SEARCHING FOR A STABLE CURRENCY REGIME IN EAST ASIA

—Role of Yuan, Dollar and Yen—

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Preface

Since its adoption of reforms and open-door policies, China has seen rapid economic growth, and succeeded in gaining membership in the WTO, thus becoming a full-scale participant in the global economy. Meanwhile, not only East Asia, including Japan and South Korea, but also Europe and the US, have all felt the considerable impact of concentrated direct investments in China, as well as of the rapid expansion of trade with China.

Above all, some observers argue that China's competitiveness may not be a reflection of its true economic might, since the yuan's exchange rate is practically fixed to the dollar. This issue was reportedly discussed at the G7 finance ministers' meeting held during the Annual Meetings of the IMF/ World Bank in September 2003.

In light of this background, the Institute for International Monetary Affairs, the Sankei Shimbun, and the Keizai Koho Center (Japan Institute for Social and Economic Affairs) organized a symposium to discuss the impact of the growing Chinese economy on the global and regional economic structures, as well as how the future course of the yuan's exchange rate will affect other economies and currencies. We had invited as panelists the most knowledgeable experts from financial and business circles in Asia, the United States, and Japan, whose names and short profiles are shown below.

We hope this publication that records their speeches and discussions will be of any help to those who are interested in the development of Asian economies. Please note all responsibility in compiling these speeches and discussions is solely of IIMA's as are any errors in their presentations here.

Panelists :

Chen Yuan

Governor, China Development Bank

1981 M.A.in Economics, China Academy of Social Science

1982 The Secretary of the Party's Committee of Xicheng District, Beijing

1984 Director General, Department of Commerce and Trade, Beijing Municipal Government

1988 Deputy Governor, People's Bank of China

1998 Governor, China Development Bank

Zhang Yanling

Executive Vice President, Bank of China

1977 Joined Bank of China, Head Office

1998 General Manager, Banking Department

2000 General Manager, Bank of China Milan Branch

Executive Assistant President, Managing Director

2002 — Executive Vice President, Managing Director

Il SaKong

Chairman & CEO, Institute for Global Economics, Korea

(Former Minister of Finance and Economy, Korea)

1964 Graduated Seoul National University

1966 MBA, University of California at Los Angeles

1969 Ph.D. University of California at Los Angeles
Assistant Professor, Economics and Finance, New York University

1973 Senior Fellow, Research Director, Vice President
Korean Development Institute

1983 President, Korea Institute for Industrial Economics and Trade

1983 Senior Secretary to the President for Economic Affairs, Office of the President, Korea
1987 Minister of Finance, Korea
1989 Special Consultant, International Monetary Fund
1993－ Chairman and CEO, Institute for Global Economics, Korea

Jesper Koll

Managing Director & Chief Economist,
Merrill Lynch Japan Securities Co., Ltd.

1980 Graduated the Lester B. Pearson College of the Pacific
1986 M.A., the Johns Hopkins University
Research Fellow, Institute of Economic Research
Kyoto University
Research Fellow, Institute of Social Science
Tokyo University
1989 Chief Economist, S.G. Warburg Securities Ltd.
1994 Chief Economist, J.P. Morgan
1998 Managing Director, Tiger Management L.L.C.
1999 Managing Director, Merrill Lynch Japan Incorporated

Yoshiaki Fujimori

President & CEO, GE Asia and Pacific

1975 Graduated from University of Tokyo
Joined Nissho Iwai Corporation
1981 MBA, Carnegie Melon Graduate School of Business
1986 Joined General Electric
1988 Manager, Business Development, GE Medical Systems Asia
1990 General Manager, GE Medical Systems, USA
1997 Vice President, General Electric
President & CEO, GE Medical Systems Asia

2001	Senior Vice President, General Electric
	President & CEO, General Plastics
2003	Senior Vice President, General Electric
	President & CEO, GE Asia Pacific

Fujio Cho

President, Toyota Motor Corporation

1960	Graduated from Faculty of Law at University of Tokyo
Joined	Toyota Motor Co. Ltd.
1988	Director, Toyota Motor Corporation
	President, Toyota Motor Manufacturing, U.S.A., Inc.
1994	Managing Director, Toyota Motor Corporation
1996	Senior Managing Director
1998	Executive Vice President
1999－	President

Haruhiko Kuroda

Special Advisor to the Cabinet
(Former Vice Minister of Finance for International Affairs, Japan)

1967	Graduated from University of Tokyo
	Joined the Ministry of Finance
1971	M.Phl. in Economics, Oxford University
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 (Finance) Bureau
1999	Vice Minister of Finance for International Affairs, Japan

2003-	Special Advisor to the Cabinet Professor, Hitotsubashi University, Graduate School of Economics

Moderator :

Toyoo Gyohten

President, Institute for International Monetary Affairs

1955	Graduated from the University of Tokyo Joined the Ministry of Finance
1984	Director-General, International Finance Bureau
1986	Vice Minster 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, Institute for International Monetary Affairs

Good afternoon, ladies and gentlemen. Thank you very much for taking time out of your occupied schedule to attend this symposium. The Institute for International Monetary Affairs, together with our co-sponsors, the Sankei Shimbun and the Keizai Koho Center, are very pleased to see such a high level of attendance.

