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**Emerging China and the Asian Economy
in the Coming Decade**

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Preface

This is a record of proceedings of the 11th symposium by IIMA, which periodically sponsors symposiums and seminars on international economic and monetary matters. The 11th symposium was held on November 14, 2002, at Keidanren Kaikan Hall in Tokyo, with the cosponsorship of the Yomiuri International Economic Society (YIES).

Many East Asian economies suffered from the unprecedented hardships inflicted by the financial crises of 1997-98, but with assistance from the international financial world, as well as their own efforts toward structural reform, soon got on the road to swift ---albeit uneven---recovery. In the last 5 years, these countries have experienced three important changes : comprehensive reforms covering budgetary and legal structures, and corporate governance ; deepening interdependence in trade and capital transactions, and progress in regional cooperation ; and the expansion of China's market economy, and its increasing impact on the global economy after gaining membership in the WTO.

Against this background, what efforts should be made for East Asian countries to form an economic area equal to the EU or NAFTA, and to regain the former vitality of the "Asian Miracle" ?

Each representing their own countries, our distinguished panelists focused their discussion especially on the progress and future prospects for structural reforms in their countries ; ways to facilitate regional cooperation and market integration in East Asia, as well as a desirable currency regime ; and the impact of China's high economic development on regional trade structures, together with desirable international division of labor (i.e., specialization) within the region.

The names of the panelists and organizers and short profiles of them are available below. (Please note that all responsibility in compiling these speeches and discussions is solely of IIMA's, as are any errors in their pres-

entation here.) We hope the opinions and discussions presented here will be informative to those interested in the developments of the Asian economies and their regional cooperation.

Panelists :

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Managing Director and Executive Vice President, Bank of China

- 1979 Graduated from Beijing Second Foreign Languages Institute
- 1980 Joined Bank of China
- 1985 Master's Degree in International Management Studies, University of Texas at Dallas
- 1999 Managing Director of the Board
- 2000— Executive Vice President

Dorodjatun Kuntjoro-Jakti

Minister, Coordinating Ministry for Economic Affairs, Indonesia

- 1965 Degree in Economics, University of Indonesia
 - 1966 MA in Financial Administration, University of California, Berkeley
 - 1981 Ph.D. in Political Economy, University of California, Berkeley
 - 1994 Dean and Professor of Economics, Faculty of Economics, University of Indonesia
 - 1998 Ambassador of Indonesia to the US.
 - 2001— Minister, Coordinating Ministry for Economic Affairs
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Pridiyathorn Devakula

Governor, Bank of Thailand

- 1961 Graduated from St. Gabriel's College, Bangkok
- 1967 Bachelor of Economics (First Class Honors), Thammasat University
- 1970 MBA (International Business), Wharton School, University of Pennsylvania
- 1971 Thai Farmers Bank (last position : Director and Senior Executive Vice President)
- 1990 Government Spokesman
- 1991 Deputy Minister of Commerce
- 1993 President of Export-Import Bank of Thailand
- 2001— Governor of Bank of Thailand

Choongsoo Kim

President, Korea Development Institute

- 1973 BA in Economics, Seoul National University
 - 1979 Ph.D, in Economics (majoring in Econometrics, Labor Economics)
 - 1979 Senior Research Associate, Center for Human Resources Research, Ohio State University
 - 1988 Director, Research Planning and Coordination, KDI
 - 1995 Minister and Head of the OECD Office, Korean Embassy in Paris
 - 1997 President, Korea Institute of Public Finance
 - 1998— Professor, Graduate School of Pan-Pacific International Studies (GSP) , Kyung Hee University
 - 2002— President, Korea Development Institute
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Tsutomu Kanai

Chairman of the Board and Director, Hitachi, Ltd

- 1953 Graduated from University of Tokyo
- 1958 Master's Degree in Mechanical Engineering, University of Tokyo
- 1958 Joined Hitachi, Ltd. (General Research Laboratory)
- 1959 Ph.D. in Mechanical Engineering, University of Tokyo
- 1981 General Manager, Hitachi Works
- 1985 Executive Managing Director and Group Executive of the Power Group
- 1986 Senior Vice President and Director
- 1989 Executive Vice President and Director
- 1990 President and Director
- 1999— Chairman of the Board and Director

Haruhiko Kuroda

Vice Minister of Finance for International Affairs, Ministry of Finance

- 1967 Graduated from University of Tokyo
 - 1967 Joined the Ministry of Finance
 - 1971 M. Phil. in Economics, University of Oxford, United Kingdom
 - 1975 Advisor to the ED (Japan), International Monetary Fund
 - 1987 Director, International Organizations Division, International Finance Bureau, Ministry of Finance
 - 1992 Deputy Vice Minister of Finance for International Affairs
 - 1996 President, Institute of Fiscal and Monetary Policy, Ministry of Finance
 - 1997 Director-General, International Bureau
 - 1999— Vice Minister of Finance for International Affairs
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Hiroshi Yasuda

Chairman, Yomiuri International Economic Society

- 1957 Graduated from University of Tokyo
- 1957 Joined the Ministry of Finance
- 1986 Deputy Vice Minister, the Economic Planning Agency
- 1988 Deputy Vice Minister, Ministry of Finance
- 1990 Director-General, Budget Bureau
- 1991 Vice Minister of Finance
- 1994 President, Export-Import Bank of Japan
- 1999 President, Japan Bank for International Cooperation
- 2002— Chairman, Yomiuri International Economic Society

Toyoo Gyohten

President, Institute for International Monetary Affairs

- 1955 Graduated from University of Tokyo
 - 1955 Joined the Ministry of Finance
 - 1984 Director-General, International Finance Bureau
 - 1986 Vice Minister of Finance for International Affairs
 - 1990 Visiting Professor at Princeton University
 - 1992 Chairman, the Bank of Tokyo, Ltd.
 - 1995— President, Institute for International Monetary Affairs
 - 1996— Senior advisor, the Bank of Tokyo-Mitsubishi, Ltd.
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1. Opening Remarks

Toyoo Gyohten, President of IIMA

Good afternoon, ladies and gentlemen. Thank you very much for coming to this symposium co-sponsored by our Institute and the Yomiuri International Economic Society.

In 1997 the Asian financial crisis and currency crisis broke out and it has been five years since that event. Thanks to the strenuous efforts made by each individual country, the serious impact on the economies stemming from the crisis had been eliminated with the pre-crisis conditions restored more or less. However, more recently here in Asia we have seen the re-emergence of a variety of geopolitical risks. We have seen terrorism in Bali, Indonesia, which is just an example of such risks and the development, holding or ownership of nuclear weapons by North Korea is another such example of geopolitical risks.

In terms of the world economy, the US economy is quite slow in achieving its recovery. Because of the Iraqi conditions the uncertainties have been amplified and all in all the factors of instability still persist.

In the coming decade under such circumstances, each individual country in the region needs to strengthen the structure and constitutions of one's economy while tightening regional cooperation, both in monetary and economic areas as much as possible. One of the points of greatest interest for the future of Asian economies, in my view, is the role to be played by the Chinese economy.

As is well known, with the combination of effective economic policies,

active introduction of capital and technology from abroad, and also the vigorous entrepreneur spirit in a very appropriate way, Chinese economy achieved a remarkable development and growth in the past two decades. Especially using as a lever cheap and abundant labor force of high quality and under-valued exchange rates, China actually has become an important production base for the world of a broad line of products.

The position of China has risen sharply in the global export markets and at the same time the foreign direct investments are increasingly concentrating in China. These facts among others serve as a very important stimulus as well as challenges vis-à-vis other economies within Asia.

Of course, other Asian economies also need to improve competitiveness by achieving financial rehabilitation or industrial structural reform. They need to heighten their competitive edge through these means. But at the same time we need to institutionalize the cooperation within the region in terms of trade, investment, monetary and financial affairs to achieve further development, so that competition within the region produce positive and plus-some effect.

Today, the Institution for International Monetary Affairs and the Yomiuri International Economic Society are jointly organizing this international monetary symposium. We have the privilege of inviting the distinguished leaders from both public and private sectors of major economies in the region to talk about the outlook as well as challenges of the Asian economies in the coming decade from their respective perspectives. It is indeed a great pleasure for organizers to be able to invite such renowned panel members to add to the significance of the symposium. At the same we are enjoying the tremendous support and cooperation of another institute for the organization of this symposium, to whom I would like to express my sincere gratitude.

So, for the coming half a day or so, I hope you would take enough time in enjoying, or enjoyment may not be the appropriate word I should say, but make the best use of whatever you can learn from this symposium. Thank you very much.

Hiroshi Yasuda, Chairman of YIES

Good afternoon, ladies and gentlemen. My name is Yasuda, Chairman of the Yomiuri International Economic Society. Together with the Institute for International Monetary Affairs, YIES has organized this international monetary symposium today.

First of all, to our six distinguished members on the panel, I would like to express my sincere gratitude for agreeing to be the panel members despite their extremely occupied schedule. Furthermore, I would like to express my appreciation to each and everyone of you in the audience for showing such a great interest to the theme of the symposium today. I would like to thank also all of you for taking time to attend this meeting. I sincerely welcome you all.

Our organization, the Yomiuri International Economic Society, was established some 30 years ago. At the time the so-called Nixon shock or Nixon crisis triggered the exposure of the Japanese economy to the full-fledged wave of internationalization. It was back in 1972 that YIES came into being, and it has been 3 decades since then. In these intervening three decades of changing world economy, we have organized symposiums as we are having today, or seminar meetings occasionally in a very active manner, taking up important challenges and agendas at the time.

Here today we have joined hands with Mr. Gyohten who is well known as the so-called monetary Mafia member, and serves as President of Institute for International Monetary Affairs. Together with his institution IIMA, we have the privilege of organizing this symposium. It is indeed a great privilege and honor for us to be able to do so. I trust that the symposium being held at this time is a very timely one.

The theme of today's international monetary symposium is "Emerging China and the Asian Economy in the Coming Decade." Through active and enthusiastic discussion, I hope you will be able to gain constructive and fruitful conceptions.

We once talked about the Asian crisis and I hope in the symposium we would like to discern the ways and avenues for restoring the path toward Asian miracle once again. Thank you very much for your attendance today.

Gyohten : Thank you very much. Gentlemen, now I would like to open Part I of the symposium. As was introduced, this part will be dedicated to listen to your initial presentations. I would like to call upon each one of you in the order stipulated in this program to make your presentation. I think you might go up to the podium to make your presentation. I am sure audience would like to see your face, not only listen to your speeches. So, may I call upon Mr. He, first. Thank you very much.

2. China's Economic Restructuring and Banking Reform

He Guangbei, Managing Director and Executive Vice President, Bank of China

Mr. Chairman, Ladies and Gentlemen. It is my pleasure to take part in today's International Monetary Symposium. I would like to share with you my views on three topics, namely China's economic restructuring, the reform of the state-owned commercial banks and the disposition of non-performing loans.

China's Economic Restructuring

China's economy has experienced rapid growth since 1979 when the country adopted the open-door policy. After the Asian Financial crisis, to offset the negative impact of external factors and to address structural problems of the economy, China adjusted its economic policy in 1998 to expand the domestic market. Macro economic policy in recent years has focused on maintaining an active fiscal policy and a stable monetary policy, promoting market-based economic structural change, improving overall operating environment and market order. This policy mix has allowed China to increase its economic efficiency, expand the size and depth of its domestic market and open its economy further to international competition. Since 1998, China's annual GDP growth rates have all exceeded 7%.

In terms of nation-wide industry structural shift, China has used its fiscal policy, in connection with adjustments in corporate ownership, geographic economic reallocation and urbanization of the rural areas to promote structural changes. In the last 5 years, the percentage of the industrial sector

in the GDP rose from 49% to 51% and the service sector from 32% to 34%, while the agricultural sector dropped from 19% to 15%. It is projected that by 2005, the ratio of the three sectors in the total national output will be 51%, 36% and 13%, a significant optimization from the past.

Now, let's further look into each sector. Agriculture saw continued enrichment in its product mix driven by diversified market demands. Further geographic concentration of agricultural production allowed the sector to achieve far better economies of scale. The industrial sector has been largely led by manufacturing, especially electronics and communications, transportation, mechanical equipment. These industries contribute the most to the growth of industrial sector accounting 35.7% of the increase of the sector in 2001, 4.5 percentage points more than last year. Meanwhile, contribution from power, oil and IT increased noticeably. In contrast, traditional industries, such as iron and steel, textile and building material, declined comparatively. The service industry, which has gained some growth, still remains under-weighted in the economy and has a lot of room to grow. Demand for services will increase in pace with China's sustained economic development. As aggregate domestic demand increases, areas such as catering, telecommunication, transportation and financial services will achieve above-average growth. Moreover, as the entry barrier for a selected tertiary industries, such as telecommunications, aviation and financial services, are being gradually lowered, more investments will drive their further expansion.

China has maintained a stimulus fiscal policy since 1998, the key feature of which is the total of RMB 510 billion infrastructure treasury bonds issued by M.O.F. The funds have been used to finance energy, transportation, communication and environmental protection projects in order to improve industrial structure, investment environment, geographic allocation of resources and commodity flow across the nation. The infrastructure bonds

served as start-up funding for the projects which attracted 5 times as much capital spending on related projects. Meanwhile, domestic private investment has also increased by a large margin. Between 1998 and 2001, domestic private investment increased at an average annual rate of 18.8% and its share in total investment climbed from 35.9% in 1997 to 44.6% in 2001.

Since 1998, per capital disposable income of urban households and net income of rural households have increased steadily, at respective annual rates of 7.38% and 3.16%. This has boosted domestic consumption. Despite the flagging consumer price index which reflects long-time structural problems and excessive production capacity in certain commodities, sales of consumer products rose constantly. In the first three quarters of 2002, consumer goods sales rose 8.7% with communications devices, car and housing propping up much of the increase. Spending on tourism and cultural entertainment has also risen rapidly.

Although state-owned enterprises still play a key role, private enterprises are becoming an increasingly important part of the national economy. In 2001 alone, the registered capital of private enterprises rose by 36.8%, reaching 1.82 trillion RMB. In some well developed provinces, their activities have constituted over 60% of the provincial GDP, over-taking the SOEs to become the back-bone of the local economy.

In 2001, China's international trade volume reached US\$509.8 billion U. S. dollars, ranking the sixth in the world trade league table. While strong growth has always been the characteristic of China's external trade, structure and components of trade are gradually shifting away from the traditional prototype. Though low value-added products and agricultural goods still occupy a chunk of the export, machinery electronic goods and high-tech products are growing much faster and have become the driving force of the

export growth. Just take the first eight months of this year for example, the share of machinery-electronic products reached 47.5% of total export and high-tech products export was 17.5% of total export. At the same time, in the first three quarters of 2002, the import of machinery-electronic products and high-tech products increased by 24% and 38.8% compared to last year respectively. I think our import of capital-intensive and technology-intensive products will continue to increase in the next decades or so.

Despite of the efforts and improvements we have made, the same problems still exist. In fact, some of the problems may not be fully solved at all. Structural problems, such as mis-allocation of resources, low productivity and efficiency, weak agriculture sector, the low proportion of the service industry and unemployment, are issues that could hinder China's further growth. And the Chinese government needs to address these problems. In my opinion, the following will be needed to ensure the success of further reforms. First, maintain the active fiscal policy and stable monetary policy to keep the momentum in domestic demand. Second, promote technological innovation to enhance productivity. Third, increase investment in agriculture, improve production structure and quality and raise the income of the rural population. Fourth, improve infrastructure and environment to achieve coordinated growth between different regions. And fifth, improve investment environment, stimulate domestic private investment.

