a matter of time before it became a political superpower, too.

Now, as you know all too well, the image is completely different. Very strongly abroad, and also quite strongly here in Japan, Japan's economy is considered to be dangerously weak. Macro economic management in Japan is viewed sometimes with pity, often with disappointment, sometimes even with a certain amount of contempt.

The image held in the mid-1980s, when I was a correspondent in Tokyo, contained a lot of elements of exaggeration, elements that grew and grew and became more exaggerated as the decade became older, and we now know, with the bursting of the bubble economy, that Japan was not quite as perfect or as strong as it often seemed.

But it is also true that the image that is held today about Japan contains a lot of exaggeration. In future, I believe, and I hope, that it will become realized that Japan in 1998 was neither as flawed nor as weak as it seemed. Yet, just as the exaggerated view of the 1980s was dangerous at the time because it made a protectionist anti-Japanese backlash likelier, so the exaggerated view that is held today is also dangerous. Indeed, it may even be more dangerous than the exaggerations of the 1980s because this view, this exaggerated view, is being held in a world climate that is itself far more fragile and dangerous than was that of the 1980s.

So, let me risk giving what may turn out to be my own exaggerated description of this exaggerated view of Japan. I have to simplify, and so I will offer a caricature of this outside view, but my caricature is not far from a fair summary of what seems to be widely believed.

To many people outside Japan, and by that I do not just mean inside the beltway of Washington, DC, today's dominant view is that Japan is a sick economy that is sinking into depression and a sick economy that is dragging the rest of East Asia down with it.

Moreover, it is seen as a sick economy in which politicians are too preoccupied with their own squabbles to take the actions that are necessary to rescue the economy and in which the bureaucracy is too discredited or too incompetent or too corrupt to initiate the rescue themselves.

This view is of a Japan that is apparently harming the rest of the world through its inaction but a Japan that still does not really seem to care very much about the harm that it is doing.

Now, some elements of this view are fair but, taken as a whole, it is, in my view, wrong. Let me stress that point again. This view, taken as a whole, is wrong, and I do not hold it, certainly not in this very exaggerated form. But the fact that this view is widely held is itself important and does have an influence on policy towards Japan now and possibly in the future.

This exaggerated view is wrong for two main reasons. The first is that, in my opinion, it exaggerates the troubles in Japan's economy. The share of Japan is in recession, but a short term drop in output and spending is certainly not the same as a depression. That word "depression" gets used far too easily these days.

A truer summary of Japan's past few years is that a once excellent performer has turned into a somewhat disappointing mediocrity, thanks to the disaster in its financial system, combined with some overinvestment and poor management decisions, and it has, indeed, taken far too long for politicians to wake up to the magnitude of those problems and officials, too, have tried to evade the problems rather than to deal directly with them.

As I said recently on the cover page of my own magazine, *The Economist*, Japan now exhibits what I said in quotations was "an amazing ability to disappoint". It is amazing because in the past we felt that Japan was so efficient, so decisive and so effective, disappointing because each apparent effort to produce a reform plan for the financial system or the economy seems to end in collapse or delay or, on closer examination, the plan turns out to be rather less impressive than it first seemed.

And, yet, despite all that, despite those harsh words, I remain an admirer for all this amazement and disappointment. What one has to remember is that this new Japanese mediocrity, by comparison with the past, is a rich mediocrity with low unemployment and low levels of poverty and with many world class products, services and companies.

Certainly, things could get worse in the Japanese economy, but they would have to get a lot worse than they are now before Japan would really look as if it was in an economic crisis worth that name. Japan could, indeed, sink into the much forecast spiral of deflation and depression.

But I don't think that seems likely today, and it's worth saying that such a disaster could really only happen because of new quite severe policy mistakes by the authorities. In a country as strong and rich as Japan, a depression does not simply happen of its own volition, by its own actions. It takes mistakes to create a depression, and the question for the future is whether those mistakes will actually be made.

The second reason why the common consensus exaggerated view is wrong is that, in my opinion, it completely misunderstands the relationship between East Asia's difficulties and those of Japan, for if East Asia's economic crisis had not erupted in the summer of 1997 Japan would probably not be in a recession today at all. By now, it would have been several months into something of an economic recovery. The troubles of the financial system would still have been gigantic but they would have looked more manageable than they do now and, bit by bit, they would have been diminishing.

The Finance Ministry's strategy of playing down the problems of reforming slowly, of relying on new competition to restore the financial system to help over a five-year or longer period, would have looked at least respectable. For many people it would have seemed too slow and too risky but, nevertheless, by now it could well have been looking fairly successful. Things in the economy would have been getting better. Criticism by outsiders many thousands of miles away, like myself, would have looked perfectionist and out of date and out of touch.

The collapse in East Asia last summer changed all that. It cut demand for exports, it added to Japanese banks' bad debts, it hit consumer confidence, and all this

happened at the worst possible time.

This was bad luck for Prime Minister Hashimoto and bad luck for the finance minister. I think the ministry and Mr. Hashimoto can be blamed and criticized for reforming things too slowly, as I said before, and, therefore, for leaving Japan vulnerable to such a shock to a stroke of bad luck as happened.

But it must be recognized that the direction of causation was from East Asia to Japan, and not the other way around. Japan, after all, had nothing to do with the collapses in Thailand, Indonesia and South Korea. It was their victim, not their villain.

Contrary to the consensus view that Japan is, in some way, responsible for Asia's problems, the truth is that, in large part, Asia is responsible for Japan's most recent problems. The only way in which Japan can intelligently be said to have made East Asia's troubles worse arises only because of the things that Japan could not do. It could not rescue Thailand, Indonesia or South Korea by lending them huge sums of money or by buying increased quantities of their imports.

It did play a leading role in the international rescue packages for Indonesia and others contributing a lot of money, but if it had been in a stronger position itself it could have probably have done more, taken more of an initiative.

I don't, of course, believe that Japan could have averted the crisis altogether, but it might well have been able to have more of a moderating influence than it was able to.

I think it is a pity that Japan was unable to play this role in 1997 and this year in 1998, and that lost opportunity is the real loss imposed on Japan by itself by virtue of the disappointing decade of the 1990s. The East Asian crisis represents a great missed opportunity for Japan to take a leadership role in the region and to cement its relationship with its neighbors as a friendly, supportive, peaceful power. It represents a missed opportunity for Japan which could, for once, have been ahead of the United States in

regional affairs in Asia and could perhaps have shown some greater attractiveness relative to China but in a friendly non-confrontational way.

Once again, this was a pity, but this is now just a fact of life and of history. The important question facing us all, and the one about which we must think and discuss today, is how Japan will now shape up during the next few years of East Asia's economic and political turmoil and, possibly, economic and political turmoil in the world as a whole, and whether it will be able in future to grab opportunities that may well arise to improve its international position and image, and whether it will be able to avoid dangers that may well arise during this period.

None of us can know what East Asia's future will hold. All we can do is to understand, or try to understand, what is the range of possible outcomes or, at least, the most plausible range of such outcomes, and I think that for the present purpose the most important thing is to understand what are the worst possible or plausible outcomes for the region, for it is such bad outcomes that would have the biggest potential impact on Japan and would pose it the biggest challenges as well, perhaps, of offering it the greatest future opportunities.

Indeed, as I argued a moment ago, the main policy mistake of 1997 was the failure to take into account the possibility of a worst external environment than had previously existed and had previously been expected. This was understandable given that no one expected such a widespread disaster in East Asia as has happened. But it is not a mistake that should now be repeated.

I am, in fact, or, unfortunately, personally quite pessimistic about the way in which the East Asian and broader external environment may develop in the next few months and years. I hope that I am wrong in this pessimism, but I hope also that these pessimistic signs are being taken account of here in Tokyo and elsewhere.

The economics of the crisis in East Asia have been so striking that it is not

surprising that economics has grabbed most of the attention. Countries are suffering annual falls in GDP of 5 percent, to even possibly 20 percent in Indonesia's case this year. The current account of the balance of payments of several countries is altering from deficit to surplus by as much as 15 to 20 percent of GDP in barely a year. Unemployment is rising rapidly. Export volumes, too, have begun to recover, but only slowly. The overhangs of debt in the corporate sector remain huge.

My feeling, however, is that to look solely at the economics of East Asia is seriously to underestimate the magnitude of what is happening in the world today and what might happen in the fairly near future. I think this for two main reasons.

The first is that, in economic terms, the most important question is now not the fortunes of East Asia, on which we have been spending so much attention and time, but, rather, the economic fortune of the United States of America. It is everyone's biggest market and is, in many ways, the financial leader of the world.

Up to now, the United States has been fairly well insulated from the Asian crisis, but in the past two months this has begun to change, and change rapidly. If economic growth in the United States remains healthy and the turbulence in equity and bond markets does not, in fact, turn into a domestic credit crunch and a sharp drop in consumer spending in America, then it can be said that the prospects for Asia will look fairly calm or benign in economic terms.

But if these much worse outcomes do happen in the United States, a domestic credit crunch, a sharp drop in consumer spending driven by the meltdown which we see in so much of financial markets at the moment, then, I'm afraid, this will mean that Asia's recession is going to be much longer and further aggravated than would otherwise have been the case.

The second reason for looking beyond economics in East Asia is that within the region many of the biggest long term questions are really political rather than economic.

True, these questions, these political questions, arise because of the economic crisis and because of the effect of that crisis on national and regional politics.

But the crucial variables in future are, I think, going to be political. These are quite probably the regional variables that will determine whether the current crisis is one of just a few years or whether it could last as much as five or even ten years.

After all, East Asia is a region in which both national and international politics are strikingly fragile, contains a number of authoritarian regimes many of which look unstable and vulnerable.