It has already been six years since the outbreak of the currency crisis in Asia. Time really flies, and subsequent to the outbreak of the currency crisis, many unforeseen events actually took place on the world scene. In the economic scene, the so-called IT bubble saw the boom, and then followed by the bust or disintegration, and in Europe, after 50 years of unyielding efforts, the single currency euro was introduced at long last.

On the other hand, in New York the tragedy of so-called 9.11 terrorist attack occurred, and war broke out in Iraq. So-called geopolitical events that are indeed earth shaking occurred in the world, while the outbreak and spread of SARS caused serious consternation on our part.

However, while such unforeseen events impacted the world economy one after another, the Asian economies in relative terms have been able to retain their economic vigor. Especially noteworthy is the rapid development of the Chinese economy. The Chinese economy has undergone the Asian currency crisis, various natural disasters, changes of political leadership, membership in WTO, and outbreak of SARS. The Chinese economy successfully weathered those various incidents and happenings and continued a rather strong pace of growth. As a result, characterized by a huge domestic market and strong export competitiveness, the Chinese economy has not only emerged as a prominent base for production, importation and exports in the world, but also China is now emerging as a technologically advanced country, as indicated by its success of manned flight to the space. We have seen increasing numbers of major Chinese companies are making significant inroads into the world markets.

At the same time, needless to say, the serious vulnerability of the financial institutions is another characteristic of the Chinese economy. The many disparities in the economic scene such as the excessive reliance on exports and foreign direct investment and a significant level of unemployment are also features of the Chinese economy.

More recently, China has come to have a huge trade surplus as well as a surge in its foreign exchange reserves. Trading partners have begun to question the appropriateness of the value or the exchange rate of the RMB.

With such a growing presence of the Chinese economy, what would be the likely course of the Asian economies in the future is of course a matter of great interest. Will the Asian economies be able to retain stable trading and currency relationships among them? Especially the major players on the Asian scene, China, Japan, Korea, and the United States, will need to pursue appropriate policy and strategy. But what would be such an appropriate strategy or policy for those governments or businesses to pursue?

So this is the agenda that we will keep in mind, and we are fortunate enough to have seven prominent and learned panel members joining us for the symposium and to benefit from their diversified discussion on this particular agenda. The symposium will last only three hours. The time is very short. I am not sure whether time can do any justice to the presentations or remarks by such prominent speakers, but since this is a golden opportunity I hope those in the audience will be able to listen carefully to the presentations by the panel members and also to be very forthcoming with questions and actively participate in the subsequent Q&A session.

So first, starting from this side, I would like to ask panel members to make their keynote address one by one. Because of the time constraint, I will not introduce each and every one of the panel members and their bio data and, as was mentioned already, there is no intermission during the symposium. So, once again, I would like to express my sincere gratitude to your participation. Thank you.

1. The Development of Western China - Lessons Learned from a Work in Progress

Chen Yuan
Governor, China Development Bank

Respected Mr. Gyohten, distinguished guests, ladies and gentlemen, It is my delight to be with you today and discuss some of the issues concerning the ongoing development of China's western provinces, a mammoth project about which much of the world knows next to nothing.

China's western areas are vast, embracing twelve large provinces and bordering on fourteen other countries. Together, that portion of our country that we designate as our west covers 6.85 million square kilometers and has a population of 367 million people. To put these numbers in perspective, they amount to 28％of our country's total population and over 71％of our land area. If they were a separate nation, they collectively would constitute the sixth largest in size (behind Australia) with the third greatest population (70 million more than the US). The population density is less than one-sixth that of the rest of China, but still twice that of the United States.

However, it is an economically impoverished area with worsening environmental conditions. Statistically, in 1999, this population earned only two-fifths as much GDP per capita as those people in the eastern part of our country and was losing ground still further. At the start this new millennium, our national government made an important strategic decision - Western China would be economically rehabilitated.

That was three years ago. In that relatively short period, the progress has been dramatic. Given the central government focus and economic injection, together with the impetus of targeted-development finance from our organization, China Development Bank, Western China has made more progress in three years than it did in the previous generation. Of course, it included the building of infrastructure, such as the Qinghai-Tibet Railway, the east-west gas project and the similar east-west electricity generation and transmission project. Moreover, for the first time, projects saw farming lands converted back to forests, and natural forest resources given a preservation imprimatur.

Revitalization in China isn't just a word - it's nation rebuilding, often from scratch. We have the annual statistics that show the effectiveness of rebuilding the western regions, and they are certainly remarkable： Average annual increase of fixed asset investment - 18.8％(50％greater than the national average), including a 22.4％figure for the 2001-2002 growth. Western China has experienced a GDP growth of 8.5％, 8.7％and 9.9％for the last three years, which is certainly impressive for a backward area.