Reform of the State-owned Commercial Banks

Financial system reform will remain to be an important part of China's overall economic reform in the coming years. China's ongoing financial reform includes establishing and improving the structure of financial system, financial market, regulation and supervision. The reform of the state-owned commercial banks is a critical task of the financial reform.

2001 was an important year for China's state-owned commercial banks. Progress achieved in the year includes :

First, asset expansion and diversification of asset structure. By the end of 2001, the total assets of China's four state-owned commercial banks reached 13 trillion RMB, an increase of 16% over 2000. Meanwhile, asset structure has been improved as a result of product diversification. New financing products, such as receivable financing, discounted bills, credit card financing and mortgage loans, have increased their shares in the asset portfolio, reversing the dominance by traditional corporate loans and project financing. Take discounted bills for example, its business volume has increased by 91.55 % in 2001 alone. In addition, investment in marketable securities, such as treasury bonds and bonds issued by policy banks, has also increased. Such changes allowed banks to increase the liquidity and efficiency of their assets while reducing the risks.

Second, the profitability of the state-owned banks has increased. In 2001, state-owned commercial banks made a collective 27 billion RMB in profit, up about 100% compared with 1998. This was achieved after spending 80 billion RMB in provisioning and loan write-off. The profitability figure was more reliable as banks had adopted prudent accounting principles.

Third, more efforts have been made in improving corporate governance in the banks. All banks have tightened risk control to ensure the asset quality. Five-tier loan classification method has been widely applied and the loan approval procedure remolded after international best practice. New accounting standards have been adopted and financial disclosure significantly improved. Meanwhile, banks have generally introduced performance evaluation and incentive schemes for its employees. The pace of consolidation of branch network and streamlining of employees has also quickened. By the end of

2001, 34,000 bank offices had been closed and the number of total staffs in state-owned commercial banks had been reduced by 127,000. With the above measures, state-owned commercial banks achieved better asset quality, profitability and operational efficiency.

The reform of the state-owned commercial banks is a long journey. Thorny problems such as the high NPL ratio, which negatively impacts the capital adequacy ratio and profitability, and the problem with the governance structure cannot be solved overnight. To press ahead with the reforms, the People Bank of China, China's central bank, made a plan to launch a comprehensive reform of state-owned commercial banks. The target is to, in about five years'time, build the four state-owned commercial banks into large modern commercial banks which are able to compete in the international financial market. Further reform measures would include :

First, change the ownership structure of state-owned commercial banks to bring in good corporate governance. In this regard, the state-owned commercial banks should follow a step-by-step approach to be ultimately listed in the stock market. Corporate governance can be best strengthened once banks are subject to market discipline and investor scrutiny.

The next part of the reform would be to recapitalize the banks through increasing retained earnings, subordinated debts and equity offerings. The near term target is to increase the capital adequacy ratio to above 8%. Asset quality has to be further improved with the increased efforts in NPL disposition and risk management. To increase earnings, state-owned commercial banks are encouraged to introduce more financial products to meet the need of their customers.

The government has also laid out rules for monitoring the performance

of commercial banks. Timely performance evaluation of state-owned commercial banks will concentrate on four key aspects, asset quality, earnings, liquidity and capital adequacy. Moreover, state-owned commercial banks are urged to enhance information disclosure and transparency. Commercial banks are required to fully disclose their financial information in accordance with international accounting norms in two years.

In the whole process of China's banking reform, ownership structure is the linchpin. In recent year, real progress has been made in this direction as exemplified by the restructuring and listing of the Bank of China Hong Kong operations. In 2001, the Bank of China restructured its operations in Hong Kong and formed Bank of China (Hong Kong) Limited. In July 2002, BOC Hong Kong (Holding) Limited was successfully listed in Hong Kong, making BOC the first state-owned commercial bank to have its operations listed. The listing was an important step in China's financial reform and was deemed to have strong influence on the country's financial sector.

The Disposition of NPLs

Reducing the NPL ratio has long been a priority task for China's state-owned commercial banks. In my opinion, to root out the NPL problem, we need a two-pronged approach. On the one hand, historical problem assets have to be resolved. On the other, the quality of new loans and earnings growth has to be secured.

In the last few years, all the state-owned commercial banks have stepped up their efforts in reducing NPLs. Asset management companies were formed to take over a large part of the NPLs from the four state-owned commercial banks. Up to the end of August, 2002, the total amount NPL disposed by the AMCs reached RMB 510.9 billion, over 40% of the total NPL taken by the

AMCs. In addition, NPLs workout departments have been formed in state-owned commercial banks, making the effort a day-to-day task.

Thanks to China's economic growth, commercial banks have been able to expand their loan books. The establishment of AMC and special department inside the banks also helps them to achieve better results in NPL recovery. Moreover, stronger earnings in recent years have allowed banks to write-off bad debts more quickly than before. As a result, the four state-owned commercial banks were able to reduce both the balance and the ratio of NPLs in 2001. The balance of NPLs declined by 9.07 billion RMB and the NPL ratio reached 25.36%, a reduction of 3.81 percentage points over the previous year. By June 2002, this ratio was further brought down to 23.39%. In the same time, the quality of the newly dispersed loans has improved significantly. Starting from January 1, 2002, China adopted the five-tier loan classification method. This demonstrates the commitment of the Chinese government, the regulatory authority and the commercial banks in addressing the NPL problem. In 2000, a target was set for the four state-owned commercial banks to reduce the NPL ratio by 2-3 percentage points each year and to bring the NPL ratio down below 15% in 5 years

Mr. Chairman, ladies and gentlemen, China is speeding up its process of integrating into the global economy and China's banking industry is facing new growth opportunities and challenges. We are confident that China's banking industry will be revitalized through further reforms. We look forward to strengthening the cooperation with you in the future. Thank you.

(Based on written text)

Gyohten : Thank you very much, Mr. He, for your very comprehensive account on the current status of Chinese economy and also many challenges it is faced with. Thank you very much. Now, I call upon Minister Dorodjatun

from Indonesia, please.

3. Indonesia's Four Reforms and Integration in the Region

Dorodjatun Kuntjoro-Jakti, Minister Coordinator for Economic Affairs, Republic of Indonesia

Excellencies, Ladies and Gentlemen, Distinguished Guests,

First, allow me to express my sincere appreciation to the Institute for International Monetary Affairs and Yomiuri International Economic Society for inviting me to this prestigious symposium, to represent the views of Indonesia.

May I begin first to convey on behalf of the Government of Indonesia, the people of Indonesia and President Megawati, our deepest sympathy and condolence to the bereaved families of victims and casualties from Japan because of the Bali tragedy. Also on this occasion, let me thank you, the people and the Government of Japan for your kind sentiments and support in the aftermath of the attack in Bali. I would particularly like to thank the Government of Japan and the Vice Minister of Finance for his sympathetic letter to the G-7 countries urging their support for Indonesian recovery. I can assure you that your genuine concern for the welfare of the Indonesian people will never be forgotten.

Ladies and Gentlemen,

At the outset, may I brief you on the aftermath of the attack in Bali. The terror attack in Bali was an outrage. Sadness and anger linger and we all still grieve for the victims and their families. However, we must now turn to the monumental task at hand, and that task in Indonesia is, and remains, how

best to develop and implement critical structural reforms. While at the same time sustaining efforts of capacity building, our responsibilities now include addressing the serious impacts of the Bali bombing.

We recognize the fact that continued reform will be difficult if not impossible in an environment where citizens and investors are concerned about their safety. We are resolved to improve security and fight terrorist groups, whether the source of terror is domestic or international. While appropriate steps have already been put in place to immediately deal with internal threats to security, the most immediate task is to find and bring to justice those involved in the Bali attack. Let me mention some of the anti-terrorism measures that the Government has taken since the attack in Bali.

The most important measure is the least quantifiable -- the resolve of the government of Indonesia to exterminate terrorism, root and branch. I want to stress that the Cabinet is standing shoulder to shoulder in facing this issue. It is a recognized fact that there are terrorists operating in Indonesia and we need to deal with them. In order to do this thoroughly and expeditiously, we have taken several initial measures.

First, security has been dramatically increased at tourist-related sites and for vital projects as well as critical infrastructure. We are leaving no stones unturned in the hunt for the perpetrators who are involved and the Government has enacted two Government Regulations in Lieu of Law (Perpu) to allow us to apprehend and prosecute individuals whose intent or action is terrorism. These regulations were not hastily constructed. They have been undergoing a careful development process for quite some time and therefore reflect the balanced set of priorities in the law on anti-terrorism that we are now proposing to Parliament. In fact, the leaders of Parliament have been active participants in the drafting of these anti-terrorism measures and all of

our main actions have been executed with its full support.

Second, the President has recognized that the fight against terrorism will not be a quick of easy victory. We will need stronger institutions and better trained personnel and this will be a priority in the years ahead. However, one of the short-run solutions is improved coordination among the intelligence units, which has been implemented. The President has issued instructions on how this is to be carried out.

Third, we are moving to quickly implement the Anti-money Laundering Law. The head of the Financial Intelligence Unit has been selected and his organization is being developed. This will put teeth into our ability to track financial flows related to terrorism and other crimes.

Distinguished Participants,

Now, let me brief you about the Government's Economic Strategy after the attack. Just a few weeks before the attack, the Government had intended to place the main emphasis to the donor country members of the Consultative Group on Indonesia (CGI) on the substantial progress made on the macroeconomic front, and on the opportunity that this presented to press on aggressively with our reform agenda. However, in virtually a repeat of the way things turned out last year, priorities will now have to be adjusted this time in the wake of the terrorist attack in Bali, as targets have been necessarily changed. Nevertheless, we remain determined to push ahead with the economic and structural reform measures agreed to by the parliament and the IMF.

If I have one central point to make today it is this: The present Government came into office in August 2001 determined to restore

macroeconomic stability, and we have no intention of sacrificing this strategic goal. This was and will remain the centerpiece of our economic strategy.

The key to this has been our effort to reduce fiscal deficit, and under President Megawati the Government has worked hard on this, attaining significant progress. We have been succeeding in reducing the debt that was still about 105% of GDP in three years ago is now closing in on 70%. This has not been easy: we have held down expenditures, adjusted prices for subsidized commodities and increased tax revenues, all in the face of a slow economic recovery.

We have also pursued another difficult political agenda this last year, accelerating the sale of assets held at the State Bank Restructuring Agency (IBRA). There are three reasons why we have pushed this agenda despite some opposition. First, we believe that a recovery in investment cannot occur until these assets are back in private hands. The Government is not in the business of owning business. Second, the longer these assets stay at IBRA the more they are likely to deteriorate, leaving the people of Indonesia, who have entrusted the Government with the sound management of these assets with diminished returns upon final sale. And finally, the funds from their sale can be used to meet budget needs or retire high priced debt.

Because of our commitment to promoting asset sales, this year there has seen a dramatic increase in IBRA activity, including the sale of large amounts of restructured and unstructured loans and property, the return of Bank Central Asia to the private sector, shortly followed by Bank Niaga which its sales and purchase agreement was signed last week, and will be followed by Bank Danamon, along with an effort to resolve the issues of former bank owners or take them to court. Last month's sale of property assets, our first sale in the aftermath of the Bali attack, resulted in assets sold at 139% of

their assessed value. We are now hopeful that a second offering of the other 50% of the property we hold will also receive a positive response. I might also note that the bombing has not influenced our plan to dispose of remaining assets and close IBRA by late 2003.

The Indonesian Government has also been working to resolve debt restructuring programs with large projects including those that involve Japanese funds such as the Chandra Asri Petrochemical project in Banten, the Tanjung Jati B electricity project in Central Java, Paiton I and II electricity projects in East Java ; Tuban Petrochemical in East Java. The Iskandar Muda and ASEAN Aceh Fertilizer plants in Aceh have been operating again for the last 12 months, while negotiation on the gas pipeline between South Sumatra and West Java is in the process of completion.

This focus on fiscal consolidation and accelerated asset sales has been effective and has, among other things, helped deliver increased macroeconomic stability. The Rupiah now is much less volatile than in the first weeks after the bombing, which resulted in a depreciation of a little over 1.5%. Inflation, despite the impact of higher fuel prices, is falling and should still be less than 10% by the end of the year. Interest rates have been coming down dramatically, declining from over 17% to 13% or over 400 basis points this year.

We had expected this progress to result in higher exports, investment and faster overall growth. And we also believe that there were indications that growth, exports and investment have actually began to pick up from their low points earlier in the year. However we have now had to reassess the situation and reduce some of our estimates for next year. The Government's position is that the current shock, while serious, is a temporary setback in our recovery program and one that with an effective and coordinated policy stance, and

some help from the international community, can be overcome within a year or so.

We will continue to pursue an economic strategy based on macroeconomic stabilization. Indeed, as we see it, the impact of the crisis leaves us little other choice. A failure to maintain fiscal stability would quickly affect the exchange rate, and in turn would push up inflation and interest rates. This would shorten time horizons, deter investment and promote corruption. However it is important to bear in mind that macroeconomic stability is a necessary but not sufficient in itself to maintain renewed growth. The other necessary conditions involve the rest of the reform agenda.

Ladies and Gentlemen,

On the larger picture of reform agenda, the bomb attack will not derail our commitment to completing “the Four Reformasi” to transform Indonesia which for three decades was governed by one of the longest, most severe and corrupt authoritarian regimes in the world, to an open-market democracy.

It is my belief that the success of the system of open-market democracy in Indonesia will be one of the major factors that will influence the future shape of the political, economic and social landscape of Asia. As a consequence, there are many strategic questions that will be answered by the continuing transformation of Indonesia. Questions such as: Will democracy work in a widely diversified large population country? Will Islam and democracy go hand-in-hand, complementing each other? Will the implementation of democracy disturb the stability and cause a decline in the economy of a developing country, as it did in some other countries?

I would like to make use of this opportunity to speak to you about how the REFORMASI (Reform) has changed Indonesia and its economy, and how the country will not merely recover from its financial crisis in the late 1990s, but also establish a new platform for a sustainable development in the future. As it would be a tall order to discuss this detailed issue comprehensively in a single session, I will endeavor to keep my remarks short and look forward to the question and answer session at the end of this presentation.

First, is political reform. A country as large and diversified as Indonesia should never have been and cannot be governed by an authoritarian system. With more than 300 ethnic groups and 600 languages, authoritarian rule is simply un-Indonesian!

Today, as a result of gains made during the REFORMASI in particular following the 1999 General Election, Indonesia has now evolved into the freest and most open society in Southeast Asia. The parliament, the press and non-governmental organizations are now an integral part of Indonesian politics. I always remind my fellow officials that we are now living in the glass house and can no longer throw stones to those who oppose the Government. We fully realize that we are the elected representatives of the people of Indonesia and entrusted by the people with the safeguarding of the heritage of future generations.

In the 2004 General Election, as the result of the Constitutional Amendments officiated by the People's Consultative Assembly (MPR) last August, the people will directly elect the president and vice-president. This will practically return the ultimate sovereignty of the people, which at the present holds by representatives of the people at the MPR, back to the people. The parliament will only consist of elected representatives, in the form of the current House of Representatives, and the new Council of

Regions Representatives, which its members shall be elected from every province through a general election.

The Amendments will improve the stability of the Indonesian Government in the future. It will create a strong Presidential system with better checks and balance and with separation of powers between legislature, executive and judiciary. The last MPR meeting has also constituted that the unitary state form of Republic of Indonesia and the Preamble of the constitution are unamendable, while at the same time reject the inclusion of Islamic Law in the Constitution.