At the top of that list one must put China. Although the Communist Party remains in charge and the position of President Jiang Zemin remains unchallenged for the moment, I think it's important to acknowledge that both the broader power of the party operators and the specific position of all, or part, of the current leadership would be highly vulnerable in the event of a sharp economic downturn in China and a big rise in unemployment.

People's expectations have been raised by recent years of rising living standards. Labor has become far more mobile within China and with it unemployment has attained a new political and social significance. Political dissident movements remain active and the tensions between local and central government have grown. In good economic times, such observations would be unimportant, but the big question is what will happen in bad economic times.

China's economic growth rate remains much higher than East Asian average, but it is clearly slowing. Exports are under a lot of pressure and domestic demand is being depressed by deflation. The official target of 8 percent growth this year looks unattainable, and the figure closer to 4 percent looks much more likely with growth slowing further in the first part of next year. The risk must be that even these figures will prove optimistic. Last week, JITIC(?), the Guangdong investment corporation,

went bankrupt in what may be the first sign of fragility in Chinese financial institutions.

Plenty of people observing China are more optimistic than I am, and I hope they are right, but the impression I get from reports from China is that much of the economy is now grounding to a halt. A big public spending drive on infrastructure is underway to try to counteract this, and it may succeed, but I remain worried, and I feel it's right to remain worried.

Mass unrest in China, combined with a power struggle within the communist leadership, should now be seen as quite a plausible outcome during the next eighteen months. It is not at all inevitable but the possibility must be taken seriously.

In other countries in the region, we have seen that, with hindsight, one of our mistakes was to put too much faith in the ability of impressive technocrats to keep control of their economies. The same mistake of overestimating the ability of technocrats to control the economy may well be now being made by outsiders about China with excessive faith being put in the ability of Premier Zhu Rongji and his colleagues to keep things going.

The consequences of such a slowdown and political instability, or even a fear of this among the Chinese Communist Party leadership, would almost certainly include the much discussed devaluation of the renminbi and of the Hong Kong dollar with all their knock-on effects elsewhere.

More important perhaps even than that, in the long term it would raise big questions over China's role in regional stability as the possibility began to arise of a change in the leadership, hard liners gaining position, hard liners who might favor a more aggressive stance.

The other two countries in which politics matters more than economics are Indonesia and Malaysia. Indonesia is in the middle of a change of regime, but to what

kind of regime we simply do not know. Meanwhile, riots are spreading and starting up again as the economy shrinks further. Separatist movements remain strong, separatism remains a strong possibility.

We can say that the likeliest new regime is towards a more liberal democratic form of government, but we must also acknowledge that this is not, by any means, the only possibility. A military takeover or other extreme solution still cannot be ruled out despite quite beneficial developments over the last six months.

In Malaysia, Dr. Mahathir Mohamad and his ruling Malay Party UMNO seem to be digging themselves in for a long siege. The economic situation, dominated by large domestic debt burdens, by insolvent banks and by big property losses, rather like in post-bubble Japan, is getting worse. Malaysia's ethnic divisions make that country almost as much of a powder keg as Indonesia, and Dr. Mahathir's treatment of his former deputy and assumed successor Anwar Ibrahim has revealed his repressive instincts. This treatment, this reaction, may work but also it might well spark off a dangerous political revolt within Malaysia.

There are, of course, other countries whose politics could jump out from behind a chair to surprise us. India and Pakistan on China's western flank have already shown their willingness to shock. North Korea is always with us and always keen to grab an opportunity to make its survival more secure.

But I think that the three that I have just mentioned--China, Indonesia and Malaysia--are quite enough and they are the ones that pose the most important challenges in a region in which territorial disputes are rife and in which the notion of a settled harmonious arrangement between major and minor powers is remote, to say the least.

So my pessimistic view, which I think should be taken as at least a view that is within the range of plausible outcomes, is that today's economic troubles in East Asia could well turn into tomorrow's political troubles within stability in China, Indonesia and

Malaysia, raising deep questions about the broader stability of the region and of the direction both of security policy and, perhaps, of policy in trade and investment matters. And, then, this East Asian pessimism needs to be, in turn, placed in the context of a broader worldwide pessimism, as already outlined.

Crucially, the United States is likely next year to be either in a sharp recession, brought on by an equity market crash, or it may be in a milder economic downturn. Either way, its situation in the next twelve months is going to be worse than the situation in the past twelve months.

Europe's economic upswing may continue, but will surely continue more moderately than had been hoped for. Russia will not remain Russia and, hence, it will remain in chaos. And Latin America seems destined to have a slower 1999 or, perhaps, even worse than that.

So, the prospects are not good for the next year or two. Beyond that kind of perspective, it is not sensible to forecast, but we must accept that they are not good, they are poor for the short term, at least, or the medium term, if you define that as being one to two years.

The question is what does this mean for Japan and for its efforts to burnish its international image and relations. Clearly, it is a bad situation. It means that Japan will get no help from the external environment in boosting its own economy, and it means that Japan will continue to face the onslaught of difficult choices overseas.

What matters for the future is how well placed Japan will be to make those choices to face that onslaught, how well placed will it be to respond to possible instability in China, to regional tensions, to a new dive in local economies, to fresh and probably far more intense pressure from the United States, both in trade and in regional economic intervention.

It is possible that these challenges may not arise as my pessimism may prove to be unfounded, but the right plan for Japan in the light of these possibilities must surely be that it must make sure that it is well prepared for the worst.

Above all, of course, for Japan to be capable of dealing with these challenges, it must work to get its domestic house in order as rapidly as possible. As every lecturer says these days, this means essentially a root and branch reform of the financial system for it is the weakness of banks and life insurance companies that makes Japan's situation dangerous rather than simply difficult.

This is not at all a surprising view, nor is it anything like a new view, but its importance must be stressed in today's turbulent context. If new regional crises are accompanied by bank collapses in Japan or other forms of new severe financial weakness, then, Japan will merely be a feeble onlooker unable to act or react and, in that event, one should even include in one's worst scenarios some risk of political instability even in this country.

So, is a banking reform happening? Well, that has been the question dogging observers inside and outside Japan for the past few weeks as the government and opposition parties have continued their negotiations. It has been very hard to make up one's mind, particularly from outside Japan, but perhaps also from inside. What is clear is that in the past few days we have had a breakthrough, a very welcome breakthrough, the passing of bills through the Diet making potentially available some 60 trillion yen in public funds for various uses, making possible, at last, the nationalization of the weakest banks, making plausible, incredible, the transparent management of this restructuring process.

This passing of the reform bill is still only a first step in remedying the problems of the banking sector, but it is a huge step.

The issue of the use of public funds and the necessary imposition of the strict conditions, proper management, enforcement of those conditions and transparency on all the banks receiving public money, perhaps still does not quite feel as if it has been satisfactorily or convincingly resolved in this negotiation.

Why do I say that? Well, because since the government party itself opposed many of the tougher necessary conditions, it is reasonable for outsiders to be skeptical about whether all of those conditions will, in the future, be fully and properly enforced when the plan is being implemented. Such skepticism may be unreasonable. It may be that now the reform plan moves out of the realm of politics and into the hands of the professionals, and the professionals will, indeed, implement the plan properly, as I'm sure they will want to. At least one can say that the skepticism from outside, from people like me, has diminished substantially this week.

There is still the potential of new shocks to disturb this plan and, in future, the actions in line with this plan will be larger and more dramatic, I'm sure, than are currently envisaged. Probably a much wider phase of nationalization of banks, a much wider restructuring will be necessary.

Amid the skepticism about the ability of the current government to do much more than muddle along with this kind of plan, my observation, admittedly an observation, as I say, by someone far removed in London from the detail of this issue and from proper judgment of the circumstances, must, nevertheless, be that for full implementation of this whole process of banking and financial reform, there will need to be a new and more secure government. And even if that is not true as a fact, it will be true as far as the view of Japan outside is concerned.

I will be interested in the view of the panel on this point whether or not the status of the government makes a crucial difference. But if this view is right and, again, I don't think it's an extreme or controversial view, then, there may well need to be a general election and the arrival of a government with a more secure majority before people

outside are really convinced that the plan is being thoroughly implemented.

So the objective interest of outsiders must be, therefore, for an early election in Japan, perhaps even within the next six months. Such an election may not solve all problems, or even most of the problems, but without an election, on this outside view, at least, Japan will surely continue to drift somewhat and, at least, be thought of outside as drifting.

This is important because without its domestic house in a much better order, Japan will continue to be more of a victim of East Asia than an active ingredient of the region's recovery and, moreover, will likely find that its political position within the region diminishes relative to that of the United States, perhaps China, and others. By dint of its economic size, it would still play a big part, but that part would be shrinking and it would be more of a follower than a leader.

Getting Japan's domestic house in order does not mean necessarily that the economy needs quickly to be enjoying rapid economic growth. I doubt if such growth is attainable, in any case, given both the internal weaknesses, including those of the public finances and this reverse external environment that I have been describing.

So, in looking at the policy mix, I personally would put less emphasis than some do on the importance of new fiscal boosts and the like of new tax cuts or spending increases. Some further boost may well be desirable, but it is not going to have a decisive effect, and the public finances are in such a poor state that, in part, it could also store up some trouble for the future.

Reflation through the monetization of debt by the Bank of Japan, expanding the money supply through purchases of government and other bonds, may well be more effective and necessary in current circumstances. This process has begun already, although in a relatively small way. At the time it began, particularly in September, many people were worried that expanding the money supply would gravely weaken the yen

causing problems elsewhere in the region and prompting a Chinese devaluation.

After last week's extraordinary and violent climb in the yen's value against the dollar, one can certainly not say that markets are calm, but I would say that this stronger yen, if it lasts, ought to make such a monetary expansion both less risky and more vital for the future of the economy.