Unfortunately, these statistics don't tell the full story. Developing Western China to the level of its eastern counterpart is a long-term project, a generational task. Qualitatively, the area is facing many problems that still aren't under control, including worsening environmental conditions. Infrastructure is still backward compared with eastern China. As expected, educational systems are less advanced, so there aren't sufficient numbers of bright young minds full of learning to adequately assist in nation building. There are acute agricultural problems, while science and technology development lags.

In Western China, there is no solid economic foundation on which to build. In the last three years, national government spent disproportionately large amounts to kick-start large projects； these totaled 270 billion RMB (slightly over $US33.4 billion). Again assisting in a disproportionately large fashion, our government has also floated approximately 160 billion RMB in long-term construction bonds for Western China development, so that's another $US19.8 billion to build and develop. These funds have played an important role, but are far from being enough to meet Western development needs.

As Western China development has continued, more and more attention was and is being paid to capital formation and financing-mode innovation, to extend and widen financing channels. Some time during that process, we at China Development Bank (CDB) figuratively stepped back to assess the situation and made discoveries that I wish to relate to you today. This speech concerns more than an internal Chinese development project - instead, it's about the lessons we learned during the funding process, lessons we feel have a substantially broader application.

You see, we found the key to widening the funding channels lay in financial institution defects and deficiencies in Western China, which were and are a bottleneck to development. Backward financial institutions lack a market-based creed of corporate governance and an efficient, reliable financial infrastructure - Western Chinese financial institutions were indeed backward. We could only render efficient service towards development when we could effectively and efficiently fund, and we were throttled by the existing financial institutional systems.

We had to rework the financial institutional system in Western China before we could effectively carry on development. In cooperation with the national and regional government, we did exactly that. Western China was virtually devoid of responsible, modern market-based personnel, institutions and methodology, so we literally had to create the entities that would develop and the banks that would fund them.

As I've employed the term, "corporate governance" includes the persons, rules, regulations and procedures that concern legal entities and their management structure, ownership and property rights. "Financial infrastructure" embraces the accounting standards, payment systems, credit systems, performance reviews and law enforcement. The institutions are like the cells of the market organism, while the infrastructure activities parallel those of the internal regulatory organs. Both elements are independent, essential and complementary. I am certain that many of you would have already picked up the scope of this endeavor - it is far more than standardization, because it goes to system integrity as well as the modernization aspects of efficiency and reliability.

This was lesson one: In today's world, a country's economic competitiveness is not merely measured by its scientific research, its technological achievements or its production or material resources. More than material items or intellectual achievement, the sophistication of a country's economic institutions is the core force and essential spur to physical and material productivity. Indeed, faulty and imperfect institutions can effectively (whether by accident or design) devalue scientific research, material and production resources until they are mere inefficient castaways in world markets.

Lesson one was negative, but lesson two was positive: Institutions can play an important and positive role in many fields of economic activity: (1) efficient allocation of resources; (2) strengthening of cooperation and trust between the (commercial and public) elements of the project, with governmental entities and the financial community; (3) promoting fair competition, by avoiding or eliminating conflicts; and (4) maintaining social stability. The Western China development project punctuated these needs, but we believe they are required for all Chinese economic growth, and for economic growth virtually anywhere in developing countries.

We applied this lesson to the project by adopting this principle: Financing channels are widened by the continuous construction of market-based corporate governance and financial infrastructure, and by setting the overall economy and institution in a modernization and market-based orientation. We can stimulate investments and material production by promotion of this principle. Thus, institutional reform and modernization provide more than an impetus. Together with financial injection in the form of sovereign kick-start funds and targeted-development loans from our bank, they provide a powerful institutional guarantee to China's Western development. In China, we see this principle and the application scheme we have noted as a way to coordinated urban and rural advancement, to balanced overall area development, to economic and social progress, and to the harmonious cohabitation of man and nature, and to better domestic and international cooperation.

The Chinese financial institutional modernization I am discussing calls for the joint efforts of government, the financial sector, business enterprises and the public to see the job done. In other words, it will be the convergent work of the entire economy. The fundamental economic and financial institutions in developed countries are the product of scores and hundreds of years of transition and improvement. China, as a latecomer, can leapfrog directly from primitive to advanced, bypassing the glitches and errors that time has lain bare. China, with its strong macroeconomic growth and abundance of resources and capacity, has at present an excellent opportunity to tackle the mission of total financial institution modernization. We have the momentum economically, so now is the time for our government to prioritize financial institution modernization at a high tier on the national agenda. Government credit should be intensively utilized into this program.

The establishment and growth of credit systems and their inculcation into the everyday habits, thoughts and practices of the people and institutions of Western China is the primary change we have sought in financial system reform and modernization in that region. Western China was devoid of modern concepts and practices involving credit, but credit is essential to modern business, so that market-based transactions can determine prices and mutual exchanges; it underlies schedules and contractual timetables and gives flexibility to project management. The various funding activities in Western development are all executed through credit. Funding and schedules are mythic conceptions without a credible, efficient and reliable credit system.