Second, is economic reform. As the largest archipelago in the world, Indonesia for centuries has always been open to international trade and business. Most Indonesians are market people. It is very unusual that a country as large as Indonesia would have its export and import a ratio to GNP of more than 50%. This simply shows that market distortions created by the Government's policies during the last 20 years prior to the REFORMASI were once again, un-Indonesian. The economic policies that I have explained earlier are clear evidence of the sustainability of the economic reform.

Third, is administrative or bureaucratic reform, which is known by the more popular term, "decentralization." The centralized system of the past, when every single issue in the entire country was decided by Jakarta has changed dramatically and unequivocally. The huge central bureaucratic system has been decentralized. Authority and decision making power has been delegated to provinces and districts.

Fourth, is legal reform. All of the three reforms mentioned earlier have to be institutionalized to be effective and sustainable. This takes place in legal

and judicial reforms, which will provide certainty and clear “rules of the game” for the new Indonesia. The Government will no longer and indeed cannot implement policy in the absence of laws and regulations.

Ladies and Gentlemen,

I have always been asked what the nexus is of these reforms taking place in Indonesia. I would say it is the competitiveness of the country, as well as the provinces and districts under the new democracy determined firstly by regional trade liberalization such as the ASEAN Free Trade Area/AFTA, APEC and various interactions between these bilateral and regional trading frameworks, and in the final analysis by WTO rules and regulations.

This is the reason why Indonesia always embraces many ideas and concepts of trade and economic integration in the region. Within this notion, we welcome the enhanced partnership between ASEAN with China, Japan, and the Republic of Korea as a group known as ASEAN+3, as well as between ASEAN and each respective country agreed in the last ASEAN summit last week.

The ASEAN-China summit on Nov. 4 produced further breakthroughs in regional cooperation. A bilateral framework agreement on economic cooperation was signed, providing for an ASEAN-China free-trade area (ACFTA) to be implemented over a ten-year period. In a decade or more, ACFTA would become the largest trade agreement in the world, with a combined market of 1.7 billion people, GDP of \$2 trillion, and two-way trade of \$1.25 trillion. The agreement goes far beyond free trade issues, however, to include “economic cooperation, particularly in the areas of agriculture, information technology, human resource development, mutual investments, and the Mekong River Basin development.”

To that end, ASEAN and China signed a memorandum of understanding (MOU) on agricultural cooperation ; China will provide ASEAN with training and capacity-building activities in agriculture, fisheries and aquaculture, biotechnology, farm machinery, agro-industry, livestock production, harvest technology, and food security.

On the political front, the ASEAN leaders welcome the signing of the Declaration on the Conduct of Parties in the South China Sea by their respective foreign ministers that provides confidence-building activities between ASEAN and China. Indonesia, who is not among the disputing parties, always plays an active role in increasing the confidence-building measures between the claimant countries by hosting 12 meetings since 1990.

In addition to the Declaration on the South China Sea, the two sides adopted the *Joint Declarations of ASEAN and China Cooperation in the Field of Non-Traditional Security Issues*. China has expressed its interest to accede to the *Treaty of Amity and Cooperation in Southeast Asia* and stated its willingness to work with ASEAN to push for early accession to *the Southeast Asia Nuclear Weapons-Free Zone*.

These new accords are important contribution to the cause of regional and global peace. The Agreements also served the useful purpose of reviving attention to two major development projects in the region, which have received little attention since the 1997 economic crisis in Asia. These are the Brunei, Indonesia, Malaysia, the Philippines East Asia Economic Growth Area, known with its abbreviation BIMP-EAGA, surrounding the contested area of the South China Sea ; and the Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation zone, which complements the Greater Mekong Sub-regional development concept.

In addition to the potential gains as an ASEAN member, Indonesia has always supported China's economic development without any reservation. China's engines of growth would become an important market for our gas, coal and other mineral products. Last September China has signed a 25-year deal for the Tangguh gas field in the Province of Irian Jaya to supply around 2.5 mn tons of liquefied natural gas (LNG) per day to the Province of Fujian. The project is scheduled to start construction next year and be completed by 2006. It will require an initial investment of some US\$2.0 bn for two LNG trains with combined capacity of around 7.0 mn tons per day.

During the first Indonesia-China Energy Forum in September this year, Indonesian and Chinese companies have signed another six memoranda of understanding (MOU) to cooperate in the country's oil, mining and power sectors, marking closer relations between the countries in these fields. The six MOUs consists of three electricity power projects, one gas pipeline project, one oil and one coal exploration projects.

These are: the development of 65 Megawatt (MW) combined cycle power plant in Palembang, South Sumatra. The East Palembang power project, as it was named, was delayed by the government in 1997 due to the economic crisis. The project will be developed by China National Chemical Engineering and China ChengDa Chemical Eng. Co. with Indonesia's state electricity company (PLN) ; PLN also signed two other MOUs with Chinese companies. First, with China National Machinery & Equipment Import & Export Corp. to build a 220-MW coal fired power plant in Labuhan Angin, Sibolga, North Sumatra. The project is worth \$447 million ; the other China's company that signed an MOU with PLN was China Machine Building International Corp. for the development of the Parit Baru in Pontianak coal-fired power plant. The 100-MW power project is worth \$246 million ; Indonesia's state gas distribution and marketing firm, PT Perusahaan

Gas Negara/PGN, and CNOOC signed MOU to cooperate in the development of the gas pipeline linking East Kalimantan and East Java. The project is worth \$1.7 billion and is the largest gas pipeline ever built in Indonesia ; the Chinese state-owned energy giant, Sinopec, signed an MOU to buy a stake in the Batumandi, Diski and Basilan blocks, in North Sumatra from local Indonesian company ; while Indonesia's state-owned mining firm PT Bukit Asam also agreed with China National Technical Corp. to develop underground coal mines in Ombilin in South Sumatra.

At the same time, China has also expressed its interest to Indonesia's state oil company, Pertamina, in buying three million tons of LNG from Bontang field in the Province of East Kalimantan to supply China's province of Giangshu. China started establishing its foothold in the country's energy sector early this year with CNOOC, acquiring the Repsol-YPF assets in Indonesia. It was then followed by an acquisition of another Chinese state energy firm PetroChina of all the Indonesian assets of American firm Devon Energy. Today, both firms account for 12 percent of the country's daily oil output of more than 1.2 million barrels.

Ladies and Gentlemen,

I hope this presentation will provide you with a better understanding of how Indonesia's economy is progressing at the moment, as well as our views on China and the Asian Economy in the coming decade. I look forward to the questions and answers session to discussing many other important aspects of this topic.

Thank you. (Based on written text)

Gyohten : Thank you very much, Minister Dorodjatun. I am sure the audience was impressed by your determination to tide over the difficulties

created by that horrible experience in Bali. Thank you very much indeed. Now, may I call upon Governor Pridiyathorn of the Central Bank of Thailand.

4. Potential Problems and Opportunities in Asia

**M.R. Pridiyathorn Devakula, Governor,
the Bank of Thailand**

Mr. Gyohten, Mr. Yasuda, Distinguished Participants, Ladies and Gentlemen

With limited time we have, I would not bore you with too many details on what Thailand has done in the past 5 years. Every country facing the financial crisis has gone through, more or less, the same agenda—building a strong and sound economic foundation.

To rescue our financial situation, we shut down a large number of finance companies and a few banks. Moreover, we sold a couple of banks to foreign strategic partners and merged some of them together. All major banks were encouraged to increase their efficiency by closing unprofitable branches, improving their operating systems including computer systems, and overhauling their risk management strategy.

Asset Management Companies were established to separate bad assets from banks and other financial institutions. Restructuring of Non Performing Loans has received full attention from the government and the Bank of Thailand. Stringent regulations on loan loss provisions, risk assessment and good governance guidelines have been implemented to shore up our dismal financial sector. Some laws were amended to facilitate debt restructuring. But more need to be done to strengthen our financial system. The most important factor is that we have to keep up the good work and not let reform-fatigue get into our way.

Ladies and Gentlemen, the topics that I would like to spend more time on are the potential problems and opportunities for Asia to prosper in the future. This year, almost every country in Asia, especially East Asia has experienced a much better growth rate than last year. Mainly, the growth has been generated by the improvement of domestic consumption and intra-regional exports. The increasing trend in intra-regional trade within East Asia is a very interesting phenomenon, which I would like to spend more time on later.

But coupled with this good news are some threatening facts. A slump of demand in Japan, EU and US, and excess production capacity has resulted from China's emergence in the World Trade Arena. The prices of export goods by East Asian countries have fallen. In the first half of the year, a reduction of 10-12% was experienced. The effect of price reduction is so severe that all countries in East Asia are now facing either deflation ; or disinflation which potentially could end up in deflation.

How can we prevent or survive the deflation? Research by Professor Feldstein shows that under current circumstances, monetary policy alone would not be efficient. I agree. As Japan tried to solve her deflation problem with various monetary measures, their efforts have not been successful. Fiscal policy measures are necessary to cope with the existing deflationary trend. Which fiscal measures would be the most effective, however, depend on the economic environment of each country.

Fiscal measures---with the aim of increasing domestic demand---would only help to lessen the effect of deflationary pressures. But to get out of a cycle of deflation, we need an increase the external demand, in other words, greater international trade. As the major markets such as US, EU and Japan are experiencing recession, our only hope is that of increased intra-regional

trade.

I believe that luck is now on our side. In the past year, we have seen a clear sign of growth in intra-regional trade within Asia 9 (or the non-Japan East Asia) . During the first 8 months of this year, exports from Asia 9 to other Asia 9 countries have seen overall growth of 9%, compared to a growth of 0.4% to the U.S. Asia 9's exports to China have largely been positive, compared to exports to other regions. For instance, Taiwan's exports to China rose 86.5% compared to its exports to the US that declined by 5.6% y-o-y. Thailand's exports to other Asia 9 countries grew by 6%, while exports to Japan and the US fell by 4.9% and 1.4% respectively.

On the import side, y-o-y growth of imports to Asia from other Asian countries (with the exception of Indonesia) were all positive and almost exclusively in the double digits, ranging from 10.0% in Singapore to 21.7% in Malaysia, for the second quarter of this year. While Asia 9's imports from the U.S. fell by 9.0%, imports from within Asia 9 countries grew by 5.7%. Share of imports from Asian countries to the region ranged from 25.8% in Korea to 66.8% for Hong Kong.

Now the question that arises is whether or not the demand for imports in Asia is the final demand. Certain facts indicate that the portion of intra-regional trade, which is final demand within the region, is increasing at a fast rate. Growth in imports of Asia 9 has been observed not only in raw materials and intermediate products (52% of imports), but also in imports of capital and consumer goods that are more sensitive to domestic conditions. Japan's passenger car exports to Asia 9 rose 54.6% y-o-y, with car exports to China up 152%, to Korea Taiwan Hong Kong and Singapore up 21%, and 27% to the Southeast Asian countries. Exports of other final demand goods such as construction machinery (30.1%) and consumer electronics (25.8%)

also rose. China is now the largest export market for Taiwan, second largest for Korea, and increasingly important for Japan and ASEAN. China's GDP per capita has risen from USD 350 per year in 1990 to about USD 1,000 a year in 2002 and per capita income may be expected to double every 7-year period.

Some may argue that a significant portion of intra-regional trade consists of intermediate and processed goods, which are exported intra-regionally for further processing or assembly. These goods are then partly re-exported to final destinations outside the region. However, statistics show that while intra-regional trade up to 2001 was growing at the same rate as that of export from region to countries outside the region, in 2002 growth rate of intra-regional trade has clearly out-paced exports to countries outside the region. And this gap of growth is widening.

What I'm trying to conclude here is that intra-regional trade is really expanding and regional domestic consumption is also increasing. This is our real hope of saving or preventing us from deflation or potential deflation. But we must be cautious. There are a few important points on the agenda that we need to work together to promote the opportunity for regional trade.

1. Further intensifying of trade liberalization within the region is needed. This can be done on a bilateral or multi-lateral basis. The recently proposed Free Trade Agreement between ASEAN and China, is a good example. The recent 8th ASEAN Summit which was held in Phnom Penh between 3-5 November 2002, has expanded ASEAN effort on trade ties to include India and Japan.
 2. Aside from Free Trade Agreements, cooperation is also needed for financing arrangement to facilitate trade. The scheme to pool reserves
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under an Asian Bond Fund would help develop regional capital markets. Trade financing facilities for intra-regional trade should be considered to facilitate traders in the region.

3. Exchange Rate Stability within the region is very important for trade to grow. The benefits of an optimum currency area theory, as proposed by Mundell back in 1961, are still relevant today. The ultimate goal of a common Asian Currency is visionary, but many factors need to be overcome. It may take a long time to do it or it may not be overcome finally. On a more practical note, East Asia may consider the exchange regime of a “snake in the tunnel” , as that used in Europe in the early 1970s designed to stabilize the intra-European exchange rates within relatively narrow bands in an environment of extreme volatility. Or if we want to achieve more stability, a proposal for a common basket peg could be explored for three major currencies to minimize exchange rate fluctuations among members and foster greater intra-regional trade and investment. There may also be other alternatives to achieve the goal. But it will not happen until we start working together as one team towards this goal.

Thank you very much for your attention.

(Based on a written text)

Gyohten : Thank you very much, Governor, for your very insightful presentation on the Asian economic future. Now, I call upon Dr. Kim from Korean Development Institute.

5. Economic Restructuring in Korea, Regional Cooperation in East Asia

Choongsoo Kim, President, Korea Development Institute

The events in Asia over the past few years are highlighted by the successful recovery from the 1997 East Asia financial crises, and the emergence of China as a world economic power. China became a member of the WTO and her membership will serve as a good opportunity for China to play a larger role in the international community. Crisis-hit economies have managed the economic crises successfully, leading their economies to have recovered rather rapidly. Japan has endeavored substantial efforts to deal with their set of financial restructuring and economic recovery, and it still remains to be seen whether or not Japan's efforts will turn out to produce the desired outcomes. Countries here in Asia knew that they must integrate their economies more than ever if they were to stand a chance of flourishing, or withstanding competition, in an increasingly globalizing world. To achieve this, economic cooperation among the regional economies is recognized to be the key to the future of common prosperity in Asia.

As such, I would like to address these important policy issues from a Korean perspective by elaborating on the approach Korea took to reform and integrate itself more deeply into the Asian economy, share some thoughts on the emergence of China, as well as on the potentials for greater strides that can be made for regional cooperation.

I. Economic Restructuring and Institutional Reform in Post-Crisis Korea

In response to the crisis, the Korean government introduced a

comprehensive four-sector reform program including corporate, financial, labor and public sector reforms to overcome the 1997 economic crisis. While due attention was paid to each sectoral reform, higher priority was placed upon resolving the following two major challenges. First, “legacy costs” or problems resulting from misjudged decisions of the past had to be urgently addressed. Foremost in dealing with this problem was to resolve the massive non-performing loans (NPLs) that had resulted from unprofitable investment. Public funds had to be injected to clean up NPLs and rehabilitate the financial sector. Second challenge was to avoid repeating the same blunders from the past, and thus institutional reforms had to be implemented to achieve this. The pre-crisis distortions in financial resource allocation and corporate governance also had to be fixed.

I-1. On Resolving the “Legacy Costs”

In the early post-crisis period, financial institutions were neither willing nor able to take tough measures on NPLs, for that would lead to a further deterioration of their balance sheets. The decimation of merchant banks and unprecedented closure of banks in 1998 reinforced incentives for the creditors to take less than a principled stance against insolvent firms. As such, Korea’s financial institutions had to fight for their survival in the post-crisis period. There were massive layoffs as well, especially in 1998. Between end-1997 and end-1998, the number of workers in the financial sector declined by a whopping 24.1 percent. It declined further to 31.1 percent by end-2001. After closing the worst of distressed financial institutions, the government had to step in with public funds and urge financial institutions to take proactive measures against insolvent firms. Although the injection of public funds was likely to generate political controversy, the government decided to stabilize the financial system.