This will be necessary if domestic demand is to have any chance of being revived in Japan in the near future, but it will not, on its own, be sufficient for the fundamental question for Japan and its role abroad is for Japan to reduce the possibility of a true collapse of its domestic financial system. It is this chance that has dominated Western views of Japan as well as hurting consume confidence at home.

Currently, a betting man might place the chance of such a collapse as high as 25 percent at least before this week's passing of the bills. In recent years, if government policy had been more appropriate and more aggressive, that prospect could, by rights, have been as low as 5 percent or less. Reducing the possibility, reducing the bet of financial collapse, has to be today's greatest challenge and most important task, for I do believe that once this banking reform has really got underway, and has been seen to get underway in a credible and transparent manner, Japan's image abroad will be transformed, perhaps not overnight but it will, I think, be transformed.

More important, so will Japan's ability to respond quickly and effectively in a regional crisis. Japan must have the resources to assist in a new economic or political crisis as well as the credibility that its assistance will be sustained.

Vitality, it must also stand shoulder to shoulder in the region with the United States. Your two countries' long term interest in the region surely coincide. Going separately is not an attractive option for either country, but this could become a temptation for Japan if you felt weak, if you felt unloved by America, and if you felt that the dangers of regional conflict were high.

A rapprochement with China sacrificing, or at least edging away from the U.S.-Japan Security Pact, could, in very extreme circumstances, become a temptation, but it would surely be a mistake. It would not only be a sign, then, of Japan's weakness but also a long term guarantee of such weakness. It could win temporary gains but would, in all currently foreseeable circumstances, sacrifice Japan's long term security and its freedom of maneuver.

What is at issue in East Asia in the coming few years could well be of the highest possible importance. We could well be entering a period in which the uneasy political relationships of the past thirty to fifty years in the region are called into question, a period in which all the old assumptions come into doubt. The biggest error would be to underestimate the magnitude of the dangers and challenges that could arise.

On the flip side, on the other side of dangers and challenges, however, lies also opportunity. The opportunity for a stronger Japan in which the risk of depression had been removed, is also substantial. A fractious troubled China would be more of a threat to its neighbors and more of a concern worldwide than in recent years.

America, in recession with its own attention again turning inward and becoming defensive, as is often, and always, perhaps, the danger, could become less able or willing to exercise its influence in the region.

Japan, by tradition, has been a reluctant intervener in regional affairs, held in some suspicion by its neighbors, but also preferring, for its own reasons, to take a low profile or to stand back.

But a regional crisis of a pessimistic sort that I described, but one in which Japan, nevertheless, shone like a beacon of liberal strength, could be just the sort of event that would establish Japan as de facto leader of the region aligned with America but, in this case, acting ahead of it.

This also applies in the areas of trade and investment policy as in the grand, but sometimes scary, areas of politics. It is early days yet in the course of this crisis, but we have all heard of the worries about a new protectionism in Asia, a turning inwards led by Malaysia.

This may not happen. Indeed, perhaps a more optimistic analysis of the past twelve months would be that the great surprise is that there has not yet been any great shift towards protectionism to any great extent. But if it does begin to happen, the country most suited to leading an effort to discourage it would be Japan. Probably it could require gestures from Japan towards more opening of closed or restricted sectors of its own.

Certainly, it would require Japan already to have got its financial problems under control if such a leadership role were seriously to have any credibility.

So, ladies and gentlemen, the fundamental fact around us is that a storm is gathering around the world and around Japan, a financial storm, an economic storm, and, possibly with it, a political storm.

The true debate in the world is not about whether the next year or two are going to be bad or whether they are going to be better. The true debate is about whether they are going to be merely bad or truly disastrous. Such stormy weather will challenge Japan and will pose new dangers to it, especially in regional politics, but it will also give Japan new opportunities to offer leadership and perhaps to firmly cement its position as East Asia's leading regional power.

The question before us, and before our panel discussion, I am sure, is whether Japan will be able to be in a position to take those opportunities.

Thank you very much for listening so patiently to me.

MODERATOR: Thank you very much, Mr. Bill Emmott. This concludes the keynote presentation.

We shall now break for 20 minutes and the panel discussion will begin at 3:15. The discussion will start at 3:15. There will be a 20 minute break.

(COFFEE BREAK)

PANEL DISCUSSION

Panelists: Mr. Bill Emmott, Chief Editor, The Economist, London
Professor Yoshiaki Abe, Institute of Asia-Pacific Studies, Waseda University
Mr. Glen Fukushima, President, ACCJ
Dr. Eisuke Sakakibara, Vice Minister of Finance for International Affairs

Coordinator: Mr. Takashi Hosomi, Chairman, NLI Research Institute

MODERATOR: Thank you for waiting, ladies and gentlemen. At this juncture I would like to open the panel discussion. Mr. Hosomi, Chairman of NLI Research Institute, will be acting as the Coordinator for the panel discussion. So here I would like to hand the microphone over to our Coordinator, Mr. Hosomi.

COORDINATOR: Good afternoon, ladies and gentlemen. Before starting the panel discussion, allow me to briefly introduce the panel members to you, including their bio data.

Seated to my immediate left is a very well known figure here in Japan, Mr. Glen Fukushima. Mr. Glen Fukushima graduated from Stanford University and he also studied at Harvard University, and he served at the USTR. He was the head of the Japan Desk as well as Deputy USTR, and currently he is with

Arthur D. Little (Japan), a consultancy firm, in the capacity of Representative Director and President.

In 1997 he was elected President of the American Chamber of Commerce in Japan. He is still serving as President of ACCJ. While he was with USTR he participated in the so-called Framework Talks, and he authored a book called Politics of Japan-US Economic Frictions, The changing of the United State, Can Japan Change.

His wife is also quite famous here in Japan. Some of you may, I'm sure, know his wife as well.

Mr. Bill Emmott was already introduced.

To his right as viewed from you is Dr. Eisuke Sakakibara. He graduated from the Economic Faculty of the University of Tokyo, and he entered the Ministry of Finance.

After that he studied at the Economic Faculty of the graduate school of Michigan University. He obtained his Ph.D. in Economics. After that, he came back to the Ministry of Finance, and at one point in time he served as associate professor at Saitama University. He was also a visiting professor at Harvard.

After serving as Director General of the International Finance Bureau, his current position is Vice Minister of Finance for International Affairs. He may be better known as "Mr. Yen" through Japanese newspapers.

Structural Reform for the New Century from Progress to Symbiosis is one of the books he authored. He has been extremely busy and active in many spheres of activities, and it is, indeed, a surprise that he is able to join us at this time of the day for a panel discussion.

Seated at the furthest right is Dr. Yoshiaki Abe. After graduating from Keio University from the Economics Department, he finished his doctorate study at Cornell University and he joined the World Bank. He experienced various positions in the World Bank, ultimately becoming the Director General of the Latin American Bureau of the World Bank. He is the highest ranking Japanese official in the World Bank.

After returning to Japan, when the new center called Asia-Pacific Research Center was established in Waseda University, he was invited as professor in that research institute. He is well known both at home and abroad, and it's a pleasure for us to have a person like him on the panel.

So much for the introduction of the panel members. Since we have listened to a very interesting keynote address by Mr. Bill Emmott, at the very outset of the panel discussion, in view of the fact that the keynote address was so wide in its coverage, I would like to invite each one of the panel members to refer to any aspect of the keynote address made by Mr. Bill Emmott, maybe in the form of questions or probably debate or discussion as they see most appropriate.

Probably in the first round I would like to give ten or fifteen minutes to each speaker, and we will have a second as well as, if possible, a third round. So I would appreciate it if each panel member can limit themselves to the initially given ten minute time frame.

FUKUSHIMA: Thank you, Mr. Chairman. I do not have too many major differences with Mr. Emmott's speech because I found it to be quite balanced, and I found much to agree with in his comments.

I would like to focus on one particular element of his discussion which has to do with the evaluation of the Japanese economy looked at internally within Japan versus externally from outside of Japan because I myself, on my monthly trips abroad outside of Japan, am struck by just how different the assessment is of the Japanese economy, and I

think that this gap in perception between how the Japanese economy is viewed in Japan versus outside of Japan is one of the reasons why there is some level of frustration about Japan when viewed from the outside.

I attribute this gap in perception to at least six reasons. The first is the gap between analyzing economic data, on the one hand, versus actually living in Japan. That is, when one looks at Japan's economic performance, minus growth rate, 4.3 percent unemployment, which is perhaps actually 8 or 10 percent unemployment, housing starts, construction starts, department store sales, 600 billion or trillion dollars of non-performing loans, when one looks at the data one has to conclude the Japanese economy is in very dire strait.

On the other hand, I think most people living in Japan don't sense that there is an impending collapse or meltdown of the Japanese economy. So I think that is one reason for the gap.

Another has to do with the fact that, looking at Japan from the outside, there is a tendency to focus on Japan's financial sector and to look at the bad loans and the difficulty of stimulating domestic demand while ignoring the strength of Japan's manufacturing sector.

Although the decline in demand in Asia and domestically in Japan has meant that the income statements of Japanese manufacturing firms have suffered, still, I think the manufacturing capabilities of Japan are quite strong, and once demand picks up I think the Japanese companies will be quite competitive internationally. But this is not often focused on.

A third is that there is a tendency often looking at Japan from the outside, especially by the uninformed observer, to lump Japan into the category of Asia's financial problems and, therefore, the problems are attributed to so-called crony capitalism or to government intervention, and there is often a tendency to lump Japan along with Korea or

with Indonesia, Malaysia, Thailand, and so forth, without recognizing the scale of Japan's economy, the sophistication, the technology, the 240 billion dollars of foreign currency reserves, 130 billion dollars of current account surpluses, high savings rate, etc.