Western China development has required three types of funding, that must be coordinated, lest our credit loans are compromised or negated by budgetary or fiscal policies or practices: (1) Central government budgetary (grant) monies, to act as seed capital; (2) Bond monies, which further transition projects into the market economy; and (3) Credit loans, in the form of targeted-development finance granted by China Development Bank, which are the core capital. Projects within the overall Western development program generally proceed sequentially through the three funding modes.

Targeted-development finance (TDF) has played an important role in correcting prior market failures and institutional defects in Western development. With sovereign assistance, TDF can promote quality corporate governance, aid in organizing the enterprise as a proper legal entity, strategize cash flow management and evolve a credit culture. In such a climate, project funding, societal improvement and institutional modernization are developed in parallel.

In practice, TDF functions in the following way: (1) it integrates sovereign credit with market performance effectively; (2) it combines quasi-treasury financial bonds with asset management methods; and (3) it aligns its advantage in financing with that of government in organizing and implementing enterprise capability to meet the government's objectives.

For those of us at CDB, lesson three was the most important: Properly handled, targeted-development finance is profitable banking with a gratifying social and economic outcome. Through September 2003, CDB funding of TDF for Western China development has amounted to a total of 212 billion RMB ($US26.2 billion). These loans have been made in coordination with state bonds. Throughout the lending process - from initial application through loan administration - we have insisted on taking an active role; we have done the same at all parallel project steps, from enterprise creation to completed operations management. It can fairly be said we have nursed these projects along.

This pro-active banking has paid off handsomely. By the end of the third quarter 2003, CDB's NPL rate stood at 1.17%, its reserve for bad debts covered 231.50% of NPL, and capital adequacy rate stood at 11.10%. PricewaterhouseCoopers has audited our performance the last two years and has certified that our major performance indices are at the advanced level as measured by world standards.

CDB's objective is to build itself into an even-larger world-class financial institution for major project developments. While CDB strives to offer consistent support to key infrastructure and industries, it will focus on dealing with new bottlenecks (which are mainly institutions) and expanding financing channels. It will apply practical achievements in infrastructure sectors to the construction of the foundation and structural pillars for a well-off society. CDB will continue to support industrialization, urbanization and development of the western part of China.

Ladies and gentlemen, the prosperity and development of Western China is of great significance to China, and so to all Asia. We foresee a new Western China, with a fascinating landscape and a prosperous economy. We extend our warmest welcome to you and all or our overseas friends to visit us for business and cultural collaboration and exchange. We earnestly invite you to visit Western China to witness and celebrate its ongoing development. Thank you very much.

3. The Economic Impact of China Accession to WTO and The Prospect for RMB Exchange Rate

Zhang Yanling
Executive Vice President, Managing Director
Bank of China

Distinguished President Gyohten, Ladies and Gentlemen, Good afternoon! I am delighted to be back in Tokyo after four years. Today, on behalf of Bank of China, I feel quite honored to speak at the 12th symposium of the Institute for International Monetary Affairs, and discuss with you for the “Searching for a stable currency regime in East Asia ; Role of Yuan, Yen and Dollar”. I would like to share with you some of my views and understandings on the economic impact of China accession into WTO and the prospect for RMB exchange rate.

Firstly, let me touch on the economic impact of China accession to WTO.

Economic globalization results in a closer economic interdependence among countries. By increasingly opening to the world, especially with the accession to WTO, China has proved itself to be actively willing to integrate with the global economy.

The WTO membership marks China’s economic reform entering a new era, raising the confidence of foreign investors, bringing China into prominence as the most safe investment destination, the most potential market and low labor-cost manufacturing center. Furthermore, it will also help China to optimize the overall trade environment, build a relatively complete market economic system and promote a more transparent legal system that meets international standard.

Since entering into the WTO in 2001, although going through the negative effect of Iraq War and the SARS, the Chinese government has maintained the stability of domestic market and the safety of industries as well as a sustained growth of economy while fully implementing the commitment to WTO. These have irrefutably demonstrated the success of carrying on the proper macroeconomic adjustment policy and the constant opening policy to the outside world. According to statistics, the amount of domestic product of China reached at RMB 10.2 trillion in 2002, up 8％from the previous year. The amount of import and export broke through USD 600 billion, and the real inflow of FDI reached a record high of USD 52.74 billion. In sum, the economic growth in 2002 is showing increasing stability, better quality and efficiency within a balanced price regime and stable employment environment.

China’s trade and economic performance on implementing WTO’s commitment in the past two years are obvious to the world community. Actions speak louder than words, China has proven itself to be a responsible member of WTO. China’s accession into the WTO not only brings opportunities to its own economic growth, but also promotes the development of global economy. In 2002, China’s robust import growth also created huge opportunities for the countries all over the world, especially for its neighbors. The remarkable export recovery of most countries in Asia has clearly been driven by the growing appetite of Chinese market, instead of benefiting from the small economic rebound of the United States. According to the data from the China Customs, the current annual import growth of China from East Asia is more than twice the speed of export growth of the world, and the import growth from ASEAN amounts to 25.7％. In 2002, the export growth of Japan to China was 25％higher than the previous year, representing a trade surplus of USD 5.03 billion ; the export growth of South Korea to China was 22.2%, representing a trade surplus of USD 7.63 billion ; as to ASEAN, who has always regarded China as the major surplus resource for years, the export grew by 34.4%in 2002, representing a favorable balance to USD 13.07 billion. On the other hand, the direct investment from China to other Asian counties increased at a pace of 20%annually, while at the same time, the Chinese government also encourages more and more domestic enterprises to set up business in this region. It can be expected that China will remain a bright spot in the global picture. This will not only be beneficial to the Chinese people, but will also be good news to the world economy.