To dispose of NPLs and rehabilitate the financial sector, the government injected a total of 155.3 trillion won (approximately US \$129 billion) as of the end of 2001, equivalent to 28 percent of Korea's GDP in 2001. Two-thirds of the public funds were raised through bonds issued by Korea Asset Management Corporation (KAMCO) and Korea Deposit Insurance Corporation (KDIC). More than 40 trillion won was used to settle deposit insurance obligations and to provide liquidity to distressed financial institutions. This money is presumed to be lost. Funds used for recapitalization and purchase of NPLs and other assets made up the rest, with better prospects for recovery.

An important policy lesson is that no government dares to mobilize public funds to deal with the NPLs before a crisis hits the economy. Before Korea was hit by the crisis in 1997, there has been a long debate as to the necessity of public funds. However, due to the strong resistance by the general public in using taxpayers' money to resolve the problems created by the mistaken decisions of the private sectors, political leaders generally tended to be reluctant to rely upon public funds.

I-2. Institutional Reform

In addition to resolving "legacy costs," the government had to terminate implicit guarantees against bankruptcy, improve corporate governance, and strengthen competitive pressure so that firms and financial institutions would make their investment decisions under the discipline of market forces. Unemployment insurance and other social security programs also had to be expanded to make economic restructuring politically viable. A grand bargain between labor and management would have involved enhanced workers' rights and social security in exchange for increased labor market flexibility.

I-2-1. Reducing Moral Hazard

The most significant institutional reform in this area was the introduction of partial deposit insurance. Prior to the crisis, depositors and investors outside the informal curb market had assumed their assets were fully protected by the government. To expand their businesses, financial institutions had been all too willing to play on these expectations, “guaranteeing” high rates of return on their financial products. After shutting down insolvent financial institutions in 1997 and 1998, the Korean government introduced partial deposit insurance to contain moral hazard.

Massive corporate failures served as credible signals that the government’s implicit guarantee regime had indeed changed. Through both court-led corporate reorganizations and out-of-court workouts, the management of many leading chaebols was displaced and controlling shareholders saw their holdings either written down or altogether wiped out. In fact, of the 30 largest business groups in 1996, 14 had gone bankrupt or entered workout programs by the end of 1999. Moreover, as in the Samsung Motor and Hyundai Construction cases, it was not uncommon to see subsidiaries of a surviving chaebol become disaffiliated from the rest of the group due to financial distress.

I-2-2. Improving Corporate Governance

The government from very early on focused its corporate restructuring efforts on improving the governance of the chaebol. Five principles of corporate restructuring were announced including (1) enhancing the transparency of corporate management, (2) eliminating in-group inter-subsidiary loan guarantees, (3) improving capital structure, (4) focusing on core competence, and (5) enhancing the accountability of controlling

shareholders and managers.

Starting in 1998, a number of measures were introduced to improve financial disclosure and accounting standards, including requirement for combined financial statements covering all companies under the effective control of the same business group, regardless of the level of shareholdings. To strengthen minority shareholder rights, the government lowered shareholding requirements for bringing derivative actions, requesting termination of directors and auditors, and convening a special shareholders' meeting. The government also eliminated the system of "shadow voting," in which institutional investors had to cast their votes in proportion to other votes cast, instead of exercising their independent voting rights. To enhance the independence of corporate boards, listed companies are now required to include at least one outside director on the board of members.

I-2-3. Accelerating Liberalization

In addition to addressing the moral hazard and corporate governance problems, the Korean government paid serious attention to the competitive context of the chaebol. To strengthen market forces, the government removed various entry and exit barriers that harmed economic efficiency. The most important and extensive policy reforms occurred in the rules governing foreign investment. In the wake of the crisis, the government completely eliminated the ceiling on foreign equity ownership in the stock market. By lifting the requirement that foreigners obtain board approval for ownership of more than one-third of the outstanding shares of a firm, the government provided a powerful impetus to cross-border mergers and acquisitions. The real estate market was opened to foreigners and foreign exchange transactions were liberalized even further. A new Foreign Investment Promotion Act enacted in November 1998 streamlined investment procedures, strengthened

incentives, and created innovative new mechanisms for regional governments to play a role in attracting foreign investment.

Thanks to these measures and improved prospects for the Korean economy, the share of foreign investors in the market capitalization of companies listed on the Korea Stock Exchange more than doubled from 1997 to 2001, from 14.6 to 36.9 percent. In addition to the infusion of funds and managerial expertise, increased foreign direct investment also had political economy consequences. For example, the foreign management of Korea First Bank, taken over by Newbridge Capital in 1999, not only changed the bank's operations but flatly refused to support government efforts to orchestrate continued credit lines to firms deemed unworthy of further support. GM's takeover of Daewoo Motors in 2002 is perhaps the most symbolic of the changes in Korea's FDI regime in the post-crisis period. Prior to the crisis, selling a major company in such a "strategic" industry as automobiles to a foreign buyer would have been almost unthinkable. Putting a distressed firm to international bidding is clearly a post-crisis development.

I-3. Remaining Challenges

Since the outbreak of the 1997 economic crisis, Korea has injected massive amounts of public money to dispose of non-performing loans and rehabilitate the financial sector, as well as implement comprehensive reforms to terminate implicit government guarantees, improve corporate governance, and remove various market entry and exit barriers. Thanks to these measures, the economy is in much better shape than five years ago.

Although Korea's financial markets have changed a great deal in the post-crisis period, the dearth of autonomous financial institutions continues to make market-led corporate restructuring a difficult proposition in Korea. Even

if Korea manages to import state-of-the-art bankruptcy laws and institutions from abroad, the governance problem created by government or chaebol control would distort incentives for financial institutions. Bank privatization and separation of banking and commerce (including NBFIs) should be an integral part of economic reform if financial resource allocation is to continue to improve.

II. Regional Monetary Cooperation

In the following section, I will elaborate on the need for regional monetary cooperation through assessing the feasibility of a currency union and the potentials for a monetary fund in East Asia.

II-1. On the Feasibility of a Currency Union in East Asia

Forming a currency union incurs both benefits and costs for the member countries. The benefits are reduction of transactions costs incurred in international trade and investment, and reduction of risks stemming from the uncertain future movements of exchange rates. The cost is the inability to use an independent monetary and exchange rate policy as an instrument of economic adjustments, resulting from macroeconomic disturbances. Economies with highly diversified industrial structures tend not to be affected as much, thus the loss of independent monetary and exchange rate policy is not as severe.

The benefits from currency union rises with the extent of intra-regional trade, the share of manufactured goods in trade, and the degree of openness. According to IMF Direction of Trade Statistics, the average share of intra-East Asian trade in total trade was about 46 percent for exports and 62 percent for imports in 1999. These numbers are close to those of the

European Monetary Union countries prior to the signing of the Maastricht Treaty. Their average share of intra-EMU trade was 52 percent for exports and 51 percent for imports in 1989. The average degree of openness for East Asian countries is 1.03 (the ratio of exports and imports to GDP) while that of EMU countries is 0.92 in 1999. According to IMF International Financial Statistics, the share of manufactured goods in exports is 0.70, slightly less than the EMU average of 0.80 in 1995~1997. Note that China's degree of openness is 0.40 and its share of intra-East Asian trade is 0.46, and that Japan's degree of openness is 0.19 while its share of intra-East Asian trade is 0.37 in 1999. Japan is a possible candidate to be an anchor country if a currency union is established, yet for now, Japan is relatively less open and has a low share of intra-regional trade to manage this role.

However, in order for the monetary union to be successful, the following must be resolved. First, an economic and monetary union with a single currency should be established on a step-by-step basis. The first step towards a currency union may be commercial integration, which refers to the movement towards the establishment of free trade areas and custom unions. Moreover, free movement of factors must be guaranteed. Commercial integration and free factor mobility may enhance intra-regional trade and the correlation of East Asian business cycles. The second issue is in finding an anchor country. As mentioned earlier, Japan is a possible candidate. Yet, the efficiency of its financial system lags behind other developed countries. Furthermore, apart from political burdens, Japan has many economic problems that have to be resolved. For example, Japan must deal with the difficulties associated with non-performing loans, which amounts to more than 43 trillion yen as of March 2002. Finally, contrary to the European Monetary Union, a significant gap remains among East Asian countries in levels of development, population, per capita income, and economic and political institutions. Furthermore, there is no political solidarity that can

overcome this gap. Note that the success of the European integration process has been largely due to political solidarity, achieved through frequent consultation and institutionalization. Thus, political cooperation and institutionalization seem crucial for formation of a monetary union.

II-2. On the Need for Establishing a Regional Monetary Fund

A typical argument for establishing a regional monetary fund goes as follows. As trade tends to be regional, the region loses disproportionately from trade disruptions caused by the currency crises. Thus, the region has incentive to prevent the spread of these crises. A regional monetary fund with its ability to conduct surveillance and lend with conditionality would alleviate such losses.

The above argument presumes that peer pressure may work better at the regional level. This may be true in Europe, where mutual surveillance has a long history. Yet in contrast with Europe, East Asia lacks institutions comparable to that of the EU's Monetary Committee. Furthermore, East Asian countries do not seem to be ready to negotiate an international treaty, which makes provision for serious sanctions and fines like those in the Maastricht Treaty for countries that fail to adjust their domestic policies.

Even if there were sufficiently strong political and diplomatic will so that the Asian Monetary Fund could be established, in order for the Regional Monetary Fund to function properly in promoting international financial stability, each member country must complete institutional reform. Given the propensity for financial problems to spill across borders, international financial stability requires domestic financial stability, and domestic financial stability can only be attained through institutional reform. Policies toward external trade and payments may be helpful, but definitely not sufficient in

stabilizing a country's financial system. For a stable financial environment, we first need to meet all disclosure requirements for financial institutions and corporations, and prudential supervision. Disclosure requirements are necessary for market discipline to work and prudential supervision is necessary for correcting any banks' or firms' inefficient risk-management practices.

Furthermore, the use of internationally recognized auditing and accounting practices should be a part of the domestic institutional reforms. Without it, lenders will have difficulty in accurately assessing the financial condition of the banks and corporations to which they lend. Effective creditor rights should also be institutionalized. Without it, claimants will have difficulty in monitoring and controlling the financial decisions of managers. Investor protection laws should also be implemented to prevent insider trading, market cornering and related practices. Without these, securities markets will not develop. Finally, fair and expeditious corporate bankruptcy procedure should be adopted to reduce transactions costs involving the resolution of debt hangover.

III. Emerging China and Establishing a Free Trade Area in Asia

III-1. On Impacts of China's Development on the East Asian Trade Structure

The rapid expansion of the Chinese economy gives a new growth opportunity for the East Asian countries as well as for the rest of the world. The size of the Chinese economy has grown 3.5 times from 1985 to 1999, and China's entry into the WTO is an economic opportunity for her trading partners to reach into a bigger market with eased trade barriers. The question is, then, who will benefit relatively more from China's development?

Trade between China and Korea had begun in full scale in 1991 when the two countries restored diplomatic relationships. According to an empirical study on comparative advantages of international trade, China has comparative advantages over Korea in high-tech industries except communications equipment including semiconductor, though the margin is narrow. In mid-high tech industries, China has comparative advantage in electrical machinery including home electronics, and Korea shows comparative advantage in the remaining mid-high tech industries. In mid-low tech industries, Korea has strong comparative advantage in rubber & plastic and petroleum-refining, and except for these two, China has comparative advantages in the remaining mid-low tech industries. In low-tech industries, China has comparative advantages except for that in food.

China's trade with Japan shows very stable trade specialization patterns in high tech and mid-high tech industries, where Japan has mostly the strong comparative advantages. Yet in mid-low tech industries, China is gaining her comparative advantage, and in low-tech industries, China has comparative advantage in all sectors except for in food.

The changing trade specialization pattern of China exemplifies how comparative advantages can be created. The rise of China's computer and communications equipment industries is a prime example. Coupled with multinational corporations' strategies to capitalize on the growth potential of the biggest country with 1.2 billion populations, the Chinese government has introduced deliberate industrial policies to commercialize a strong technological base. Alongside, indigenous firms are growing and accumulating technological capabilities that are comparable to foreign competitors.

China's trade relationships with other Asian economy show where the

Chinese economy is heading. Currently, the Chinese economy has strong comparative advantages in low-tech industries. Yet at the same time, China is gaining her comparative advantages in more technology intensive sectors. Already, China has strong comparative advantages in some high tech and most mid-high tech industries over ASEAN. Even in some high tech industries China shows comparative advantages over Korea, though only with a small margin. However in the case of Japan, there exists a wide gap in high tech and mid-high tech industries. Therefore, in the coming years, where competition between China and Korea as well as other ASEAN countries is expected to be intensified, China will not be an immediate threat to Japan in world high and mid-high tech products.

III-2. On Establishing Free Trade Area

The dynamics of relationships especially in East Asia, as competitors as well as partners, provide a prime opportunity to steer this strengthened economic linkage toward a positive outcome, by realizing the establishment of free trade areas. As we know, this idea for an Asian FTA has been proposed over ten years ago (at the Fourth ASEAN Summit), but only recently become a substantial reality through ASEAN+3. China, Japan and Korea are the leading countries as forerunners actively seeking partners for FTA including those of ASEAN countries. Recent developments benchmark these efforts as Japan and Korea recently concluded Free Trade Agreements with Singapore and Chile, respectively. Korea and Japan have long studied jointly on establishing FTA between them. China already shows interests in establishing FTA with ASEAN, and Japan is also reported to sign a statement consenting to pursue Japan-ASEAN FTA. All these initiatives show that once such FTA is formed, its impact on the world economic order will be significant.

There is a growing argument that a regional bloc in East Asian region comparable to EU and NAFTA would benefit the regional economies even more. Thus the FTA in Asia, particularly among East Asian economies and ASEAN appears to be an unavoidable trend. A remaining challenge is the speed of negotiation and the degree of integration. Perhaps, a practical way of expediting regional cooperation is establishing a “soft” regional bloc. It goes without saying that a fully integrated FTA is most desirable. However, since it takes long to conclude the FTA agreement, efforts can be made to establish free trade agreements on certain specific sectors and industries where conflicts of interests are less severe. By such endeavors, policy cooperation can be practiced without causing conflicts and the participating economies will learn the benefits of regional cooperation more smoothly. Moreover, less time will be required to conclude an agreement on such a soft regional bloc since political implications will not be as serious.

While strong political leaderships are necessary to promote regional economic cooperation and FTA, careful studies as to the effective methods for achieving such goals are also desired. As such, it is important to take opportunities such as this seminar to launch collaborative researches among the concerned parties. (Based on written text)

Gyohten : Thank you very much, Dr. Kim, for your very informative account on Korea’s experience in overcoming the difficulties and also on your perspective of the regional cooperation.

Ladies and gentlemen, it is time to invite two representatives from Japan. Let us begin with Mr. Kanai, the Chairman of Hitachi, Limited. From the perspectives of a business person I am sure he has a great insight to share with us. Here is Mr. Kanai.

6. Emerging China and Corporates' Strategy in Asia

**Tsutomu Kanai, Chairman of the Board and Director,
Hitachi, Ltd.**

Mr. Gyohten, thank you very much for your kind introduction. I understand it is the 11th International Monetary Symposium. Amongst the professionals of the economy and currencies, I am here as a layman, as a business person, to share my perspectives with you.

The coming ten years with emerging China for Asian economy certainly will have a lot of implications to the business world. Therefore, it is my great pleasure to be able to share my views with you.