Fourth is that, especially in the United States, there is still a holdover from the 1980s, the so-called industrial policy debates, where many American economists who had difficulty explaining Japan's successes in the 1980s take great delight in looking at Japan's difficulties now, and as they argued back in the 1980s that the kinds of government-business cooperation and so-called industrial policy, that these are mistaken policies that are bound to fail, and I think there is a sense of triumphalism among some American observers that they had been proven correct.

Fifth is that there is a tendency among many in the West, especially American mass media, to take the Japanese mass media negative reporting about events in Japan and to take them at face value and report them abroad.

For instance, there has been one major newspaper in the United States that has reported at least two major articles in the last few weeks about suicides in Japan, about the incidence of suicide, as an indication of just how bad the Japanese economy is. I think, without denying that suicides do take place in bad times, that the tendency to focus on very, very negative news helps to create this gap of alarmism, alarmist views of Japan.

Finally, I think that there is a lack of an attempt to explain by Japanese government officials and Japanese business leaders and others about what's going on in Japan more clearly and effectively to the outside world.

With the exception of Mr. Sakakibara and a few others, I think that generally there is a reluctance, well established or well known, where Japanese often, whether in private conversations or in international conferences, do not assert and state clearly what

their vision is or their policies or practices, motivations of Japanese economic policy, goals, intentions.

It's a very interesting contrast to me to observe China in this regard because I think China has gotten tremendous credit in international meetings of all kinds for contributing to the stability of the East Asian economies, to helping in the recovery of the East Asian economies, whereas Japan is often not given the kind of credit that I believe it deserves. I think part of it is the result of a lack of explanation and assertion on the part of Japanese, both in the private and public sector.

So I think these six factors contribute to the quite large gap in the perception between outsiders, especially in the United States, and in Japan with regard to the Japanese economy.

A second major gap in perception that I would like to just conclude with has to do with Japan's role in the East Asian financial crisis. I think that there are quite a few in Japan who believe that Japan's role ought to be to provide for bilateral assistance especially in the form of loans, aid packages, export credit and so forth.

Perhaps this 30 billion dollar program announced recently by the Japanese government is an example of this, but I think because Japan sees itself as being a wealthy nation--high savings rate and foreign currency reserves and current account surpluses and so forth--there is a tendency to think that Japan is a creditor nation providing credit to countries. That is Japan's role.

Obviously, that is a constructive and positive role, but I think that the expectation on the part of many in the United States, and I think among many in Asia, too, is that Japan would act as a role of importing products and, thereby, helping to contribute to the recovery of the East Asian economies.

So I think there is a slight mismatch there in the expectations of the role that Japan ought to play. In fact, there are some in Japan who have claimed that there is a clear division of labor in the Asian economic crisis with regard to the United States and Japan. Japan's role is to provide credit and the US role is to import, and that has not been received well in the United States.

So those are just my opening comments. Thank you very much.

COORDINATOR: Thank you very much. Then, in terms of the first round I would like to invite Dr. Sakakibara to comment next.

SAKAKIBARA: Mr. Emmott's presentation was, indeed, very well balanced, and I think he covered the majority of issues. So I don't have any particular disagreement, but there is one thing that I want to emphasize and I'm not sure Mr. Emmott is aware of this. This is something that I have been continuing saying since the Thai crisis.

We are not facing an Asian crisis per se, but it is a crisis of global capitalism. Global capitalism crisis has surfaced at a very rapid pace and this has been so since autumn. In August Russia became de facto default and that reached Latin America, and everyone is concerned about the development in Brazil. And in this process hedge funds suffered tremendous losses. Mr. Soros apparently lost 2 billion dollars in Russia, LTCM also was in the headlines of the news. The bail-out package was designed to be very similar to the Japanese convoy system, so LTCM was bailed out.

So the difficulties of hedge funds may be much bigger than we believe they are. In the Asian crisis context, Americans were talking about transparency and disclosure, but when it comes to hedge fund crisis there was no disclosure whatsoever. LTCM, what is the leverage ratio? They told me it was 250. The chairman of the UBS had to resign because of this. According to the internal regulations of UBS you are not supposed to lend to a leverage ratio of more than 30 times, but it was 250 so he was

forced to resign because it was against the internal regulations.

So it is a worldwide crisis almost, becoming worldwide. Emerging markets in Latin America and in Asia, no new money is being supplied to Brazil, Mexico. They are not receiving new loans. Liabilities over something is like one thousand several hundred basis points. Even with this premium they are unable to borrow money. The junk bond market is almost nil, collapsed today in the United States. Corporate bonds and treasuries spread has been widening extraordinarily. So it is clear that there is a credit contraction worldwide, and that is true inside Japan.

Japanese banks' external lending is also going through the same process. The American and European banks are withdrawing loans, and that is one cause of the strong yen. The hedge fund's loss had to be covered, and because the banks had withdrawn their loans from the hedge fund, that has oppressed the liquidity.

Now, in leverage funds they borrow in Japanese yen, and that proceeds is invested in US dollars and elsewhere. So everyone is unwinding their positions. That resembles the nonbank implications on the entirety of the Japanese financial system. So that is what is happening in the United States. So I say that we are facing the crisis of global capitalism.

Another awareness is being shared by many. I have been attending G7 meetings and I believe that the Americans have started to feel the sense of crisis. Europeans are still somewhat complacent because their growth, their upswing, is still quite high, but they are beginning to feel the implications. The European banks in Latin America and in Russia and Asia had suffered difficulties, so, sooner or later, they would go into the deflation spiral. I think that is where we stand today.

Mr. Glen Fukushima talked about the perception gap between those in Japan and outside of Japan. Whenever I return to Tokyo I feel that there is a lack of sense of urgency of the Japanese people. The Japanese people do not feel this urgency. I

preach to them that it is a critical situation but they still are taking it quite easy. If you listen to the debate in parliament, the same sentiment was dominant.

In September there was the Miyazawa-Rubin discussion and it was pointed out that the Japanese lack in a sense of urgency. I had to agree. Secretary Rubin met with the governors of the central banks of Latin America and also the finance ministers, and it was immediately after those meetings that he met with the Japanese counterpart. So he was very cognizant of the Latin American crisis, so he was filled with a sense of urgency and crisis.

Of course, I should not be using too exaggerated fearful words, but today I think we are facing the single most serious crisis of the postwar world. How are we going to tackle this is really the question.

The last year's Asian crisis I have been observing that and have felt that global capitalism is occurring at such a rapid pace so it is almost a virtual world. A company can be healthy, and then in deep sickness in a matter of a few weeks like Korea. In September-October no one dreamed that Korea would have any difficulty. In September Hong Kong hosted the IMF General Assembly. No one really talked about the potential difficulties of Korea. Well, they said that Koreans are lending a lot of money to Indonesia. It would be all right. That was the extent but, as you know, the Korean economy almost collapsed later that year. It only took three months.

So, things are moving very rapidly particularly in the financial area. Through information and financial instrument the crisis can be expedited, accelerated, and countries fell one after the other--Thailand, Indonesia, Korea, Russia, and now Latin American countries--and it is reaching the shores of the United States and, of course, not to speak of, Japan.

Therefore, given this situation, the role of Japan is very important, and I agree with Mr. Emmott 100 percent. Yes, we must aggressively tackle with financial reform

and we must take quick actions. Well, I'm sure Mr. Emmott will say that my ministry will have to take part of the blame, but don't look back into the history. Let's look into the future. So we will have to expedite and take actions, and the seriousness of the crisis should be shared by the private and the public sectors, the bureaucrats and the citizens alike, and business. Things are becoming more global worldwide.

I think Mr. Emmott, when he talked about pessimistic views, tried to be moderate and sort of have a subdued expression, but I am a pessimist, too, so radical, fundamental, bold action must be taken as soon as possible. After all, the world is falling down, going down the hill so quickly, and if the US falls, so would Japan, and vice versa.

I think there is an advantage that Japan has. We're in an advantageous position. That is, we are the world's largest creditor. We have a net lending credit of about one trillion dollars, and the Japanese savings ratio is very high. Therefore, in order to revive the Japanese economy by Japan, we don't have to borrow from outside. What we have to do is to issue government bonds or to use postal savings. We don't have to lend from outside. That is an advantage.

Mr. Fukushima said that bilateral assistance is not the solution, but we can extend a lot of financial support to Asia, so we should translate or capitalize on the advantages of being the largest creditor country with a high savings ratio. The US has 1.4 trillion dollars of net debt, external debt, and it has doubled in a matter of two months, so the American financial system is facing difficulties.

So Japan is the largest creditor country in the world. We must not forget this so that we can take a very bold fundamental action, and that action is needed more than ever. I believe that Japan can, and should, be playing a very important role.

COORDINATOR: May we turn to Dr. Abe.

ABE: The other speakers have stolen my words out of my mouth, more or less, so let

me be brief.

Mr. Emmott in his presentation referred to, well, it wasn't exaggeration or simplification or caricature. What he said was none of that. It was very much a mature commentary, editorial commentary. Of course, he was moderate in his expression. Therefore, that leaves us panelists with the responsibility to be more radical in our statements, so I will try to be just that, radical.

For Japan, by coincidence, I think Japan's interest is shared by all the Asian countries. In other words, what Japan must do now, in terms of Japan's economic policy, which must be implemented speedily, the objectives and interests are the same, aligned in the same way with the interests of Asia. So if you can only implement all those measures in Japan, we must, indeed, do that.

Mr. Emmott talked about, for instance, there is a probability of 25 percent, but the probability will be much higher if we can accelerate all our efforts in terms of policy measures with all the resources to back them up because, as was mentioned by Mr. Sakakibara, the savings rates in Japan are very high so we have a very deep pocket. I think that is what he was suggesting.