However, entering into the WTO also brings greater challenges to the Chinese economy. Firstly, in the interim, key risks for the Chinese government lie in the course of opening the market, transformation of government function, improving the legal system, addressing international trade relations and disputes, etc. Secondly, there are still some deep-seated structural problems to be solved, especially the unemployment pressure, industrial structure adjustment, and incomes gap. Thirdly, fierce competition is confronting many capital or technical intensive industries such as Auto-manufacturing, IT or Financial Services sector, while industries such as Agriculture and Tourism have been greatly impacted. Furthermore, external appeals for appreciating the RMB exchange rate are increasingly louder. Finally, the most critical period is the 5-10 years ahead. There are some other hidden problems brought in with the WTO membership.

Now, let’s move on to the topic of the prospect for RMB exchange rate.

From the second half of 2002, a growing number of critics have complained about China’s exporting its deflation overseas, alleging China’s currency as undervalued. There are mounting pressures from the international community on revaluing China’s currency. Japan’s Finance Minister Masajuro Shiokawa, European Central Bank President Wim Duisenberg, U.S. Treasury Secretary John Snow, Fed Chairman Alan Greenspan as well as policymakers from some countries all expressed their desires to revaluing RMB or seeing the Chinese currency fluctuate in a wider range. Some Non-Government Organizations like the U.S. National Association of Manufacturers and “Coalition for a sound Dollar” are even planning to turn the browbeating into government policies. Meanwhile, International Monetary Fund also suggested that more flexibility in the exchange rate was appropriate. However, such allegations were denounced by some well-known world economists. They unanimously warned that appreciation of RMB would not address the developed countries’ economic problems, but rather damage the economic stability of Asia and the recovery of global economy.

Nobel Economics Prizewinner Robert Mundell strongly opposed the RMB’s appreciation. He argued that appreciation or floating of the RMB would involve a major change in China’s international monetary policy and have important consequences for growth and stability in China and the stability of Asia. He pointed out that Asian counties would benefit from the progress of CEPA, which is established on the basis of a stable RMB.

Stephen Roach of Morgan Stanley emphasized that, only when greater progress is achieved in the reform of financial sector can capital account be opened to the outside world and RMB be allowed to float freely. Otherwise, it would probably result in turbulence of global financial market. In this regard, to maintain the current exchange rate for yuan is the best choice.

The latest government response towards growing international pressure to revalue the currency is: China will continue to maintain the general stability of the RMB exchange rate, which would benefit the economic stability and development of China, benefit the Asia-Pacific region as well as the rest of the world.

Chinese President Hu Jintao stated at the APEC Summit that a stable RMB is in the best interests of both China and the global economy. Chinese Premier Wen Jiabao also stressed at the ASEAN summit that China adopted a regulated, singular, floating exchange rate regime based on market supply and demand. The system is not only appropriate for China's practical situation, but also shows China's high sense of responsibility to the international community. People's Bank of China Governor Zhou Xiaochuan pledged the current exchange rate is reasonable and has performed well. In view that China's current foreign exchange system is in line with the nation's economic reality, there is no convincing evidence that China should alter its yuan policy at the moment.

I am personally quite agreeable to these viewpoints and believe the following reasons stirred up the public voice :

Since the slow-down of world economy from the year 2001, its recovery has been repeatedly below the expectations, a sharp contrast with China's fast economic growth is even more striking. In 2001, although China took 4％of the global GDP, it contributed 17.5％to the 2％growth of the world. Similarly, China's manufactured goods export accounted for 5％of the global, representing a portion 29％of the total increase. What's more, China achieved USD30.4 billion of trade surplus and received FDI of USD 52.74 billion, an increase of 12.5％, which made China the biggest FDI destination. As a famous Chinese saying go, "wind will destroy any tree that overgrows the woods". All these gave rise to the built-up of external pressure for the appreciation of RMB. As the reforms of China's financial system and foreign capital management go further, more and more international capital are coming into China in various ways, with speculation adding fuel to the flames.