The first issue is how we should view the Asian economic development as well as the emergence of China, and how they affect our business strategies is another perspective. Especially FTA in East Asia will have a major impact on the business strategies. Therefore, these are the areas that I would like to touch upon.

Now that the 21st century has arrived, it seems obvious that the Asian economies have entered a new development stage. This can be seen clearly in the way we at Hitachi have been deploying our manufacturing bases in Asia. As the Asian economies have grown, so has our business in Asia. In the 1960s Hitachi, Limited had six Asian subsidiaries or operation centers. This increased steadily to 11 in the 1970s and to 17 in 1980s. Then in the 1990s, 22 companies were added to make the list 39. On the consolidated basis the number has even doubled. And more than half of this increase is due to our direct investment in China. This demonstrates how our view of Asia has

become decidedly positive.

China's entry into the WTO symbolizes the start of a new stage for the Asian economies. That China has officially joined the world economy is a cause for great joy and to be welcomed from the heart. For me there is one more event indicating a new development. That is the recent moves in Asia to conclude free trade agreements. It is truly remarkable that the concrete FTA moves are now under way in East Asia, which until recently had remained detached from the worldwide FTA discussions. It is important that we make the most of what we have learned from the financial and currency crisis that hit Asia in 1997, and as a corporation we naturally welcome this development. Looked at from a different angle, this can be seen as a reflection of how competition over economic growth has heated up between regions and between nations. That is why I see this as evidence that Asia has entered a new stage of development.

Now, I would like to point out five points on how these developments in Asia will influence corporate business strategies.

The first is that in China, we see the start of a worldwide competition. More and more companies are coming to China from all over the world, but their aims and the significance of these moves are gradually shifting. Initially the lure of China was its low-waged labor force and its potential as a base for export operations. By now China is well under way to establishing itself as the "factory for the world." More recently, however, it is its growing domestic market that is attracting interest. Partly due to China's entry into the WTO, companies are investing to boost their sales in this market. Because of the size of this market, there is a possibility that China will start to disseminate de facto product standards to the rest of the world. That is to say, even products originating in developed countries will have to succeed in the

Chinese market before they can become world standards. That is why many Japanese companies, including certainly ourselves, are broadening the scope of their direct investment in China from manufacturing bases to bases for sales operations, procurement, and R&D. The importance of the Chinese economy in business strategies is all the more increasing because of the huge scale of the Chinese market.

The second point is that, even though the importance of China's economy is growing, this does not mean that we should be directing all our investment there. Companies need to look at both growth potentials and stability. In terms of growth potentiality, no one would deny that China is the most promising market today. But that is not the only requirement for direct investment. Stability includes the political situation in a country, and safety from the threat of terrorism which has become a significant factor lately. Also highly important is the stability of rules and regulations, in areas like taxes and finance. To what extent has the infrastructure been put in place for conducting economic activities, and how extensively is the system enforced? If such matters are subject to sudden or frequent changes, or vary from one place to another, we cannot invest there with much confidence. With that in mind, many Japanese companies are not only investing in China but will continue to place no less importance on ASEAN countries. Some ASEAN members seem to be worried that Japanese companies will pull out of their country and move operation to China. What is in fact happening, however, is that Japanese companies are mainly shifting their operations in Japan to China.

The third point is the moves to conclude free trade agreements in East Asia. This will be an extremely positive factor in planning aggressive business strategies.

The AFTA that went into effect last January, for example, lowers the trade barriers for transactions among the six ASEAN participants. It sets a Common Effective Preferential Tariff, or CEPT, which lowers the customs tariffs on many items. This allows companies to carry out their business more efficiently within the region. Already the Japanese auto-makers, for example, are in a move to concentrate their operations in Thailand rather than in Malaysia, which has delayed the removal of the tariffs until at least 2005. This is an example of how companies are shifting their business strategies toward more favorable countries and regions. It also means that countries are competing with each other to build more attractive environments for establishing production bases.

There are various areas of interest for business management. Taken into account are such matters as taxation and the physical infrastructure, the wages of ordinary workers, the ease of filling needs for engineers and management staff, and the situation regarding rules and regulations.

Lately, Japanese companies have been paying close attention to issues of intellectual property rights. The flooding of Asia with counterfeit products has greatly harmed Japanese companies and can no longer be ignored. The situation in China has improved somewhat recently as it becomes more actively involved in setting up the necessary regulatory infrastructure, such as in requiring payment of patent fees and punishing violators. Realistically, however, it will likely be some time before an effective system is in place where adequate rules and commercial practices are properly monitored and enforced in accordance with international standards. In the past there were even some Chinese officials who asserted the presence of so many foreign companies in their country meant the intellectual property rights issue was non-existent. As the Chinese economy aims for the next higher level, however, they may realize the importance of this problem and come to

rethink that view.

Certainly the quality of Chinese products has improved, and its technological abilities have greatly advanced. More and more engineers have the advanced degrees. It will take considerable time, however, for China to give birth to innovative technologies, or to create large system technology. Genuine progress in science and technology requires longtime research and development, as well as deep-rooted and broad-based ones. These depend on the wide availability of human resources that enables these and the fostering of an environment and culture that respect academia and research. If you look at so-called high-tech companies in China and other Asian countries, you will see many engineers who earned their doctorate degrees in the United States, and yet you will find few of these high-tech companies have surpassed their overseas counterparts. It takes a long time for science and technology developments to extend to the industry. Most important is to cultivate the human resources, and develop industries where those people can make a living. It is essential to this end that a country establishes and enforces rules on intellectual property rights that are in harmony with international rules. Although this may sound harsh, it can be said that the Chinese economy, even though it is becoming the “factory for the world”, is still at the starting point to the economic growth path toward eventually joining the ranks of the developed nations. Before it will be able to achieve economic growth by promoting new industries on its own, it will need to tackle many issues in areas like science and technology policy and the implementation of various rules and regulations that are needed.

The business strategy will enormously benefit from the free trade area movements in East Asia if they develop, like the EU, from market integration to ultimate monetary union. However, there are many challenges to be overcome. In that context, I think it is important that the FTA should be

developed from areas and countries that can actually do so, then gradually expanded to a bigger movement. As the fourth point, such FTA and regional integration could be accelerated by IT-led technological innovations. When IT succeeds in networking the world, and when electronic commerce and digital government become commonplace, both consumers and suppliers will have access to the same information on products, prices and distribution. Geographical and time differences will also be narrowed, and this will give people a sense that regional economies are becoming integrated. Then if IT causes a shift of value standard from “goods” to “knowledge” in economy and society, in the future we will see the main arena for economic activities moving from trading in goods to transactions in cyber-space. In that case, the integration of regional economies will effectively be a virtual reality.

At present, the trade volume between Asia and Europe and between Asia and America amounts to about 500 billion dollars each, well comparable in scale to that between Europe and America with China becoming the so-called “factory for the world.” When we compare the flows of information on the Internet between these same regions, however, the volume of the flow between Asia and America is only a quarter of that between Europe and America, which is 160 times greater than that between Asia and Europe. This gap indicates the fact that Asia has lagged far behind the US and Europe in the Internet penetration. When good progress has been made in providing the information infrastructure, I believe the integration of the regional economies will be able to proceed more rapidly. Seen in this light, an early establishment of broadband networks in East Asia will be an urgent issue common to the entire region.

So far I have discussed various ways in which further growth in Asian economies, through the formation of the free trade agreements and the like, will lead to an increase in direct investment in Asia by Japanese companies

and be a major plus factor for expanding their business in Asia. The other side of this coin is that if this trend continues to proceed along the same lines, it will mean the shrinking of domestic industrial activities in Japan itself. In other words, as a fifth influence on business strategy, it needs to be pointed out that there is a concern for the hollowing out of domestic industries.

From the standpoint of international competitiveness as an environment for establishing production bases, which I mentioned earlier, none of the business conditions in Japan is attractive today. This starts with taxes (e.g., the effective rate of corporate income tax and the offering of tax incentives), and extends to various regulations, the high cost structure of production due to land prices and office rents that are three to ten times higher than other regions, and electric power costs that also two to three times higher.

One of the advantages of a free trade agreement, in fact, is that it aims at restructuring of industry in each country so that both parties will become more advanced. A free trade agreement that energizes industry in one country and causes the hollowing out in the other would be essentially meaningless. For that reason, each country must compete in adopting policies that will boost the strengths of its own industry and thereby aims for industrial advancement.

In Japan's case, what is needed is to advance its domestic industry to the level of a "knowledge" industry that develops and puts to use innovative technologies not found in Asian or in the rest of the world. Unfortunately, government policies are not currently functioning well toward that end. In the area of taxation, we can at least look forward to some tax breaks for investments in IT and R&D in the next fiscal year ; but there is still no prospect for a reduction in the effective rate of corporate incomes tax, nor the

introduction of tax incentives for venture businesses. So far the discussions on tax policy have focused almost entirely on the side of balancing of the budget. Tax policies aimed at strengthening industrial competitiveness have received almost no consideration. There has been a little improvement lately, but taxation is only one of many problems. The same can be said for policies on science and technology, regulations affecting health care and agriculture, educational policy, judicial affairs, foreign policy, trade and exchange policy and so forth. The hollowing out of industry will not be solved even if the government manages to solve the current problem of non-performing loans. What this means for corporate strategy is that, while of course every effort is being made to create new businesses, we are being pushed in the extremely unfortunate direction of cutting back on domestic business. So, I must stress that the growth of Asian economies is accompanying this side-effect as well.

Finally, I would like to conclude by stating that free trade agreements will give further impetus to the growth of Asian economies, which will make corporate activities more efficient, and is therefore much welcomed. We are hopeful that government officials in each of the countries will exercise their leadership toward bringing about a freer economic environment in East Asia at an early date, and aiming for broader integration of regional economies. Thank you very much.

(Based on interpretation of a speech in Japanese)

Gyohten : Thank you, Mr. Kanai, for sharing with us a very clear view of the future of the East Asian economies as well as the Japanese economy from a very practical viewpoint.

Lastly, it's my pleasure to invite Mr. Kuroda, Vice Minister for International Affairs of the Ministry of Finance. Mr. Kuroda, please.

7. Progress in Regional Financial Cooperation in East Asia

Haruhiko Kuroda, Vice Minister of Finance for International Affairs

I would like to talk about the progress made in terms of regional financial cooperation in East Asia to date and some of the challenges ahead, including some global and historical perspectives.

More specifically, I would like to discuss the regional cooperation in three major arenas of trade and investment, regional financial cooperation and regional monetary cooperation.

First of all, let us review the regional cooperation in the trade and investment arena from the global perspective. In addition to the EU which has a long history of Customs Union, we have seen various agreements concluded, including NAFTA that is promoting liberalization, not just of investment but of trades in services, the MERCOSUR which is conducting mutual reduction of tariffs, and also AFTA in Southeast Asia. So we have seen numerous regional trade agreements being born. As of January 2002 we had 162 such regional trade arrangements or agreements.

Here in Asia, a number of individual businesses and companies had already established networks based upon their global strategy, so a *de facto* economic zone is being formed here in Asia, and more proactive efforts are underway toward economic partnership to further solidify and enhance those existing *de facto* networks.

Japan has already concluded with Singapore the Japan-Singapore

Economic Agreement for a New Age Partnership, and is engaged in the consideration and study of a free trade agreement with Korea. With respect to Japan and ASEAN, Prime Minister Koizumi proposed initiatives for comprehensive economic partnership when he visited ASEAN countries in January of this year, and, in parallel with the efforts toward arrangement involving the entire ASEAN nations, we have decided to start talks in bilateral partnership wherever possible. Already joint study groups have been established to consider economic partnership between Japan and Thailand and between Japan and the Philippines.

In the series of heads of governments meeting involving ASEAN, Japan, China and Korea (ASEAN+3), held in Phnom Penh last week, Prime Minister Koizumi and leaders of ASEAN countries signed a joint declaration toward the realization of initiatives for comprehensive economic partnership. Furthermore, the leaders of China and ASEAN signed the Framework Agreement to establish a comprehensive free trade agreement and, furthermore, Chinese Premier Zhu Ronji proposed a free trade agreement involving three countries of Japan, China and Korea. These moves symbolized very active moves toward the realization of a free trade agreement in East Asia.

Furthermore, movements toward a regional trade agreement are not limited to East Asian economies. Efforts are underway to conclude the trading agreement across the Pacific. Just last month Korea and Chile concluded negotiations on a free trade agreement, and Japan initiated negotiations with Mexico for an economic partnership agreement.

Secondly, I would like to talk about regional cooperation in a particular area, i.e., the financial arena. The most advanced area in this regard is the EU where a common currency, euro, was introduced, but various developments

are observed elsewhere, too. Especially in Asia, within the framework of ASEAN+3, various cooperation or efforts are underway in quest for more proactive cooperation. More concretely, since the currency crisis in 1997, there has been growing recognition that cooperation and coordination amongst regional economies is vital for East Asian regional financial stability. Especially toward the IMF annual meeting in September 1997, there was a growing interest amongst East Asian economies to establish an Asian Monetary Fund to supplement IMF resources at a time of crisis. For various reasons this idea did not materialize.

However, subsequently in the context of the Manila Framework, or the New Miyazawa Initiative announced by Japan, regional financial cooperation within East Asia has made substantial progress. Based upon the progress made toward the strengthening of regional financial stability and cooperation, the ASEAN+3 Summit Meeting held in Manila in November 1999 reached agreement on the need to strengthen the mechanism for self-help and support in East Asia.

Following that, in the ASEAN+3 Finance Ministers Meeting held in Chaing Mai, Thailand, in May 2000, the Chaing Mai Initiative was agreed upon to establish a network of bilateral swap and repurchase arrangements amongst ASEAN+3 countries.

With subsequent efforts made by each country, for example, Japan has already concluded bilateral swap arrangements with five countries, including South Korea, Thailand, the Philippines, Malaysia and China, and with Indonesia we are likely to conclude a similar arrangement in the near future. Taking ASEAN+3 as a whole, bilateral swap arrangements already concluded amount to a total of US\$36 billion, representing a concrete progress made thus far.

In order to ensure effective and smooth operation of such regional financial arrangements, it is vital that each country can accurately grasp regional economic conditions through close policy dialogue. From this perspective, in April of this year in Yangon, Myanmar, the Deputies Meeting of ASEAN+3 took place, and actually a policy dialogue was conducted on that occasion. On that basis, in May this year the ASEAN+3 Finance Ministers met in Shanghai to explain economic conditions of their economies and policy issues and exchanged their views, thus conducting political dialogue at higher level. Furthermore, the 2nd Unofficial Deputies Meeting for Policy Dialogue was held here in Tokyo yesterday and I had the privilege of chairing that meeting.

In addition to the expanded conclusion of swap arrangements, we will make further efforts toward cooperation for regional monetary and financial stability, through reviews of regional economies and strengthened policy dialogues. Of course, concrete efforts are being made strenuously by Japan, but, at the same time, sincere efforts are also underway within the framework of ASEAN+3.

Thirdly, I would like to refer to the potential for coordination and cooperation in the monetary regime. Already some distinguished panel members have referred to this issue. Here in Asia, like in Europe with the introduction of euro, whether a similar arrangement or currency regime can be introduced is a major agenda.

Up until the Asian currency crisis in 1997, currencies of major East Asian economies had been pegged to the US dollar on a de facto basis. Exchange rate stability amongst Asian currencies was attempted by pegging to the US dollar. If this system had been sustainable, it could be hoped that

such an arrangement laid the ground for further economic integration through the stabilized exchange rates among the currencies in Asia via the US dollar. However, there was a serious pitfall in the dollar peg. Although East Asian economies had very close trade and investment relationship not only with the United States but also with Japan and the European region, these relationships were not well reflected in the *de facto* peg vis-à-vis the US dollar.