From my experience, I tend to look at things from the perspective of developing countries, and I would like to gear my discussion in that direction. One characteristic of the East Asian economies is that they all have high domestic savings ratio. In Japan we have high savings and in East Asia also we have high savings ratio. If they are combined then there could be enormous impact felt.

So Japan can be initiators, so to speak, of some scheme to combine those strengths or resources. It is high time that we work out something to capitalize on the strength of the high savings resources of this region.

The second item may be a good discussion for the second round but it has to do

with the international role of Japan, the role that Japan can play internationally, because when I look at the current crisis, and we heard this from Mr. Sakakibara, it is a large major crisis.

I was with the World Bank for 29 years in the Bretton Woods system, but if I look at the current crisis this is beyond anyone's imagination. Therefore, the solution for this has to be bold enough for us to even be willing to overhaul or break down the Bretton Woods setup because there is an article of agreement for the IMF or the World Bank, and if you read those documents the purpose was for the postwar reconstruction, to deal with the postwar situation, but it has been fifty years since the end of the war now.

And adding to that is the advancement in financial technology that we have seen over these years, and the speed of contagion, the speed of the spread of all these diseases. All of that, in terms of quantity and quality, far surpasses what we have been able to foresee at the time of the creation of the system. Therefore, we should be willing to break this system down completely, to overhaul and reconstruct the whole system from scratch, and the role for us is to start and initiate that process by expressing ourselves to that effect, and I will leave my concrete suggestions for that purpose to the second round.

But in Japan we have to try to implement measures to realize a strong and powerful recovery of the economy with all the policy measures aligned to that end.

Another point is that we have to be aware, we have to have the recognition that the current crisis now is an enormous crisis and, therefore, what the wise men, including Keynes, created in a small village after the war is now not viable. Therefore, Japan should present the idea that the whole system must be once brought down to be replaced with a completely different system.

COORDINATOR: Thank you very much for your comments from a very wide perspective having a very broad coverage as well. We have just had the first round of discussions by the panel members, and nobody took issues with Mr. Emmott in what he

said. But what about you, Mr. Emmott? Do you have any comments to add at this juncture?

EMMOTT: Thank you. Can I say that it's quite rare for me to be described, particularly by Mr. Sakakibara, as "too moderate and too balanced", so I take pleasure in the compliment.

I very much share the view of the panelists that this is a very severe situation in the world. I think the difficulty is that, in some ways, the world has exaggerated the problems in Japan's economy but has not paid sufficient attention to the problems building up in the financial system elsewhere in the world.

In looking at the meltdown that we see in financial markets right now, I think it's important to recognize that this is not a new phenomenon in terms of its nature. The booms and busts, the panics and excessive lending, followed by excessive credit contraction that we see going on, is not something new. Anyone who reads histories of financial crashes, such as Professor Charles Kindleberger's *Manias, Panics and Crashes*, very much the best book on these things, will see every element of today's crisis written in different times in the past.

The change today is in the magnitude of the crisis. It is not in the nature of it. It is the fact that it is happening with such large numbers, such large institutions, and happening, in particular, at the same time in so many countries around the world.

I also agree very much with Mr. Sakakibara that there has been a lot of hypocrisy from the United States, in particular, from Western commentators about transparency, and the East Asian crisis and the role of lack of transparency in that because their own system is itself not at all transparent. Indeed, much of the art of working in financial markets is to try to evade transparency, and there is always a new way to avoid it. So I think that I agree with that that we don't have transparency.

Can we achieve transparency worldwide? In any communique and in any plan to try to improve the world financial system, the word "transparency" always appears. There is always a proposal that "we must have more transparency". I think that this is a desirable aim but one should not put too much hope on it. We will never achieve complete transparency and we will always find that something hidden comes out to surprise us.

We also, I think, should not expect that the solution to the financial crisis can be found in some big plan to be laid down and agreed by a group of ministers or technocrats in some great international summit meeting, that out of the meeting will come the solution.

I think there is no magic solution to the current crisis, but there are a lot of smaller solutions, particularly domestic solutions, and a very important part of that, as other panelists have said, that Japan must be sorting out the financial system in Japan and restoring confidence so that the bottom can really be established of the economic difficulties now, and we can then start moving up from there.

Equivalent measures will have to take place in a lot of other countries, including, in the future, the United States and Europe, but these are very much domestic preoccupations that will have to be then combined with an emphasis on international openness towards trade and investment flows, I think.

Trade is the particularly important one because in investment flows there is bound to be some natural reaction against the violence of free flows of capital that we have seen, a reaction towards some greater control of flows of capital but which, as long as it is a moderate reaction, won't, I don't think, do much damage.

An extreme reaction shutting off countries altogether would do damage to those countries, but a moderate reaction will not do that much damage. Whereas even a moderate reaction in trade is quite likely, I think, to lead to, then, a cycle of retaliation if

the commitments in the World Trade Organization and in regional organizations are then broken and called into question, then I think we could go into quite a severe spiral of protectionism that would be very, very hard to turn around.

That, to me, is the biggest danger of this kind of crisis of global capitalism, as Sakakibara-san says, because politically the imperative in each national country becomes protection, and it seems ideal from the perspective of each individual country, but when you take the world as a whole and add up all that process, then you get a situation for the world which would be truly catastrophic.

That's the worry to me that we would turn into that kind of cycle. In looking to the future as to whether this worry is going to be fulfilled, I think the most important place to look is going to become the United States, and in economic terms, and perhaps in political terms, China, for the reasons I said in my remarks, that I think the Chinese economy is less strong than many people think and could be the next shock to arrive in Asia, perhaps not in a sudden collapse but, rather, in a gradual slowdown, and that the attention of the world will perhaps shift away from Japan, I hope, once the financial reform really gets underway and towards the United States and China as the next benchmarks for how this crisis is going to play out.

COORDINATOR: Thank you very much. Mr. Fukushima, in relation to what has just been mentioned, China is a very important country. How should we evaluate and how should we analyze China? There seems to be also a gap of perception between Japan and the United States, and how is China viewed in the United States?

FUKUSHIMA: Well, the subject of China is quite complex and American society being the diverse society it is, there are a diversity of views about China ranging from those who are quite optimistic and believe that China will be the superpower of the 21st Century in Asia and making progress towards democratic institutions, on the one hand, versus those who believe that China is filled with instability, unpredictability, corruption, unreliability, and that there are many evils in the political system as well, including

political repressions. So there is a tremendous diversity of views within the United States, and even within the Congress of the United States itself I think there is a diversity of views.

But I do think that there is a recognition of whether one attaches positive or negative evaluations of China. It's an inevitable fact of life that China will be a very important factor economically, politically, militarily, over the next decades.

And so to deal with China in a constructive and realistic fashion is the real challenge. I am not persuaded that the United States at this particular juncture has either the mechanism or the political will to come up with a coherent strategy on China, but I do think that it is very important for the United States and Japan to cooperate with regard to their relationships, their respective relationships, with China.

It is often pointed out that historically when the United States has good relations with China, the US has bad relations with Japan. When the United States has good relations with Japan, negative relations with China. Hopefully, it is possible now to overcome that and for the United States to try to improve its relationship with both countries simultaneously.

My own view is that on the economic side there is much to be gained between furthering relations between the United States and China. However, there will, I am sure, be bumps along the road.

On the political and security side, however, especially with the problem of Taiwan always present, I predict that there will be a continued tension between the United States and China and, therefore, I think that some of the concerns within certain circles in Japan that somehow the United States is becoming very close to China at the expense of Japan, that those concerns really are not very rooted in reality.

It is true there are some in the United States who are very much champions of China, but I think, given the political and security realities of the region, that it is highly unlikely that the United States will enhance its relationship with China at the expense of Japan.

So I'm relatively optimistic certainly about the US-Japan relationship, and I think the US-China relationship, despite some ups and downs, will improve over time but, certainly, not to the level of the close cooperation between the US and Japan.

COORDINATOR: Thank you very much. On China, in Japan there are increasing views of the US by-passing Japan to get closer to China, therefore Japan would be under tremendous pressure. I think that is the view shared by many Japanese, but having listened to Mr. Emmott, when the economy fails it becomes truly disastrous, what will happen if and when China suffers from a dire shortage of food and faces economic difficulties and there is a lot of unrest. Is this a likely scenario as viewed from the United States?

FUKUSHIMA: Well, as I mentioned before, there are very diverse views on China, and so there are some who paint a very negative scenario of political instability and economic dislocation. But I think, certainly within the US government and among, I would think, most people in the US private sector, US industry, that the potential of the China market remains forever attractive and hope springs eternal that there will be economic gains to be made by having close relations or increasing the relationship with China.

So my prediction is that there will be continued attempts by the United States to improve and enhance its economic relationship with China although, obviously, tempered with the realism that there is obviously a potential for instability and for dislocations and disruptions in the Chinese economy as well as in the politics of the country as well.

COORDINATOR: Thank you very much. Let's wrap up on China and move to some other subject, and let me direct this to Mr. Sakakibara.

At this recent IMF meeting Japan presented the so-called "Miyazawa scheme or program". The French had another say, and all the countries around the world apparently have their own ideas to reform and change the IMF. But, of course, it will cost money. Someone will have to fund. Did anyone volunteer to fund such effort?

SAKAKIBARA: We are suggesting that we start from whatever we can do, so we have the 30 billion program for Asia, but from the UK, from President Clinton and others, they talked about a new IMF, i.e. new Bretton Woods system, because the existing Bretton Woods system was given birth in the 1940s. We had a fixed foreign exchange market and there were almost non private sector fund transfer. So they are no longer suitable to the current day's requirement.

So I see. I agree with that, but I particularly support the view of Mr. Emmott. We must separate the immediate challenge and also the medium and long term challenge. The politicians of the world apparently are confused between the two. They do not have a distinction between the short and mid and long term problems or challenges.