Nevertheless, we must realize that, factually, the contributions made by wholly foreign owned enterprises and joint ventures accounted for 2.1%of China's total GDP growth. And the products of wholly foreign owned enterprises and joint ventures made more than half of China's total export, of which 55%are in the form of products processed from imported raw materials. That means other countries have already shared the trade income of China, giving no reason how China's current exchange mechanism could have brought deflation to other countries. The real driver of export expansion is not the revaluation of RMB, but the competitiveness that comes from the rich labor resources and low labor cost. The statistics of International Textile Industry in the year 2000 by Werner International Consulting Institute suggests that labor cost per hour of China's textile industry was US$0.69, 1/37 of Japan, 1/20 of USA and Western Europe, 1/8 of Korea; and the pay for auto spares industry in China was just 1.7%of Japan and USA. Given the wide gap of labor cost between China and developed countries, would the appreciation of RMB for tens or dozens percent really help?

In fact, the influence of RMB exchange rate on USA, Japan and other industrialized countries has been markedly inflated.

Firstly, the huge trade deficit of the United States against China is rooted from its fiscal policies. Inadequate domestic savings requires the United States to channel in more foreign investment and carry enormous deficit under current accounts and trade. Even though the United States did not trade with China, it must see deficits in the trade with other countries. The economic scale of the US is 8 to 9 times bigger than that of China, whose export to the United States is only several percentage of total U.S. import.

Thus, the trade surplus that China enjoys becomes no threat to the U.S. economy.

Secondly, although Japan is the biggest trade partner of China, it does not have huge deficit. In the past five years, Japan saw three years of surplus while the other two years of deficit, with a net of surplus. The export from China to Japan is predominated by preliminary and labor-intensive products, the impact of it on the Japanese economy is minimal.

As Mr. Mundell says, the appreciation of RMB will not bring anything good to trade deficit, including employment, of the United States, but make Japan's deflation at present even worse. It cannot thoroughly change the basic facts of China's trade with the United States and Japan.

In the crucial days of fully modernizing its economy just after the entry into WTO, China is more confronted with unemployment, income gap between urban and rural areas, a fragile financial system and structural problem in its own economy. Greater fluctuation of exchange rate will give a series of negative impacts on China's economy, such as curbing export growth, destabilizing financial markets, weakening the effectiveness of monetary policies, increasing employment pressure and staining the prestige of RMB. A lesson should be learnt from that Japan got deeply stuck in the economic bubbles after the Plaza Accord inked in July 1985 and the appreciation of RMB will go against the stability and development of Chinese economy.

Thirdly, the appreciation of RMB is of no help to the currently very sluggish global economic adjustment and resurgence. For the second quarter of this year, the economic growth rates of the United States, Japan and Euro Zone were just 3.1%, 2.3%and 0.1%respectively. World economic growth and international financial markets are featured by some factors of uncertainty and instability, deflation, shrinkage of international capital flows and rising trade protectionism, just to name a few.

The sustained stability of RMB exchange rate and the fast-growing economy of China can inject a stabilizing power to the hardly-recovered world economy and turbulent international financial markets, more importantly, it brings along tremendous present and long-term interests as well as even broader market and further business opportunities.

To sum up, it is absolutely correct for Chinese government to make a decision on keeping the stability of RMB exchange rate. From a medium and long term perspective, it is an unavoidable trend that RMB will go internationalized. Some observations can be made at present as follows :

１. to expedite the reform of RMB exchange rate system, such as improving exchange rate establishing mechanism, adding more flexibility and advancing the course of RMB full convertibility ;
２. to strengthen the balance of payments management, tighten the control of hot money inflows, eliminate the speculation on appreciation of RMB ;
３. to take measures to lift restrictions on current and capital accounts, and increase import on certain purposes, thus to narrow the surplus under both current and capital accounts and slower the growth of foreign exchange reserve.

Ladies and gentlemen, history is a mirror by itself. During the Asian financial crisis six years ago, Chinese government had been withstanding intense pressure for devaluing RMB, an extraordinary contribution to the regional and world economic stability, which won unanimous high esteem of the international community. Today, facing the requirements of changing exchange rate policies, we will further optimize the establishment of RMB exchange rate mechanism during the course of deepening financial reform, foster foreign exchange market and straighten out the relationship between supply and demand, increase the market correction power to the RMB exchange rate. By all these, a fairly stable RMB exchange rate can be set at a reasonably balanced level on the basis of Chinese economic development, running situation and balance of payments.

Thank you for your attention.

4. The East Asian Economic Integration and Financial Cooperation

Il SaKong
Chairman and CEO
Institute for Global Economics

Good afternoon, ladies and gentlemen. I would like to begin by saying that it is indeed my great pleasure to participate in this very timely symposium with the other very distinguished panelists. I would like to thank the organizers of this symposium, the IIMA, the Sankei Shimbun and the Keizai Koho Center, for inviting me.

Although the main topic of this symposium is, “searching for a stable currency regime in East Asia,” I would like to first make a few points about East Asian economic and financial cooperation in general. I have obvious reasons for doing so. A stable currency regime in East Asia has to be searched for in the context of East Asian economic and financial cooperation, and possibly policy coordination. So I will make a few general comments, and then move on to the rise of China and the current renminbi issue as briefly as possible, since there is a time constraint.