In reality, in the context of the Asian currency crisis between 1997 and 1998, many East Asian economies were forced to abandon *de facto* peg to the US dollar and were forced to shift to the floating arrangement resulting in serious devaluation of their currencies. In the light of those conditions, what sort of currency and monetary regime should be envisioned for the purpose of realizing further development of the Asian economies? One possibility would be the introduction of a common currency into Asia just as the euro in the European area. Judging from the European experience, however, the introduction of a single common currency requires certain important conditions to be met.

The first requirement is the economic and economic policy convergence and also a mechanism to guarantee the achievement as well as maintenance of convergence.

Secondly, there must be strong political momentum amongst participating countries to introduce a single currency. There must be strong consensus amongst the peoples concerned.

As far as economic convergence is concerned, in terms of interrelationship in real economy involving trade and labor movement, interdependence and macroeconomic linkages amongst East Asian economies

are as high as or even higher in some cases, than that in Europe. So, in terms of the real economy there is a significant level of interdependence in East Asian economies.

Furthermore, the synchronization in the macroeconomic arena has increased significantly among the East Asian countries. However, when it comes to the framework for maintaining and securing economic policy convergence, the existing framework is still inadequate and weak. Furthermore, it is not easy to generate political momentum or consensus amongst peoples concerned for policy convergence, and much less for the introduction of a single currency.

Therefore, although the introduction of a common single currency to Asia deserves due consideration from a medium to long term perspective, there are numerous challenges that need to be overcome before we can reach the stage where we can seriously consider that.

Now, then, what is an exchange rate regime, the monetary regime that we need to consider at the moment here in East Asia? Actually, in January last year Japan had the pleasure of hosting the Third ASEM Finance Ministers Meeting in Kobe, and in that forum we proposed, and agreed, to conduct the so-called “Kobe Research Project” to explore further research in regional financial cooperation. The results of the Kobe Research Project were submitted to the Fourth ASEM Finance Ministers Meeting held in Copenhagen in July of this year. The recommendations of the study include the followings.

- First of all, East Asia should further pursue economic and monetary or financial integration.
 - The preferable currency regime of the emerging East Asian economies
-

would be a currency basket system consisting of the major currencies to which the stability of these East Asian currencies can be maintained.

- Furthermore, in order to strengthen the interregional surveillance process, an independent surveillance secretariat should be established in East Asia or ASEAN region at the earliest possible stage.

As I mentioned earlier, with further progress in policy dialogue involving ASEAN+3 and further progress in regional surveillance, I hope this envisioned exchange rate regime will be studied and discussed further as well as initiatives for the collaboration of the institutions be made to that effect.

Lastly, I would like to touch upon the role to be played by China for the East Asian regional economy. China already has the GDP in excess of 1 trillion dollars, reaching just over one-quarter of the GDP of Japan. Furthermore, the Chinese economy has been growing rapidly at a rate of 7 percent or higher every year, and such a rapid expansion of the Chinese economy represents a very important benefit, rather than a threat, to Japan and other East Asian economies. In that sense, the Chinese affiliation with WTO and its willingness to expand trade further while abiding by international rules is very desirable from the viewpoint of further development of East Asian economies. Various moves are afoot aiming at free trade agreements in which China is proactively participating, and I note these developments with great pleasure.

Furthermore, in terms of regional financial cooperation, the role to be played by China is increasing and becoming more important. Now that China is a WTO member, the Chinese market will be further integrated into the world economy and the importance of the Chinese role in regional financial cooperation will grow even further. I hope that China will contribute to the East Asian financial stability in proportion to its growing gravity in economic

and financial terms in this region and, at the same time, I also hope that China will cooperate fully with East Asian economies in the monetary system by adopting greater flexibility in the exchange rate regime.

Thank you very much. This completes my presentation.

(Based on interpretation of a speech in Japanese)

8. Panel Discussion

Gyohten : In the previous Part I session, we had the pleasure of hearing from six panel members. Indeed, excellent presentations were given in Part I. I would like to conduct this panel discussion under three major themes, dividing the time into three sections.

First of all, covering both present and future, we would like to discuss the challenges and problems facing the Asian economies.

Secondly, in that process we would like to focus on the role to be played by the Chinese economy, how should we envision the role to be played by China and how each Asian economy addresses itself to China.

Thirdly, various efforts are underway to realize regional cooperation. How should developing regional cooperation be further promoted and pursued?

Actually, the presentations along the lines of these three major topics were made by three panel members already in the first part. First of all, with respect to the problems and challenges confronting Asian economies at the moment or in the very near future, the conditions vary from country to country, from economy to economy. However, listening to the presentations in Part I of the program, I found one common ground in terms of the problems confronting the countries of the region, namely the problem of non-performing loans.

Needless to say, the conditions relating to non-performing loans differ from country to country in terms of the magnitude and the progress made in resolving the problem. Those differences are observed amongst countries.

However, all the panel members from Asia referred to the problem of non-performing loans and, needless to say, it is a big and serious problem here in Japan. It is our challenge as well.

So, I would like to focus, first of all, on non-performing loans, and especially the panelists from East Asia are invited to comment to what extent progress has already been made in resolving non-performing loans, and what were the most important or most difficult challenges or problems in the process of resolving or disposing of non-performing loans, and how each country has dealt with those problems or is going to resolve those problems. I think it will be very useful if we could hear from the panel members their observations on these points.

Mr. Kim, with respect to the non-performing loan problem in Korea, you made very important comments. There is no need for you to repeat what you have already said but, from your perspective, is the problem already over in Korea? Is it a past problem, or is the non-performing loan problem going to remain as a problem in the future? Is it still a problem even today? Mr. Kim, please.

Kim : Mr. Gyoten, you raised several issues and let me try to explain as briefly as possible. The first one was whether non-performing loan is a past problem or a current problem or future problem. My answer is, yes, non-performing loan is a problem of the past, a problem of the present and a problem of the future. Why? What do I mean by that?

As I explained to you, for the case of Korea the most important part was to estimate correctly the size of the magnitude when the crisis broke out. But, before that, let me elaborate a little bit more. I think many countries could learn from the experience of Korea.

In 1997 I was with the government, I was assistant minister and special advisor to the deputy prime minister at the Ministry of Finance and Economy. At that time, as you may recall, in Korea many chaebols went bankrupt, one after another. Seven out of 30 Korean chaebols went bankrupt from early 1997 to July of 1997.

Needless to say, one of the more important policy issues was what to do with these non-performing loans but, to be honest with you, government usually does not have sufficient information as to the size of non-performing loans. Probably that may be the same for all countries in the world.

Anyway, in early 1998, the first task of the government was to estimate correctly the size of the non-performing loans. The Korea Development Institute (KDI), which I now serve as president, was the institution that studied and researched the size of the non-performing loans, and we came up with the number of 133 trillion won. Nobody knew exactly the size of non-performing loans but KDI was the first one to come up with the magnitude of the non-performing loans.

At the time the government decided to mobilize public funds in the amount of 64 trillion won. Why? Because at the time the government thought that both the government and the private banking institutions should take the same burden, on a 50-50 percent rule, so half of the magnitude of the non-performing loans was supposed to be dealt with by public funds. But before the government decided to inject public funds, what the government did was that the government tried to kind of eliminate or abolish the distressed financial institutions.

Actually, at that time there were 25 commercial banks, and out of those 25, 12 commercial banks were assessed to be kind of problematic, and out of

those 12, the commercial banks whose BIS ratios were below 8 percent, 5 were assessed to be non-viable, so these 5 had to leave the market. That was the first time in the Korean history that commercial banks left the market. And then out of the remaining 7, 5 were ordered to take prompt corrective action (PCA). PCA means those financial institutions were supposed to take certain measures to increase their BIS capital ratio to meet the basic standards for soundness. And for the remaining 2 the government decided to sell.

Up until 1998 it was totally unthinkable that Koreans could sell Korean commercial banks to foreigners, but actually one bank was sold to the Newbridge Capital, which was a US investment company. At that time that was the largest commercial bank.

To make a long story short, financial restructuring was done but, as I said, these were done before government decided to inject public funds. Why? Because if the government injected public funds before that, then no financial institution would go bankrupt, would leave the market, so let the market decide who to leave the market and who to stay in the market, and then the government used the public funds to help these ailing financial institutions and then to rehabilitate the economy.

So, what was achieved by these public funds? Some financial stability was achieved, but the problem was that the Korean government was not able to mobilize these public funds until the economy was hit by the crisis.

Had we known or had the Korean government the ability to mobilize or to persuade economic agents about the necessity of mobilizing public funds, probably the severity of the crisis might have been so much smaller, but political leaders were not able to do so. Why? Probably that may be, to a certain extent, true for the Japanese economy. It is extremely difficult to

persuade economic agents to use taxpayers' money to deal with the problems created by private institutions. That was one of the questions.

The second one was what was the most difficult one. My answer to this second question is to persuade public agents or economic agents or the general public about the necessity of mobilizing taxpayers' money to deal with these problems created by private institutions.

Probably some of you who are familiar with the Korean economy may recall that the first reform program that the Korean government announced was the so-called "big deal", a business swap. For the case of Korea, excess capacity was a major problem for the case of chaebol, so the Korean government announced the business swap programs among chaebols, but later the Korean government changed the policy priority from corporate restructuring to financial restructuring. The main reason was that the Korean government was not able to use public funds to restructure the corporate sector. Why? Under the existing regime, taxpayers' money could not be used to help the corporate restructuring. That is why the government changed the focus from corporate restructuring to financial restructuring, so a higher priority was placed upon financial restructuring since then.

What are the remaining issues? The problem is that for the case of most financial institutions, including commercial banks, as of now the government has become No. 1 owner. For some commercial banks the government owns more than 90 percent of the shares, so the remaining question is how quickly the government will be able to privatize these government-owned banks.

So the Korean government consulted with the IMF very closely, and from actually last summer the Korean government announced its plan to privatize some of the banks. But, it is fair to say it will take some time

because, first of all, as I said in my speech, a certain amount of public funds was presumed to be lost. What that means is that when the government mobilizes a certain amount of public funds the government intends to recover as much as possible, but a certain portion of the public funds has to be lost, which is the burden of the taxpayers.

As of now, the Korean government estimates that out of 155 trillion won, which is about 140 billion US dollars, probably 69 trillion won would be lost. That is, either the taxpayers or financial institutions have to bear the burden of paying back.

So, the government wanted to do its best to maximize the revenues from privatizing, so that is the objective of the government, but Korea's market is not that big. And then the issue of, as you may all know, the so-called "fire sale" arises, and there was the resistance of selling some of the Korean financial institutions and big companies probably to foreigners at below the market price or below whatever price. So the government is in a difficult position because the government has to maximize the revenues from privatizing, on the one hand, but, as I said, the government has to cope with the resistance from the people for fire selling. So that is the remaining issue which has to be resolved in the near future.

Gyohnten : Thank you very much. I think both in Thailand and Indonesia one of the main instruments in the solution of this NPL is to separate those NPL from financial institutions into newly established organizations and then make the final solution vis-à-vis the market. How do you assess this approach in each of your countries? Was it really an effective and successful instrument, or did you find some serious problems in that? Any one of you, if you may.

Pridiyathorn : What we have done I find it successful. Let's say this. The peak of our NPL was June 1999 when the total NPL in the bank system was 47 percent, which is very high. After we used various AMCs, not just the TAMC recently announced by the government, to separate bad assets from those banks and leave only good assets with the banks, the NPL hanging in the banks, the last count in June this year it was down from 47 to 18 percent, and my latest count as of September it was 16 percent. Out of this 16 percent, 9 percent is either in court or pending foreclosure. That would need a change of law to speed it up. Only 7 percent of the NPL is left hanging in the banking system for further negotiation and, according to my plan with the commercial banks, we could get rid of this remaining 7 percent within, let us say, a year and a half.

The only problem left would be those hanging in court pending the court decision, or the cost in the court pending foreclosure, and for that we would need the amendment of the law to speed it up.

So I think the problem in Thailand has been handled quite well with the help of these AMCs, but when you separate the bad loans out of the system, one thing you have to be careful is that you must purchase the bad assets from the banking sector at the net book value because if you purchase at net book value it means that the remaining AMCs could easily make profit out of those loans later on. We have done that so far so I think it's in good hands at the moment.

Gyohten : Thank you very much.

Dorodjatun : Yes. I think on the Indonesian side we have also a similar strategy that we have seen in Thailand. The problem for us is that when I entered the cabinet last August we had approximately 200,000 accounts,

small and medium corporations, and we restructured almost 2,000 every year in the last 3 years. Since we are closing IBRA, the Indonesian Bank Reconstruction Agency, by the end of 2003, I wondered at that time how long this is going to take if we continue with that pace. So we started selling unstructured biggest chunk just a few weeks ago, with about 25,000 accounts, and we got approximately 48 percent of asset recovery. We are doing more like that. I hope that the disposition of 200,000 accounts can be completed in due time.

When we restructured the banking system, we followed almost the same kind of strategy that has been explained elsewhere. For me the problem is that so many of the banks report to us that they cannot move from the loan to deposit ratio of around 20 percent at that time to whatever we would like to see. Of course, I would like to see as high as 60 percent in just one year or so to re-engine the whole economic system.

The problem is that these accounts are really representing companies that are old clients of the banking system. And the Who's Who in Indonesia consists basically of these 200,000 small and medium, not to mention the big shareholders of the banking system.

Please realize that we have had the fantastic *korupsi* (corruption), *kolusi* (collusion) and *nepotisma* (nepotism) --KKN. So we are now facing, of course, the completion of the civil contracts, civil agreements, that were signed by the big shareholders. I hope to complete the whole scheme by probably middle of next month at the latest.

Now, the biggest issue is, of course, the conglomerates. I used to call them "9 headaches" because they are representing the big conglomerates in Indonesia with thousands of companies. They are almost like constellations.

One by one, for the last three years, they seem to forget their obligations and, of course, we pressure them saying that you really have to adjust to our time schedule now, or else, something like that. But the problem with that word “or else” is that you have to tie it to the legal system, in particular to the breach of the legal lending limit, or the liquidity credit provided by the central bank.

Approximately 144 trillion rupiah was used at that time by the central bank. Now, of course, we also have to rejuvenate some of the banks by issuing recap bonds. For the whole scheme, the liquidity credit and the recap bonds and smaller amounts for guarantees and so on, I am now talking of about 660 trillion rupiah. Approximately at the current rate, if you divide 66 by 9, you get the figure of about 70 billion US dollars.

So we have to solve this problem altogether, and what we are doing is, of course, selling the banks. We have finished BCA and it took us maybe about 10 hours of argument in the parliament to increase the 31 percent limit to 51 percent. It took us from 10 o'clock in the morning to 10 o'clock in the evening, but finally they accepted the arguments, and then we merged some of the banks and we sold another one, Bank Niaga. We need to follow it through.

But these have to be done together with the 200,000 accounts, small and medium, who are really our “patients in the ICU system” I call it.

Starting from that, we have to go through AMI (Asset Management Investment), we have to go through AMC (Asset Management Credit), and the whole lot actually should have been completed through a gradual process of three to four years. Because of the political crisis in Indonesia accompanying all the reformasi (reform), however, I have to do that in less

than two years'time.

So this is where we are now, but for me what really is good is that the Bank Indonesia is now already an independent central bank. We are discussing about capital maintenance scheme of about 5 to 8 percent range. Then we will issue a Treasury note and, of course, this is going to be used to really face the issue of the liquidity credit of 144 trillion, and it is going to be a redeemable capital maintenance. By that I hope that we will lessen the interest payment pressure on the budget.