Now, I would like to take this opportunity, with your permission, to go into this. The world economy has pressing issues that we must solve. That is, how are we going to stop the ever shrinking capital? In other words, what are we going to do with the credit crunch? Unless we do something, the borrowers will go bankrupt, Japan and elsewhere, and on a related note, what are we going to do with financial and fiscal policies?

When I talk too much about fiscal policies, my colleagues will be upset, so I shall not go into great depth but, as Professor Keynes wrote in his text, I think we are in a state

where we will have to take a coordinated Keynesian policy. I think that is incumbent upon us. For the past decade or two decades, inflation was the single most important challenge. A monetarist type of attitude was taken by the central banks, and Europeans also favored a monetary approach to their success, but things have changed tremendously.

Dr. Greenspan said the nature of the risk is changing from that of inflation to deflation. Therefore, a new type of Keynesian policy would be needed, so what are we going to do with credit crunch and on a new Keynesian policy, the two most pressing short term challenges? Unless we do this, we will go into the deflation spiral. We cannot afford to think about the mid and long term challenges.

Having said that, in mid and long term we will have to change, of course, the Bretton Woods system. I agree with you. But what needs to be changed and how? True, someone must find it, and the question is who? But, in any case, we must identify the areas to be changed. We must agree on how.

First, what are we going to do with the exchange rate regime? Some countries are taking the wider band range, others are on a fixed, and others on a flexible scheme, and some of them employ the currency board approach and taking a very tight attitude towards the exchange rate. So, what sort of exchange rate regime should be adopted? We must discuss that, and also the transfer of capital.

Given this capital flow, I believe derivatives, hedge funds, those short term flow must be reflected in the statistics. We must know what is happening. The multilateral organizations must be able to monitor the flow of funds at least on a short term basis, and maybe, on an exceptional note, restrict such a flow in some of the emerging markets.

Also we must internationally agree and coordinate the supervision of banks, including nonbanks and hedge funds, or even the business corporations engaged in financial operations.

Therefore, in a broad context, we must discuss about coordination of supervision over those activities. And also when a country starts to fail, then we will have to reschedule and roll over the debt. Do we involve the private sector? Yes. So that we put together a rescue plan for the countries which have or which are on the verge of failure. I think that is important.

Before it was about IMF making the decision. The IMF took the lead, but maybe the approach should be different. IMF should also be equipped with facilities to allow contingency plan should IMF become the lender of last resort, and the views are divided.

But, at least, we should address this question. So there are about five subjects where we must really seriously discuss so that we can improve the IMF and multilateral organizations. It will take six months, a year or so. And maybe not in the Bretton Woods little village but in Hakone we could invite people, have them stay there for a week and debate. Such a process would certainly be necessary.

I talked about the sense of urgency. Therefore, we must work on immediate challenges in a concerted manner, and the speed, the pace, is important, and if otherwise the world could be in serious trouble. I may have repeated the same, but that is all I wanted to say.

COORDINATOR: Dr. Abe.

ABE: The last speaker is always at a disadvantage.

COORDINATOR: You can say something new.

ABE: Yes, I know that very well. Thank you. So let me inject a new different perspective trying to look at this situation from a different angle. Monetary and fiscal

policy to improve the Japanese economy, to be quick, to be fast, in a large volume, and this is what we have to do. But, in that situation, very conscious efforts for privatization, deregulation and use of private initiative, private capital, as much as possible over a very short period of time, we must bring our wisdom to work to implement all those efforts, in other words, to shrink the size of the government. To make for a smaller government, we have to use the resources of the private sector, and also that was immediate.

But for the medium and long term perspective, international organizations have to be reorganized and, in so doing, IMF and the World Bank, I said that the Bretton Woods system has to be collapsed once, but I still believe that the IMF and the World Bank may have to be combined.

And also the relationship between regional organizations and the Bretton Woods institutions may have to be reconsidered, revisited, to make them more simple so that, with a more simple way, a larger amount of money can be mobilized with the participation of all those organizations binding together.

With regard to mid and long term reform which needs to be implemented, I am not averse to the idea of such a reform, but reforms can bring about very negative impacts short term, in many cases. So how to address those short term impacts, we froze the fiscal reform effort in Japan. The Ministry of Finance has been supporting this idea, but due to the slump in the economy we had to shelve that idea for the time being. So the need for reform is good, but if we emphasize that need, then, we stall the economic engine, more or less.

I was talking with Mr. Sakaiya of EPA and he said the Japanese are fond of reforms. Two Tokugawa Shoguns, one is valued very high, the other not. Tsunayoshi brought about the boom but the other one, Yoshimune, killed about 3 million Japanese from hunger. But he was a promoter of reform. Out there, for the people on the street, reform can be death, so it has to be balanced between the two. That is what actually the politicians and government have to work out. Yes, reform, fiscal rehabilitation is very

important in mid and long term, but we should not kill people from hunger. Not really hunger in the case of Japan currently, but unemployment should not be caused as a result.

Historically, reform has brought about monetary impact for the short term.

COORDINATOR: Mr. Emmott.

EMMOTT: To both of these comments, not about the desirability of hunger, because I think we can agree about that, but a little about this often used notion of reforming the Bretton Woods system and architecture. It is always called "architecture" but, really, if it is ever to be changed, I don't think it's the architects that need to be brought in. It may be the engineers. It has to do with the balance of power and the transmission of power through the building, not really with the actual design of the building.

What I mean by that is that the real issue that people mean when they say that there must be better monitoring, closer bank supervision, perhaps the IMF is a lender of last resort, is that they mean that sovereignty should be transferred to these international institutions, that power should be transferred to international bodies to interfere in the national policies of countries around the world.

And the big question that is going to come out, for historians, I think, out of this financial crisis, at least economic historians, perhaps, is whether or not it ends up with more power being transferred, or some of the power being taken away. I think it would be desirable if more power was transferred, but I wonder whether many people on Capitol Hill would agree with me.

COORDINATOR: Thank you very much. That was a very provocative comment, I believe. I think with ECU or EU, there could be such a consistency, but we have to wait for the time being what will happen on the European front because the freedom to be maintained by individual countries has to be constrained or restrained somewhat if we were seeking international stability. That is the argument but, then, what will happen to

free trade or free flow of capital, there is inconsistency there.

So when we think about the structure of the systems going forward, we have to rely on the wisdom of Mr. Sakakibara and the people of your younger generation. There should not be categorical inconsistency. Some systems need some restriction, some systems require complete freedom, so there has to be a good combination of the two in whatever the new system we may be pursuing.

But at the IMF General Meeting this time, in regard to free capital flow, the idea was some kind of restraint was necessary. People said that, when it was the United States or the UK speaking that, saying that, then, it will backfire on them because the US and UK are champions of free trade.

So, this is, indeed, an issue that ought to be discussed by IMF going forward. I don't want to bully Mr. Sakakibara by posing too many difficult questions but, nevertheless, let me ask this.

The current economic stagnation of Japan and all the economic difficulties or problems in Japan, do they have to do with the excessive productive capacity that exists worldwide? Obviously, there exists capacity, and in Japan we have thrived on mass production, reducing cost of production or prices so that with the strength of mass production, not necessarily on the advantages of technological strength, Japan has been able to overpower the global market.

But now we have no war between the communist world and the free world. Indeed, it is a one world. Can we still survive with the mass production methodology, the advantages of the country which heretofore relied on mass production? Now they have to compete with the countries offering low wages, so the competition will be more severe. That is, indeed, the competitive situation that Japan is facing today.

Now, the Miyazawa initiative was to give I think it was 50 billion dollars to those

countries in dire straits, but within Japan there are a lot of people who would rather see that amount of money going their way instead of going out to countries with difficulty. How can we overcome this?

SAKAKIBARA: For one thing, with respect to the domestic problems here in Japan, we just talked about overcapacity. That may be a problem. However, the problem we see today is not simply attributable to a supply and demand imbalance but, rather, the serious problem is the credit contraction. So, if we can resolve this problem of credit contraction in the real sector of the Japanese economy, I do not see that there will continue to be such a huge supply-demand gap.

Of course, if a specific product is taken, depending upon the exchange rate, certain sectors might find it very difficult to compete in the Asian context.

Furthermore, the countries covered by this Miyazawa scheme include Southeast Asian countries plus Korea, and between these countries and Japan there is a certain pattern of division of labor already established. In other words, some Japanese companies have already a plant in those countries or producing parts, importing them back into Japan, or certain materials are brought into these countries from Japan to carry out local production there.

So, not in the financial sector but in the manufacturing sector, there is a de facto economic sphere already established here, and as the yen continues to appreciate, that appreciation itself gave rise to the birth of such economic sphere, and if trade finance is made available or other restructuring fund is offered, then that will indirectly benefit the Japanese manufacturers as well.

And especially in those countries where there is rather substantial Japanese companies' presence, not in Korea but in Southeast Asian countries, if substantial fund is made available to the local economy, not simply in response to the request coming from

those countries, but by us participating in the economic restructuring plan of the country concerned, that could produce very good benefits.

The Japanese are not very good at giving advice. We used to buy consultancy service by paying fees for that. But by Japan taking part in the economic restructuring plan in Asian countries, rather than deliberately creating an economic sphere, some sort of economic sphere could materialize on a de facto basis and that, I think, is very important, and the yen's internationalization should be attempted in such context. We are very keen to internationalize the Japanese yen.

In the process of strengthening the economic ties between Japan and Asian countries, if we can assist those countries' bond issuance maybe in the Tokyo market or elsewhere, we may be able to enhance the role to be played by the Japanese yen. If we directly talk about a certain sphere, that could be reminiscent of a very misguided attempt in the past.

So, in that context, I believe the Miyazawa scheme is very important. That does not mean that no fund will flow into those needy in Japan.