Let me first make a few points on East Asian economic and financial cooperation. As you all know, East Asian economic integration before the Asian financial crisis of 1997-98 was primarily market-driven, rather than promoted by institutional arrangements such as FTAs or financial cooperative mechanisms. However, since the crisis occurred, the region has been witnessing various institutionalization initiatives to further deepen regional integration and enhance economic and financial cooperation.

Although the bandwagon effects of the rising trend of regionalism throughout the world and the launch of euro must have influenced the region to engage in such endeavors, the most critical factor, in my view, was the financial crisis itself. It caused countries in the region to realize the importance of regional integration and cooperation. They suddenly realized that their neighbors' problems can soon become their own. The crisis improved the political atmosphere for cooperation and even policy coordination for the region, including the three major Northeast Asian countries, namely, Japan, China and Korea. I cannot imagine the heads of nation of Korea and Japan officially discussing the establishment of an FTA between the two countries before the crisis. I think the crisis made the difference in terms of encouraging political leaders in these two countries to engage in closer economic cooperation.

In addition, obviously, the recent competitive initiatives to establish bilateral or plurilateral FTAs in the region have been intensified by the geopolitical motivation on the part of China and Japan not to lose their leadership positions in the region. As such, unlike in the European Union, these regional initiatives lack long-term vision and goals for the entire region. It is a response to what is happening, rather than based on a long-term vision like what happened in the European case.

Even the Chiang Mai Initiative, which is a network of bilateral swap arrangements among ASEAN+3 countries, does not have a clear roadmap or a long-term vision. I think it is a good beginning, but this beginning doesn't have a definite idea of where it is heading. I have personally been advocating that the Chiang Mai Initiative should be developed into a full-fledged regional monetary facility by which a region-wide exchange rate regime could be installed in the intermediate term. In the meantime, the Chiang Mai Initiative should be further expanded and multilateralized in its operations, with the support of regional monitoring and surveillance mechanisms, which, at this point, the Chiang Mai Initiative does not have.

Of course, the facility should be operated, and I emphasize this point, so as to be complementary to other multilateral institutions, particularly the IMF. From the point of view of the international political economy, this point is very important to get others' endorsement and support. The facility should be consistent with existing multilateral financial institutions, including the IMF, in terms of its operation.

Now, regarding the FTAs, I would also like to see countries in the region work together towards eventually establishing an east Asia-wide FTA. The ad hoc competition to establish bilateral or plurilateral FTAs across the region has the danger of creating a regional "spaghetti bowl" of FTAs. In this regard, the three Northeast Asian countries should accelerate the currently on-going China-Japan-Korea FTA study. However, for practical reasons, the Korea-Japan FTA negotiations should proceed as scheduled, but the FTA should be negotiated so as to become the core of an eventual three-country FTA.

In this regard, what I have in mind is the agricultural issue. When China decides to join the FTA, I think agriculture will become a critical issue. Agriculture is already a difficult issue for both Korea and Japan, particularly Japan. But I think if we want to have a three-country FTA, we should give sufficient thought to this agricultural issue. Both Korea and Japan need to have a very serious restructuring program for the agricultural sector.

To have closer regional cooperation and policy coordination, it is inevitable that countries in the region will have to give up some policy autonomy, or even sovereignty, to some extent. For example, to have any kind of common regional exchange rate regime, not to mention a common currency or common basket for the region, you have to make some sacrifices of domestic policy autonomy. In this regard, the region has to overcome many obstacles.

First of all, the most important challenge for the region is to enhance the level of mutual trust and improve the political atmosphere for regional cooperation. In this connection, it is critically important for the three major Northeast Asian countries to grow out of their past historical legacy. Obviously, all three countries have to do their parts. But Japan is expected to lead the way. In fact, Japan, being the second largest economy in the world, should be able to play a leadership role on the global stage. For that purpose, too, Japan should get its immediate neighbors' support and trust. How can you become a global leader without being a regional leader? So I think we all have to make an effort to really reconcile with each other and to grow out of past legacies. Otherwise, talking about a common currency or exchange rate regime is futile. It takes mutual trust, and we have to get over this mutual suspicion. Unless we take this action first, all these discussions will just remain as theoretical exercises.

For the purpose of trust-building in the region, it would be very wise for these three countries to engage in specific projects that would produce mutually beneficial tangible results soon. I suppose energy is one area, and, for example, protecting the environment may be another. Mr. Chen mentioned development in the western part of China. The three countries together should do something constructive for the region with real good intentions. I have been advocating the establishment of a regional development bank, you might call it the Northeast Asian Development Bank, to facilitate the implementation of these projects. This is the first step, in my view, toward building the base for mutual trust and respect.

Another project I am thinking of is the establishment of what you might call the Asian Financial Institute, which would not only carry out research but would train financial personnel as well, particularly financial managers, supervisors, credit analysts and all those financial sector-related personnel. I think the emerging economies in this region, including China, could take advantage of this institute. Countries in this region have a lot to share with each other. We can learn from each other's successes, as well as failures. Actually, China can learn a lot from Korea, through Korea's policy failures of the mid-1990's. When we opened up our capital market, we went in the wrong sequence, from short-term to long-term, for example. This is just the wrong sequence. So I think this is one area where we can share a lot of experiences of successes and failures. When China opens up its financial markets and liberalizes capital accounts, I think it will really need many financial experts and specialists. For this, I think there is really room for regional-level cooperation.