As to the recap bonds, we finally got the approval of the Parliament for re-profiling of the domestic debt before I left about two days ago, so I am now relieved because we will have a longer perspective up to probably 2020.

But I am very sorry to say that with all these exercises, I can only get an asset recovery of less than 70 percent of what the parliament ordered us to do. I have a feeling that this will be probably 40 percent because about three years have already gone in the exercise. So you do have to move very fast like in Korea and in Thailand. But, of course, I cannot blame what happened in the country which is really in the political transition from a very autocratic government to a democratic one like now. This is the difficulty of this kind of exercise.

May I take a little bit of time? I think this is the future challenge. I think we over-used the banking system in the past. We must actually create a capital market, and the capital market should be really very diversified, not just for stocks but also for bonds. On the other hand, we really have to modernize the taxes in the system.

What I have seen in the last three years actually is that domestic savings

continue to be good. I don't know why. Maybe it is the behavior of Asians in general, but I have also sometimes a suspicion that the reason is because of the blanket guarantee that we provide. We guarantee everything under the sun, be it on-balance or off-balance ; and really I want to find a solution for this very expensive exercise. But to do that, we must have a depository insurance scheme.

What I have explained to you is in bits and pieces, and to put them together, I think you have to sit with me maybe for two hours. But I just wanted to give you a caricature on how difficult the exercise is. I wanted to report to you also, as I used to report to the Parliament, that it looks like after more than one year if you have patience, and if you really can argue your way within the system, i.e., the political parties, the judiciary, and so on, and you explain to them openly that I will have to be accountable by 2004 to explain why we can get only a 40 percent asset recovery, and who is responsible for that ; of course, I have to talk to the Attorney General, I have to talk to the Department of Justice, and so on, because this must be a wake-up call to all of us in Asia, not to use this system again, and over-use of the banking system is dangerous if you do not have the institutional set-up to support it. Thank you.

Gyohten : Well, thank you very much, Minister.

Mr. He, I understood that in your presentation you told us that in China you have launched a very aggressive plan to reduce NPL. How do you assess the possible deflationary impact of such very rapid reduction of NPL, particularly on employment situation? And if you consider there could be a very serious deflationary impact, what kind of procedures, measures you are prepared to cope with that?

He : Thank you. Well, that's a difficult question to answer. I will try my

best. I am a banker ; I am not a policy-maker, so I can't really say much about deflation in China. But, to deal with NPL, roughly you have three ways : one is loan growth, the other one is the write-off, and then third is recovery.

In China, as far as economy goes, we think we have enough growth rate of about 7 percent. I think we should have decent loan growth requirements. And in the last few years we have experienced that, and this year we have experienced that, and especially in the second half of this year we have experienced stronger loan growth. So, our loan base is growing at a decent rate. And that would certainly naturally bring down the NPL ratio.

The second one is the write-off. To write off the balance you need the policy to support it, you need profitability to support it. In the past, in terms of the Government Support that was set by the Ministry of Finance, it was very stringent on writing-offs, but now of course that has been relaxed a lot. So, I guess, as long as we can generate enough profit, we are able to write off the bad loans.

And the third one is the most difficult one, the recovery. When you want to recover a loan, you have several ways, but the ultimate mean is to go to court. And we are a state-owned enterprise, the borrower is a state-owned enterprise ; we have to go face to face in the courtroom, and we have to bring bankruptcy, you know, that kind of thing. That was the most difficult part.

So, whether these measures will have impact on deflation or not, as far as I understand, I don't think we have a very direct relationship between NPL recovery and the deflation situation in China. In the last three or five years we have experienced to some extent some deflation, but that was mainly

because the over production capacity was cumulated in the whole economy. There was a survey over a hundred products, but in 80 percent or more of them, there was over-capacity, and less than 20 percent there was an even supply and demand. So, I would say, deflation mostly comes from the over-production capacity of most of the consumer goods, rather than the recovery of the NPL. Thank you.

Gyohten : Thank you very much. Your remarks clearly show that situations in respective economy on this issue is considerably different. So, at the end of the day each country has to decide what to do with your own problem, and one thing very clear is you certainly need a very strong determination to cope with the problem.

Well, let's move to the second one, that is, China's role in regional economy, particularly in coming years. During the Part One discussions, I think overall impression of the speakers about this China's role in the region was a very positive one. Certainly, the growth of Chinese economy means a rapid expansion of its market, and that means increased export opportunities for other Asian countries. And also for developed countries including Japan, China's development means better opportunities for investment and enhancement of their global operational efficiency.

Nevertheless, as Mr. Kanai mentioned, certainly the foreign direct investment is very much increasing in China, although Kanai-san said that investment in China is not the result of shifting from investment in ASEAN countries ; rather it means transplantation from Japan to China. But I think it is a fact that, compared with foreign direct investment in China, FDI in ASEAN countries has certainly lost its momentum in recent years.

So I wonder what do you view this situation, particularly from the

viewpoint of non-Chinese Asian countries, do you consider that this is rather an alarming situation? And if so, what measures you are contemplating to increase the attractiveness of your own economy for foreign direct investment? I think particularly in high-tech manufacturing areas, it is quite obvious that major interest of developed countries corporations has now very much focused in China. Can I have your views on this issue?

Let me see. First of all, can I ask Kanai-san to get your view on this issue?

Kanai : Thank you very much. Earlier I talked about the relationship that Japan and China, obviously investment has shifted from Japan to China, and as I said, it's not necessarily shifting from ASEAN countries to China. But of course, ASEAN countries are in competition with China in terms of foreign direct investment. I think that is certainly true.

However, although China has joined the WTO and has established laws and regulations in a rapid manner, it certainly is still in the transition. And in that perspective, in my view, Asian countries are not too certain how they can co-exist with this emerging China. Japan has a capability for developing high technology. However, whatever goods such research and technology can produce, the production will go to China after all. Whatever you may want to produce, you need components, necessary work surrounding certain product, and certainly many countries in Asia have tried so much to establish an infrastructure to induce production bases, whereas China still lacks such infrastructure, and I believe this situation is likely to continue for some time to come. It is not the commodity products that we are talking about ; they can go to China. We are talking about more systematic products which require higher level of infrastructure as well as higher productivity with reasonable labor cost and lower inflation. Therefore, ASEAN countries, I

believe, still have lots of opportunities to lure Japanese companies into them.

Therefore, I believe there is a clear demarcation between China and other Asian nations. Of course, when integration of China into WTO progresses, things may be different. At this point in time we still see many restrictions in China. When those restrictions are gone, we can expect some changes. But until that time, both China and ASEAN nations, in their own rights, have rooms to develop.

But it is true some of the investment may be shifted from ASEAN countries to China, but from macroeconomic point of view, I believe both China and ASEAN countries have ways for further development.

Gyohten : Mr. Pridiyathorn, do you have any concern about the concentration of foreign direct investment into China? Do you have any ideas about how to increase your attractiveness and appeal to foreign investment into your country?

Pridiyathorn : Well, we are aware of the fact that China is a threat as well as an opportunity. Let's face it. What we have done in the past three-four years, is to really identify industries that we could survive, industries where we have competitive edge over China. For example, with the kind attitude of Japan, our automobile industry could exist, simply because we have quite extensive parts supplies industries, which need to be upgraded, anyway, in order to feed this new version of new age of cars, which is being done.

Secondly, we have defined that jewelry industry is the kind of industry that has competitive edge over China. We have some others like garments. Certain parts of garment industry could exist. We are still one of the top ten garment exporters of the world. We have upgraded our technology. Low

quality garment was out completely in the past three years. So, further on, there are certain electric appliances which could exist. Of course, our future in electronics is very dim, you know. We haven't sophisticated deep enough our electronic industries in the past. That's why I foresee that certain part of industries of electronics would finally go ; it used to be in Singapore, anyway.

At the moment we are in the process of identifying and upgrading technology in many industries, in order to be able to have the right position not only to compete against China but also to supply certain sectors of China as well. China's emergence is quite an opportunity, as I mentioned in my presentation, in that China's income --personal income per capita-- has increased a lot, and it's about to increase more and more. A market of 1,200 million is a big market, one of the biggest in the world. So you have to position yourself right. Don't look at China as a monster. Don't look at China as one who will compete you out of the market. Look at the way that China has to exist ; they have to grow.

You simply have to position yourself in the right way. We used to grow this way, and compete the others out of market as well. So, we have to learn from the lessons of the past. At the moment we haven't yet completely analyzed the total picture of industries yet, but one by one we have done it.

The other thing which we excel very well is in food industries, especially in sea food industries. We are one of the biggest exporters of sea food industries in the world now. We don't export just normal sea foods any more, but the sea foods with a lot of value added things. For example, we export not only shrimp, but shrimp cocktail to the U.S. with sauce, you can just buy from a super market and put it on the table for about one hour, and you can eat it right away. These are things that you have to improve

yourselves. You cannot blame China for growing up. It's good that they grow up. But you have to be ready to change yourself. That's what we are doing at the moment.

Gyonten : Thank you very much. Minister Dorodjatun, do you have any view on that?

Drodjatun : The emergence of China is of course going to set up a new precedent for competition. And I believe that China also is going to take cost from a shift in the production system in the region. On the Indonesian side, however, our industrialization is probably something that can be categorized as very early import substitution industrialization, and we rely very much on cooperation, in particular, of direct foreign investment from Japan, South Korea and Taiwan. Actually on our side is a manufacturing for domestic market. Therefore, for Indonesia, China is a big market, which is structurally compatible, because we are exporting gas, we are going to export more coal, and I believe that we do have also quite a big opportunity for agribusiness commodities like palm oil, fishery, and estate commodities (such as rubber and coffee), and so on.

So, in Indonesia, the discussion on the emergence of China is taken with the view almost the same like in Thailand that this is actually something that, yes, it's going to increase competition, but also it is also a big market of rising middle class for us. So, we would like very much in the discussion with China, in the coming months and years and so on, to really reach an understanding on how to sustain this compatibility, in particular, because we do not want to cause a lot of problems in the balance of trade situation between the two countries. So we are very positive actually about this emerging China. Thank you very much.

Gyohten : Thank you very much. Earlier Mr. Kanai mentioned that Japan faces such problems as hollowing out of the domestic industry. Quite frankly, traditional countermeasures in Japan towards the hollowing out may have not been enough.

Mr. Kuroda, as a person from the Government, do you have any argument against what Mr. Kanai mentioned?

Kuroda : Before responding to that question, I think China, growing within the range of 7 to 8 percent in the coming years, will bring benefits to Japan and to other countries. Therefore, Japan and ASEAN economies and industries, over all, will benefit from Chinese growth. I think there is a higher potential that the ASEAN and Japanese economies can grow. So, it would be wrong, in my view, to view China as a threat.

But the growth of China by 7 or 8 percent means that labor productivity would grow very rapidly. Therefore, if the foreign exchange rate is fixed, for the industries which are producing products which compete directly with the Chinese products, the adjustment cost will have to be paid. But of course, adjustment will be needed, be it Japan or ASEAN, you cannot just avoid adjustment. Therefore, each country is required to change its economic structure to allow the advantage of their trade relationship with China to materialize. And I think adjustments can be made by revamping R&D and other service industries, so that each country can enhance the value added of services and goods that they produce. Avoiding or delaying adjustments would not be a positive reaction vis-à-vis the growth of China. Such an attitude will not benefit China nor would it be desirable for Asia, Korea and other ASEAN countries.

So I believe that one should strive further for industrial adjustment. And

within the framework of ASEAN plus Three or East Asia, one should continue such endeavors.

Well, one point worthy of note is that there is a deflationary trend in China. CPI is showing an empty growth. Amidst the 7 or 8 percent of GDP growth, this is an anomaly. And the renminbi is practically pegged to the U.S. dollar. What foreign exchange policies should be chosen by each country is within the discretion of each government ; other countries cannot intervene. It's up to China to continue or discontinue the dollar pegged system. And if it is consistent with other policies of China, no one can challenge or argue.

But in the meantime, we are seeing deflationary phenomena in China, and if that exists, then the consequence would be that price deflation spill over across the borders. China would be exporting price deflation to other countries of Asia and the rest of the world. So, the best way is to stop the deflationary trend within China. A developing nation, emerging nation that enjoys 7 or 8 percent of growth, and yet the price is coming down, is really extraordinary ; I think even in view of the history, that's unprecedented.

Gyohten : Thank you. Mr. He, do you have any comment on what Mr. Kuroda just mentioned about the apparent discrepancy between very high growth of Chinese economy and declining consumer price in China?

He : Well, if you look at the price indicators in China since 1998 there was a sharp decrease. But now, that sharp decrease has been substantially slowed down. For instance, this year's decline of price indicators is minus 0.3-0.4 percent. So, deflationary pressure in China is not that serious. But of course, it was a threat, say, about two to three years ago. Because people's disposable income has increased substantially in the last couple of years, over-production capacity or excessive production capacity now is being gradually digested by the increase of disposable income.

And at the same time, the Government has made a lot of efforts to adjust industrial structure. So some of the low efficient industries are being either closed, or the production capacity has been reduced substantially, and of course, some of the investments are shifted from those low efficient or low value-added product to some other industries.

So, I guess, for the time being, deflation pressure is not that serious in China, even though I agree that would present a serious issue if you are growing at 7 to 8 percent, but still facing strong deflationary pressure.

Gyohten : Thank you. Governor Pridiyathorn.

Pridiyathorn : Deflationary pressure may not be serious in China, but it's a very very serious threat to countries in East Asia. Out of the ten countries in East Asia now, the four countries are in the so-called deflation already. "Deflation" means both negative growth and negative inflation. Japan, for the one, Taiwan, Hong Kong, and Singapore for the other, are already in deflation. And out of these ten, negative inflation was in about six countries, and remaining four are dis-inflation, including Korea ; dis-inflation, for sure. The trend is worse this year than last year. Really I don't want to blame you ; it's exported from China, any way. But a country with a growth like 8 percent wouldn't feel it, Korea may not feel it now, but the other countries are feeling it.

What we are worried about is this : If the whole East Asia is like this, what comes next? We don't know yet. It's getting more and more serious. Japan has tried a lot of measures, which is mainly monetary, and some fiscal. It's not cured yet. Thailand is still in dis-inflation, but in a very near future will turn to negative inflation, because our present inflation is 0.4 percent and

it's getting down and down. The asset price dropped in the first half by 12 percent. And this major reduction of price it's very tormenting for countries like ourselves.

That's why I support Minister Kuroda in that we should call upon China to have a look at it, to have a look at reducing deflationary pressures as much, as soon as possible. China is too big not to be felt by the others. We don't know how to cope with it yet, but we will cope with it.

And finally, we have to promote intra-regional trade in order to uplift the external demand of our countries. We cannot rely on the U.S. or Europe, or even Japan nowadays. There is some sort of recession there. One thing that has saved us from deeper down into deflation is intra-regional trade.

So, China is both a plus and a minus point. But China has to understand that. Being such a biggest country in Asia, being a country which is competing with other countries, any move of yours is really affecting the other countries of East Asia. We love you, but we like you to love us as well.

Kim : Can I?

Gyohten : Yes, Dr. Kim.

Kim : Yes, I would like to make a very short and quick remark. First, I would like to agree with what Governor Devakula said about the emergence of China. Yes, China's emergence is both a threat and an opportunity to her neighboring countries. We are now talking about the policies of China, but probably what is more important, I think, is the institutional reforms of China. China became a member of the WTO ; it's a very welcoming event. But nobody expects that a big country like China could achieve such a high

rate of economic growth for long. Korea is not small, but as compared to China, it's an extremely small country. As far as population is concerned, ours is one/thirtieth or one/twenty-fifth of China. It's a relatively small country. Korea was able to manage such a high economic growth for a few decades, but Korea later was hit by the crisis. Why? Because Korea lagged behind in reforming her institution to respond to globalization trend. So, what remains to be seen is not how China will manage her economy in terms of policies, but in terms of institutional settings.