We have ten times as much funds as we are offering to Southeast Asia available. The problem is not the lack of funds but the lack of circulation of the funds itself. Japan is a rich country, but because of the suspended circulation of funds, the Japanese economy is in difficulty, so if efforts can be made to make that circulation possible, that could lead to the solution of the problem.

COORDINATOR: The next question is from the audience. In response to the kind of scheme Dr. Sakakibara has just mentioned, probably the US or the UK were not very supportive, but what are the views of the panel members, both Mr. Fukushima and Mr. Emmott?

FUKUSHIMA: 30 billion dollar program?

SAKAKIBARA: With respect to this 30 billion, Secretary Rubin and President Clinton both welcomed officially.

FUKUSHIMA: It's true that the US government has publicly expressed its support for and appreciation for this announcement by the Japanese government. However, as I mentioned in my earlier comments, there is I think an expectation or hope, informally, perhaps not formally, stated that Japan would contribute in terms of not only providing credit but also of importing from other countries of Asia.

I think that, as I mentioned before, the Japanese notion of contribution or of internationalization, globalization, has traditionally been to export products to invest abroad, to go outside of Japan. I think increasingly, with Japan's economy being as large and as important as it is, that the expectation is that Japan will receive imports from other countries, that Japan will receive foreign direct investment from other countries and companies.

So I think this is also an important element that should not be forgotten. So, whereas, on the one hand, yes, one can praise Japan for making such contributions, especially since Mr. Sakakibara insists that Japan is the wealthiest country in the world, by certain standards, that is welcome, but I think that the ability and the willingness of Japan to receive products, services, as well as investment, is important both from the standpoint of contributions and from the standpoint of globalization of Japan.

Also I would just add a little footnote. Mr. Sakakibara mentioned that Japanese organizations often use foreign consulting firms. I would point out, as someone who works for a management consulting firm, that among the industrialized countries Japan has the lowest use of outside management consultants, which perhaps may have something to do with the problems that some Japanese companies are facing now with the reluctance to look at objective third party analysis and advice.

SAKAKIBARA: Thank you.

COORDINATOR: Mr. Abe?

ABE: Well, I'm with the graduate school of Waseda University and I cover primarily Asia and the Pacific, and from that perspective I'm trying to look into Japan.

One of the observations that I have made is as follows. We have a graduate school, and we look at the Asian countries where there are many Japanese presence, and we would like to train and nurture the people of those countries so they become the local managers of the Japanese transplants. We are very eager to provide such education and revisit the human resource management of different countries and try to urge to send younger local people to Japan to be trained.

At the corporate headquarters, they say that they do not talk much about developing the local managers in the long run. If that is the case that is very strange and surprising.

COORDINATOR: Thank you. I am not going to identify a particular subject, but if anyone wishes to comment, supplement, raise new questions, ask new questions.

Well, let me just introduce one of the questions from the audience. The current exchange market is in a state of turmoil. Is this a sign of a burst of a new era or new system? Is it a dollar crisis or a world currency crisis? How would you term the current confusion?

SAKAKIBARA: For the past fortnight or so, we have seen the weakening of the dollar. As I have said earlier, hedge funds are suffering from the loss of liquidity, went around to get more liquidity, and they were in a panicky situation. The tiger fund said that they lost 2 billion dollars a day because of the currency fluctuation, 20 yen of

fluctuation in a couple of days. That's unprecedented. A similar thing has happened between the dollar and the Deutschemark. It went from 1.8 DM to 1.6.

So apparently the Wall Street and miracle financial system triggered the whole turmoil, and we may trace back further to Latin America and Brazil, but as far as this last fortnight is concerned, I think we can describe the process that way.

Is it a sign for a new age or system? We do not know. Euro will come into the market, and as euro makes its debut how would it relate itself to the US dollar? The Japanese economy is weakening. Therefore, on a relative note for the past twelve months or so, the yen has lost its strength and position tremendously.

So, given those developments, we do not know what the currency market or system would look like in the future. To build something in lieu of the Bretton Woods system, we will have to engage in such debate also.

I think we will continue to see the situation with high volatility. Therefore, don't touch or get closer to the foreign currencies. I think that's what we're saying. Currencies of different countries are going back home because that will be the least risky. If the yen comes back to Japan, at least if you're using yen in Japan, there is zero risk. If the US dollar is going back to the US, the euro currency is going to the original countries, the risk will be zero.

It is a credit contraction, but that is the best to hedge or to minimize the risk because if you buy the futures and hedge, it will be costly, so returning to the home market, the home currency, would be one idea, and that is happening. So it is a contraction process of global capitalism.

Where is it headed and in what direction? I think the next two or three months will hold the key. By the same token, the next two or three months will hold the key of the destiny of the Japanese economy, and the same thing can be said for the world

economy.

COORDINATOR: Thank you for your very stimulating view. Would anyone care to respond?

EMMOTT: I would like to respond to Mr. Sakakibara by raising a question to him as well which he may think is an unfair question.

But I very much agree with his analysis of what is happening now, that, in a way, the currency movements are a symptom of what is going on rather than the disease itself. They are a symptom of the credit contraction that's happening and with the violence of movement.

But also what will happen, as he said, on January 1st next year is the launch of the euro, so eleven countries in Europe will be sharing a single currency and, simultaneously, with worries about free floating currencies and bad experiences in Asia with semi-fixed currencies to the dollar, attention is bound sometime within the next two years or so to swing back to the idea of a yen bloc in Asia, and the idea of a currency based around the yen as a bench mark.

I wonder what Mr. Sakakibara would comment on that, and perhaps Mr. Abe looking at the Asia-Pacific area. Is this just a theoretical construction based on geography, or is there anything serious as a prospect in this area, do you think?

SAKAKIBARA: Thank you. The US dollar will continue to be used in Asian economies with no doubt. It will be the currency of trade. The Hong Kong dollar is still pegged to the US dollar. Everyone is looking at their exchange rate vis-a-vis US dollar. So, for the time being, the basic currency in Asia will be this dollar, and that will remain unchanged for sometime to come.

But, again, we are, in the mid and long term, eager to internationalize the yen, and

if we are successful in our endeavor, and if each Asian country wishes to put together a currency basket to reflect their trade, then we will have something different.

So the possibility, as you suggest, can be conceived in mid and long term, but in the short term I think in Asia as well as in Latin American countries, the US dollar will continue to be a dominant currency.

ABE I tend to agree with Mr. Sakakibara, but let me use different words and phrases. It really leads to what is the role of Japan in the world economy and, in particular, Asia. Determination, policy, would bring forth opportunities, would enhance the role of the yen, or vice versa.

So I think it is really what will be the intention. If the Japanese policies would be such that Asia and the Pacific should be taking a lead and transmitting the voice and trying to have a clout over the world, if Asia-Pacific can gain confidence, and this policy cycle can come into harmony with the actual implementation cycle, then the relationship between Japan and that of the Asian developing nations would go beyond that of production but to psychological and human exchange level, and the more we go then I'm sure we will see the advancement of internationalization of the yen in Asia.

So if we intend to do certain things, if there is a clear intention to do certain things, I think that would enhance the possibility.

SAKAKIBARA: May I add one thing? I think it is a very difficult question. English is the common language, working language, of Asian countries. Japan is an exception. We feel somewhat uneasy about English, but the other Asian countries, if you want to do something in Asia, again there is this linguistic challenge, and Asia is still a dollar bloc, and UK, after all, was a colonial power for many, many years, so the influence of the UK has not disappeared yet, and the Americans have influence over the Philippines.

So we talk about Asia, but Asia is full of diversity so we want to be closer to

Asia. The Japanese must be bilingual so that we can at least converse on equal terms with the Asians. Those A B C's, the fundamentals, are important. We cannot dare to dream about creating such Japanese yen bloc.

FUKUSHIMA: That relates to the overall theme of our discussion about Japan's role in the international community, Japan's attractiveness and international harmony, and this is a subject which I think does relate to the immediate discussion we've had that has to do with Japan's role as a market for foreign direct investment.

It would appear to me that, in addition to, as Mr. Sakakibara says, Japan becoming more active externally, that what is truly important, I believe, in thinking about Japan's role, is the receiving by Japan of investment. I think this will have many different effects, including promoting more trade, also helping to rationalize the employment system in Japan leading probably to more labor mobility, will probably increase the transparency of business transactions, will stimulate technology and technology transfer, will probably stimulate more international or so-called global standards being used in accounting and financial transactions, and also increase the stake that other countries have in the well-being of the Japanese economy.

And, so, I think for all these reasons, it is quite important to think about Japan actively encouraging foreign direct investment into Japan as a way, as really a vehicle, to enhance Japan's attractiveness both for the people living in Japan as well as for those who would like to do business in Japan.

I think this would also contribute to the international harmony in the sense of creating the environment that would lead to Japan having the capability of dealing in English and dealing with more--I know Mr. Sakakibara will take exception to this--but with some more universalistic ways of doing business as opposed to the particularistic ways that have characterized many Japanese business practices.

COORDINATOR: Thank you very much. We in Japan tend to think about the

promotion of the internationalization of the yen but, yes, we have high savings and we have to invest overseas, but how is it the case that we are accepting FDI direct investments into Japan? There is a major imbalance there.

And also when we talk about the dollar bloc or whatever bloc it may be, the dollar circulating throughout the world means the US is a debtor country. Can we leave the situation as it is forever? When euro becomes a reality, then there will be a significant rebalancing in favor of euro. It will be a major change in conditions and terms for the use of the US dollar as an international currency.

So, what do you think about the euro? Will it be a counter-balance against the US dollar? Now, the US-European trade may not be large with the introduction of euro, but what do you think about the euro introduction? Do you have comments on this, please? Mr. Emmott.

EMMOTT: I think it's very difficult to foresee what will be the effect of the euro's introduction on people outside Europe. It's easy to see what will be the effect inside, or at least to understand the direction of the change inside the single market or inside the euro eleven countries, maybe not the speed but, certainly, the direction. But outside it's much more difficult. It will be one new currency covering an economy and area of equivalent size to the United States, broadly defined, slightly larger all together, perhaps, and it depends very much on the way in which the central bank in Europe and then the national governments conduct their policies, macro economic policies, monetary and fiscal.

The likeliest prediction, I suppose, is that the new European central bank would be determined to establish its credentials as an inflation fighter and, therefore, everyone has assumed that the euro would be established as quite a strong currency with tight monetary policy to prevent any inflationary tendencies.

However, that prediction may now be out of date because of the current situation

in the world economy, the current credit contraction and, in particular, the quite severe exposures of European banks to losses in emerging markets and in hedge funds, some of these big currency movements.

So, as we approach January 1st and the introduction of the responsibility of monetary policy to the European central bank, I think we see them with quite a difficult dilemma. Are they going to want to establish themselves as tougher than the Bundesbank, or are they going to need quite quickly to see themselves as part of a rescue effort, both for their own banks and as part of a worldwide rescue effort?

In line with my pessimism about the situation, and Dr. Sakakibara's even greater pessimism about the situation, I think the balance of prediction should shift towards the rescue effort and away from the inflation fighting credentials. I think we will see the European central bank under a great deal of pressure to cut interest rates, to operate quite a loose monetary policy, which then makes it, I think, impossible to predict, really, whether or not the euro will suddenly become a currency that everyone wants to hold and start to replace the dollar, or whether the dollar will retain its supreme position.

If you force me to make a bet, I would keep my bet on the dollar rather in the way Dr. Sakakibara just did in the Asian context. But I don't think it's an easy bet to make, certainly not in the context of some countries that have very extensive trade with Europe, with the European Union, and in Eastern Europe and with Russia. There the temptation to hold balances in euros and to start a process equivalent to dollarization, of Euroization of the economy, may increase.

But, on balance, my suspicion is that the euro will be not so strong, or at least that policy will be loose to try to prevent it from being too strong and to try to help the reflation process and credit creation process and, therefore, that it's unlikely to suddenly take the leadership role away from the dollar.

SAKAKIBARA: Now, a related question, Mr. Emmott. I have opportunities to

meet with the central bankers from Europe or ministers of finance. Lafontaine will be the finance minister in Germany now, and if that happens there will be a considerable gap in position opinions of all the central bankers and ministers of finance within Europe.

The monetarist type of view, as represented by ECB, inflation fighter type of stance, that has been the position of the central bankers, Lafontaine, and Mr. Brown, I don't know what his position is there, Social Democrats, so I think their views are somewhat different, so there is a difference of balance of power. How do you foresee that balance of power going forward? I know it's a difficult question, I apologize.

EMMOTT: Well, let me say, first of all, that I think the change of government in Germany is probably of great benefit in the context of the single currency for the following reason that the previous government, and the finance minister, in particular, was closely identified with the so-called "stability pact" in the single currency, a stability pact which seeks to prevent any country from running a fiscal deficit of larger than 3 percent...

(Note: end of side A of tape)...GDP, a stability pact which it seemed to me always was an economic nonsense and was really designed for political reasons within Germany.

Fortunately, the new government in Germany will not come to power so closely identified with that stability pact. Therefore, I think that on the fiscal policy side we may see more freedom of maneuver in the euro area than might otherwise have been the case or that might be expected, so that the kind of proposal that Dr. Sakakibara made earlier about a coordinated Keynesian reflationary effort may be easier today than it was two weeks ago before the German election because there will be a more openness about fiscal policy.

If fiscal policy is permitted within Europe to take on more of the burden of demand, management of boosting demand, then that will take some of the pressure away from the central bankers. I think central bankers will still be under political pressure, of course, but they also will want to establish their independence and their credibility in the

markets, and I think that probably finance ministers will try to leave them alone as much as they can at first for that reason because they know that central bankers need to establish some credibility.

But, in this period, the first six months of the euro and coinciding with world financial turmoil, it may be that the interests of the central bankers and the finance ministers may, in fact, converge and may be not so different as they would have looked six months ago.

At the moment, I think the central bankers in Europe would be wrong to cut interest rates because European economy is still strong, the process of credit contraction has not really taken hold in Europe, and they should wait and see for a little while. European interest rates are already low by world standards, but over the next six months, as this process develops, I'm sure that we will start to see interest rate cuts in Europe if the kind of pessimistic scenario that we've been painting proves to be true. In that case, I don't think they will be under too much of an onslaught from the finance ministers because I think their interest will begin to converge.

But the key question to me is what will happen on the fiscal side. Will Europe follow a sort of new fiscal ideology of tight fiscal policy laid down by the Germans in the run-up to the launch of the single currency under the Maastricht Treaty conditions? Will they treat this as a new ideology that they must adhere to? If they do, that is dangerous, in my mind. It's too inflexible and it's too much, to me, like the kind of policy mistakes that were made in America after the Wall Street crash of 1929 when the government tried to balance the budget rather than reflating.

That's the danger in Europe. I think that the recent events in Germany, although I didn't like the election results for other reasons, this actually could be a good part of the election results.

SAKAKIBARA: Okay, thank you.

COORDINATOR: Thank you, gentlemen. We have received comments from an overall perspective, but there is one other issue on which I would like to solicit your opinion that relates to Russia and the financial crisis there.

Thus far, the IMF has been playing a central role, but how should the Russian financial crisis be resolved? Mr. Fukushima first. Russia, of course, is a very difficult country to comment on. It's too huge and its debt is too huge, too. Or should I invite Mr. Emmott first?

FUKUSHIMA: Well, not being a specialist on the Russian economy, I am not really in a position to say, but I think that the problems of the Russian economy are actually very serious. I guess I would say that I am somewhat pessimistic about the short term ability of the Russian economy to get itself out of the current malaise, and I am not very encouraged by the past attempts by economists of one sort or another from the outside to provide advice as to how to solve these problems in Russia.

I think the Russian economy over a number of years has accumulated a number of major problems that have not been dealt with and, therefore, in order to remedy the situation it is going to take, I would think, something on the order of a decade or more. So I don't have any good prescriptions in the short term to solve the problem. Perhaps Mr. Emmott does.

EMMOTT: No. I would comment, perhaps naughtily, that management consultants always think that outside advice from economists is a bad idea, but outside advice from them is a good idea.

But, more seriously, I think that the situation in Russia is a political crisis and not a financial crisis, and that the real questions are about President Yeltsin. He should resign, in my opinion, but, then, the question is what replaces him. Probably it's better if some sort of change happens sooner rather than later, but that doesn't necessarily mean

that it would be an immediate improvement.

Russia needs a secure credible government capable of reestablishing the rule of law before it can implement anybody's economic advice, and that just isn't present at the moment. It may be that Russia will have to go through a change of president, a change of administration, follow some very bad policies, see that they don't work, and then change again back towards a more liberal reform program. That perhaps is the optimistic view.

ABE: Mr. Emmott has mentioned that Russia's problem is a political one, and I don't disagree with him. A month or two ago, there was a very interesting article on foreign affairs titled "Russia's Virtual Economy". Maybe 50 or 60 percent of the Russian economy is based upon barter. It's a nonmarket economy, according to this article, a very well written one.

Admitted I am not a Russian expert, but by combining various pieces of facts and reality, it seems that such virtual economy seems to exist in Russia.

In other words, what we're dealing with in Russia is not a market economy, and that fact has become much clearer than in the past. In that case, when we talk about reform in Russia, and IMF has been supporting Russia on the basis that Russia would reform itself, but we have to question whether this approach can continue to be viable or an entirely different approach should be attempted in Russia.

If we are to have a person like Kiriyenko at the helm in Russia, would that change the situation for the better? I'm not quite sure.

In relation to the discussion we have just had, IMF tends to attach very difficult conditionality to Asia, but when it comes to Russia some people say that it doesn't attach any conditionality, it seems. IMF poured in huge amounts of funds, and nobody knows what happened to those funds made available by the IMF.

Although Dr. Sakakibara touched upon this slightly, how should we deal with Russia. This remains to be a very difficult challenge for all of us down the road.

COORDINATOR: We have just talked about the political situation in Russia. There is another question raised from the floor addressed to Mr. Emmott, one advice, actually advice, posed by a foreign journalist stationed here in Japan.

Even if the House of Representatives may be dissolved here in Japan, there may not be any political party being able to obtain majority. In the House of Councillors, which is dominated by opposition parties, the political situation here in Japan would not change for the better even if a general election may be called. This is one advice coming from a foreign correspondent in the audience.

I do have a similar view myself.

EMMOTT: I am obviously not well qualified to comment on the Japanese political situation. Perhaps nobody is, and I'm sure that that judgment is all too plausible, unfortunately.

My only comment would be that without an election the political situation is very bad, with an election it might still be bad but, at least, there would be some small possibility that it might improve if you had some kind of election. But it's only a small possibility, and the history of many countries' politics is that elections often create new problems, I agree with that.

COORDINATOR: Well, I also believe that with the election, I hope the quality of politicians will be improved for the better.

Thank you very much, indeed, for your indulgence and for your kind attention. I think only five minutes remain till the end of this symposium. Some of you may be

rather tired by now, so I would like to conclude the panel discussion with this.

Thank you very much for your participation and for your very kind attention.

MODERATOR: I would like to thank all the panel members for a very interesting panel discussion, and with this I would like to conclude and close the symposium today, and I would like to express my sincere gratitude for your participation today. Thank you. The session is adjourned.

(END OF SYMPOSIUM)