And so, the recent proposal by Chinese leaders of forming or establishing an FTA with ASEAN and other East Asian economies, I think, is a very welcoming one, because that is probably one of the ways to make the Chinese economy, not only the Chinese economy but her neighboring economies, to conform to the globalizing trend. So I think that should be the key issue to discuss in the future.

And the second very small remark to what Governor said was that, for the case of Korea, deflation or disinflation does not turn out to be a key issue these days. For the case of Korea, we expect to achieve 6 percent growth rate in real terms, just behind China. But next year we will also expect to achieve about 5 to 6 percent growth rate. But what we are worrying is not deflation or disinflation, but we are worrying about inflationary pressures. And so, a matter of discussion these days domestically is how high the inflation pressure is. And that is why the Bank of Korea and Finance Ministry are arguing, or are debating, between the two institutions, as to the appropriate level of interest rate. Anyway, the debate is on inflationary pressure, not on deflationary pressure, in Korea. Thank you.

Gyohnten : Thank you. Mr. He.

He: Well, I should say thank you very much for loving China so much, giving us such a big responsibility. China is a huge country in population, but not so large in the size of economy. It's only 1 trillion dollar. Japan is four times as much as China. So, you know I shouldn't say anything more about it. But, in terms of Chinese economic growth, the Government has tried stimulus fiscal policy, as I mentioned during my speech, and the Chinese Government and the Central Bank lowered interest rate consecutively in last few years ; now it's at historically low level. And of course, you know, it really depends on how the new government will react to the current economic situation. But personally I think that current monetary policy and fiscal policy will carry on.

But at the same time, I think that infrastructure investment that was used by the Government to improve the environment, the transportation, telecommunication, energy supply, and that kind of thing, will pay off gradually. Some of the projects started about three or four years ago, and most of them will be finished in the next one or two year time, and then the overall environment, especially in inland will be improved. For some time, most of the investments have been concentrated in the coastal regions, but as time goes by, the infrastructure will be improved in inland areas because the cost of labor is lower, and as the economy grows, the coastal region is getting more expensive compared to the inland regions. So, now we see more investment moving from the coastal regions to the inland areas.

And so, we think especially in the second half of this year, we saw a very strong—it's from a banker's point of view—a very strong loan demand. In other words, we think that the economy is gathering momentum from the second half of this year. At the beginning of this year the economic performance was not that strong, but from July-August we saw monthly growth of 7.5-7.7; now people are forecasting annual rate of 7.8. And the

price indicators are still slightly minus, but retail sales are growing at about 8 percent rate. So, I hope we will have positive growth, at the same time slightly positive price movement. Thank you.

Gyohnten : Thank you. I think this issue of China's role in the region cannot be separated from the discussion about the various regional cooperations we have discussed also. And I think on this regional cooperation, there are broadly speaking three stages. One is at the level of trade, and we talked about FTA. And second is cooperation on financial and currency issues. And third is more deeply built-in policy coordination level.

On the first, FTA, I gather that there is a broad consensus that this is a very positive and a desirable direction. And in fact, as we have heard, there are many ideas of either bilateral or multilateral FTA schemes now moving in the region. But I think, as this trend proceeds further, I suspect all countries involved will be faced with real problem of domestic industrial restructuring. And for a country like Japan and Korea, for instance, problem of agriculture will become a very serious one, and for other countries, how you are going to restructure your manufacturing industries among different countries will become very serious policy issues.

And on the financial and currency cooperation, again we've heard many ideas about that cooperation, but if my impression is not wrong, the final tone of the argument is rather cautious one, although everybody agreed that some kind of gradual cooperation will be desirable, and probably feasible, but this will be a time consuming and probably a process which requires a lot more efforts not only on the private sector but also on the policy level.

And on the policy coordination level, it seems to me that this is truly a very important, particularly against the background of global slowing down

and growing uncertainties and lack of transparencies in global situation. But yet, in order to achieve real effective policy coordination, there must be basic sharing of same infrastructure in terms of transparency and institutional set-up in the respective countries, corporate governance and also in the political level, which, in my view, does not exist yet at the same degree in all countries yet.

So, I think this regional cooperation is certainly one urgent task for the region as a whole, yet we have to accept that we are loaded with many remaining challenges to solve.

Now we have only fifteen minutes left, and I have many questions which were presented by the audience. So what I would do is to select on or two questions to each panelist and ask you to respond to those specific questions in a very succinct way.

First to Mr. He. I can pick up two questions, both of which should be very easy for you to respond. First one is : you mentioned that you are going to continue very positive, stimulative fiscal policy to maintain the high growth. But what I heard is that your government debt, if you consider the shortage of pension fund and also public fund required for the NPL solution, the entire government debt is said to exceed already 100 percent of GDP. Do you think it's possible to maintain this very stimulative fiscal policy for long? That's the first question.

Second one is a very concrete one ; it must have come from a Japanese businessman. His company in China is still forced to follow cash-on-delivery method, because it is very difficult to collect the receivables on time and in an appropriate way. So, his question is : do you have any plans to improve this kind of business environment for foreign corporations operating in

China? These two.

He : Well, a very big macro question, and a very micro one. Well, you said the Chinese Government's borrowing now exceeds 100 percent GDP. I am not so sure about it. The overall treasury bond outstanding now is 1.4 or 1.5 trillion renminbi, and the total size of the Chinese economy is between 8 to 9 trillion. If that's the right figure, I am not exactly sure whether there is other borrowing by the Government, but if you just look at the treasury bonds outstanding, and I think it's an appropriate level. So, I guess I don't have to answer the second part of the question.

And the second one, the receivable collection. It really depends on what kind of clients you are dealing with. We, the banks, of course, can help you to speed up the collection. But it depends on the credit-worthiness of the client. So it's both an overall environmental issue, but also, you know, when you talk about a particular client, we have to look at him very carefully. If you have any requirements or needs for us to identify your clients, the Bank of China will be very happy to do it for you. Thank you.

Gyohten : Really encouraging response from the Deputy Governor. Thank you very much.

Now, to Minister Dorodjatun, one question. As I see it, the Indonesian economy today is certainly enjoying very robust consumption. But on the investment side, there seems to be some slackening or very lackluster trend. Does your Government have any plan to try to stimulate the recovery of investment?

Dorodjatun : First of all, I would like to clear up the statistics that we use. The Investment Board statistics do not include, for example, oil and gas,

which is really in the hands of the Department of Mining. And also we don't know about real estate, in particular, because that is in the Department of Trade. So it is not covered by the statistics of the Investment Board.

Now, that's the reason why I hesitate to say that we really have a declining investment in the last three years. Because when I saw the statistics on export volumes, in terms of tonnage, astonishing figures, for example, like how come then last year we exported around 7 million tons of cement, or 1 million tons of copra, and you can continue. The one that suffered a decline in terms of volume was actually shoes. And textile, I would say, a hovering at the same figure for the last three years. But this is what I notice that the weakness of statistics indicates something which I really have to double-check. And for example, domestic consumption for electricity also continues to increase. How come, then, electricity continues to increase at 10 percent per annum, for example? Why the demand for fuel, which is submitted by the Parliament, every year continues in terms of millions of kiloliter?

So, this is the reason why I have a suspicion and actually I have to travel to many regions in Indonesia almost every Saturday to detect what's going on. I notice, for example, that in the regions we do have report of seaport's increasing activities. For example, I notice that we have about 4 million boxes of containers last year in terms of traffic. We have to expand some of the seaports already. So, really I think the value of trade, of export, is declining because we are suffering weakening prices everywhere in the world. We are suffering, I think, a problem of really declining in terms of trade, also, because of debt. But physically, Indonesia keeps to a large extent using the capacity of the past years, but I believe that we do have from the report by the banks on the loan to deposit ratio increase from 20 to 40 percent, and I notice also that the non-performing loan, because of all the stuff that I explained earlier, we have been able to reduce non-performing

loans at the same time to around probably 12 percent according to Bank of Indonesia. But the most amazing thing for me : this year we set up a credit ceiling for small, medium, and micro financing of about 30 trillion rupiah. By August I got a report from Bank of Indonesia that disbursement was already about 21 trillion.

So, I notice from all this that actually I have to check again the statistics which continue to report that we have problems in investment. Now I agree that foreign investment, yes, that one, I checked with Bank of Indonesia ; you do have problems with direct foreign investment. But in the mining area, in particular, oil and gas, we continue to have vigorous interest. The problem is actually with mineral, non-oil, non-gas ; we classified like that. About 150 mining initiatives, approximately about 35 billion U.S. dollars were stopped because of the very strict law introduced by the Government or President Habib, Law No. 41, year 1999. I am working out now with the Parliament to release many of these projects in the eastern part of Indonesia. With the mega projects already released, about 14 mega projects we have announced were completed, about 15 IPPs out of 27 finished. We have started again toll roads from about 65 toll roads, we have just released about 16 of them in operation. I hope that next year we will see again an expansion of investment in capacity. Thank you.

Gyonten : Thank you very much. Next, Governor Pridiyathorn, there are several questions concerning AMC, but since you responded to that question already, I will pick up one completely different one. As the Governor of Central Bank, if you were the Governor of the Bank of Japan, do you introduce this so-called “inflation targeting policy” ?

Pridiyathorn : You mean now, right? First thing I would do, I will resign right away.

Gyohten : That's the best answer.

Pridiyathorn : At the moment, yes, Japan is facing deflation. Inflation targeting, it's a good thing ; it's very decent. But it doesn't fit the situation. Inflation targeting is good when the country has high inflation like the Philippines. The Philippines has high inflation ; and the inflation targeting has been able to bring it down within one year from 9 percent to less than 3 percent and stabilized the economy. But the name of the game here is not stability. Your economy is very very stable. The name of the game is how to bring it back, which I don't really know. I couldn't think of how to do it. It would be fair to ask Mr. Kuroda, not me. But not inflation targeting now. You can introduce it, but it doesn't help, it doesn't help.

Gyohten : Well, thank you very much. I think that's a very sensible response. Now, to Dr. Kim. Well, there is a discussion or idea about trilateral FTA between Japan, China and Korea. In order to make this idea materialize, there seems to be several difficult points, particularly on agricultural issues for Japan and Korea. In your view, what will be the important points that need to be solved first for this idea to be materialized, trilateral FTA?

Kim : Well, this question is too difficult for me to answer. Yes, agriculture is one of the more important critical issues. Probably your guess is as good as mine. But one thing I can tell you is that for the case of Korea, more than 60 percent of the heads of the farm households are over 50, and basically you cannot retrain them. You've got to wait. And for the case of youngsters, youngsters don't want to do farming. So if you wait, let's say, a few more years, there will not be many who are left in the farm sector. And I think that may be probably the time to resolve the FTA problem among China, Japan

and Korea.

Actually, there were some discussions between Korea and Thailand on concluding FTA, but it was not resolved. Why? Because of agricultural problem. And at that time what I suggested was that time is the best solution, so we have got to wait a few more years.

Except for agricultural issue, I think, of course, there are some issues related to opening up of service sector. But for the case of Korea, after the 1997 economic crisis, Korea's financial sector was reformed, and so there are not many difficult problems associated with opening up of the financial sector. But there are some other strategic industries, including railroad and others which I think have some difficulties in opening up to foreigners, but it's not as severe or as serious problem as agricultural opening. So, probably Japan and Korea may be in a same boat in dealing with this agricultural problem.

Gyohten : Thank you. Now I have a question to Mr. Kanai. Amongst Japanese businesses, there is a growing tendency to shift the production bases to China. But when it comes to the most advanced research and technology area, they will be remaining in Japan, and therefore, the worry is not so great. However, this person who posed the question says : after the production bases have been shifted to overseas, the technological innovation can still exist in Japan? That's the question he has.

Kanai : Including China and other Asian countries, the most advanced technologies are often supplied from Japan. That's one. And also, the Japanese science and technologies, due to multiple government policies and other measures, have come to the point where they can lead the global science and technologies in about three years. But of course, we cannot live on patent royalties. Such innovations have to be leveraged in the industry.

The question is whether the industry will be here in Japan when such technologies are ready to be leveraged. Regulations, in IT and pharmaceutical areas, make things difficult to leverage such innovations. As a place of investment target, the cost in Japan is prohibitively high, therefore, the investment tends to go to other countries.

So, within several years we must change the structure of the industry, just like Mr. Kuroda mentioned earlier. Using taxpayers' money, certainly various research and development works have been done, and they have to come back to the Japanese taxpayers somehow.

Now, although we operate in China, the most advanced part of our operations still remains in Japan. But of course, as those technologies become obsolete, the currently new technologies go to China, and instead in Japan we may be able to create something new innovations. The point is how they can be leveraged actually in the industry.

Gyohten : Thank you. The last question to the last panelist, Mr. Kuroda. Well, Chaing Mai Initiative you talked about in your presentation is sort of a network of bilateral swap arrangement. Do you think that this network of bilateral arrangement could develop into genuinely multilateral financial arrangement in the near future?

Kuroda : With respect to the Chaing Mai Initiative, as you have correctly pointed out, it is the network of bilateral swap arrangements, and therefore, there is no multilateral institution in the context of Chaing Mai Initiative. It is not yet a multilateral system or institution nor initiative. Now, some time in the future, based upon the network of existing bilateral swap arrangements, it could be transformed into a multilateral arrangement. That is a possibility, and there is a potential.

I think Chaing Mai Initiative is to be reviewed in terms of its initiative three years after its introduction, and that three year initial period is about to be over, bringing about the opportunity to review the whole mechanism. But amongst ASEAN plus Three, I don't think there is likely to be an agreement to grow this network of bilateral swap arrangements into a multilateral one. For the time being, the priority would be to further refine and develop the existing network of bilateral swap arrangements as well as continuing with the economic review and policy dialogues. And once the fruits of those discussions are crystallized, they would start talking about the multilateral arrangements. So, it could be the potential for future, but not right now. With the existing network, it could function quite well if it is necessary.

Gyohten : Thank you very much, Mr. Kuroda.

Now, we have come to the conclusion of this Symposium. I think as Coordinator I am expected to make a sum-up of the whole discussion. But I have to confess that will be a totally impossible task, because what we listened and what we discussed are very rich, substantive, but very much diverse. Nevertheless, I think I can say that what we discovered from this very lively and intensive discussion is that all of us were impressed by the tremendous efforts made by each country in the region to overcome the difficulties and prepare for the future. But at the same time, it is also widely shared that we are now really faced with the great uncertainties and some looming risk for the economic development in coming years.

China is very successfully keeping its great leaps forward, but yet, as a result of the full accession to WTO, and more integration of Chinese economy with the global economy, I think China's future will require probably greater efforts for China to maintain its strong growth. So I think, on the whole, we should conclude this discussion with the considerable

elements of hope, but at the same time, renewed determination that we have to continue to strive our own effort, together with greater collective effort to cope with the situation.

And with that note of cautious optimism I would like to thank, first of all, all Panelists for your truly great contribution to the successful performance of today, and also I would like to thank all of our audience for your active contribution to the success. And last but not least, I would like to thank our excellent simultaneous interpreters who have done excellent job for us. Now, with that I would like to close the session with big applause to thank our Panelists.

Note : Special article on today's Symposium appeared on Yomiuri Shimbun on Friday, November 22nd, and on December 20th on Daily Yomiuri.