If this kind of institute had existed before the crisis, Korea could have avoided the crisis. In Korea, we implemented capital account liberalization in the wrong sequence. We did not have the prudent financial supervisory regulatory infrastructure in place. We simply opened our capital account, and hence had the problem. This should not be repeated by others.

These projects should be carried out in conjunction with more fundamental approaches toward enhancing mutual understanding and trust. In this connection, the Joint Declaration on the Promotion of Tripartite Cooperation among the three countries, made in Bali on October 7 this year, appropriately recognized the importance of, "people to people contacts, culture, education, and human resources development, etc." The declaration also rightly recognized the necessity of, "starting with easier projects and gradually expanding the scope and depth of cooperation."

I personally welcomed the Joint Declaration issued by the three heads of nation of Korea, China and Japan. It was an encouraging sign of political leadership commitment toward regional cooperation. As we move toward closer regional cooperation, what is lacking in this region is strong political leadership, unlike in the European countries' experience. In this regard, I thought the Declaration itself was an important step forward.

I was also very much encouraged that the three heads of nation decided to set up what is called the "Three Party Committee, to study, plan, coordinate and monitor cooperation activities." I have, again, been advocating setting up a small and lean but effective secretariat for the three countries. I just hope that this committee will develop into such a secretariat in the near future, so that at least it could coordinate and sort out the agenda for the summit and the ministerial meetings. In any case, I just thought that the establishment of the Committee was a very important step forward.

The East Asian Monetary Union, or East Asian Community, can be the long-term goal for the region. But such a long-term goal, as I indicated earlier, cannot be achieved without having a strong base for mutual trust and respect. That is why I think this trust-building process should be reemphasized, as the first step toward closer regional cooperation.

Let me now turn to the rise of China and its impact, and the renminbi issue. Needless to say, the rise of China provides both challenges and opportunities for the rest of the world, East Asia in particular. However, on balance, I, for one, think that China has been a stabilizing force as seen from the macroeconomic perspective for the rest of the world, and East Asia in particular, over the past two decades or so. As Madame Zhang elaborated, being not only the fastest growing but the most steadily growing economy in the region, China has been important export markets for East Asian economies, especially for non-Japanese East Asian economies including Korea, Taiwan and Singapore, making up for their declining share of exports to the US.

In fact, some of you must have read the most recent issue of The Economist, which reported an estimate based on purchasing power parity that the Chinese economy accounted for about 25 percent of world growth between 1995 and 2002. If you take the market exchange rate calculations, usually we would say that during the last five to ten years or so, the U.S. economy accounted for about one-third of global growth. But based on purchasing power parity, the Chinese economy accounted for 25 percent while the U.S. economy only contributed 20 percent. That means that China, on a purchasing power parity basis, contributed more. So in a way, the Chinese economy has been functioning like one of the major engines of global economic growth.

In any case, intra-regional trade in East Asia has been growing so rapidly because of the rapidly increasing trade with China. From this perspective, it is obvious that the maintenance of Chinese economic stability is critical, not only for China but for the rest of the world, this region in particular. This is why we would like to see China implement a very well-sequenced liberalization program, especially for its financial sector and capital account liberalization. Again, in this regard, I think China can benefit from sharing experiences with others in this region. If we, in fact, are able to establish such a financial institute for training and doing research, this would be very helpful to Chinese policy-makers.

In this context, I would like to make just a few comments on the renminbi issue and the exchange rate regime. I personally think China is not yet ready to move toward a freely floating exchange rate regime. China still does not have a sound and prudent financial regulatory and supervisory infrastructure in place which is up to global standards. As Madame Zhang and Mr. Chen mentioned, I think the Chinese authorities should work on this. The other area is, of course, dealing with the non-performing loans of major financial institutions. I think the Chinese financial sector is too fragile to be fully exposed to the international capital market. This is the kind of sequencing you have to follow. In this context, I don’t think China can abruptly switch to a fully floating exchange rate regime. It has to get the base to move toward that goal.

Looking back at what happened in 1997 and 1998, the Thai economy was much smaller than the Chinese economy today. But what happened after the Thai baht crisis? It became contagious across East Asia, and actually throughout the world. What will happen if China runs into a similar crisis? It would have a really detrimental effect on the global economy. That is why I think China should implement very well-sequenced policies, and, in this regard, again, that regional cooperation may be very useful.

That does not mean that a one-time adjustment of the exchange rate is not necessary. If you prolong the misalignment of exchange rates too long, that in itself can create a problem and lead to a crisis. China may want to consider widening the band, perhaps around a basket of currencies rather than a single currency peg. But if the economy shows any signs of over-heating, I suppose a one-time adjustment may be necessary even before moving toward a new exchange rate regime. Of course, the overall Chinese current account surplus is not that big. I think it’s about 2 to 3 percent, or maybe less than 3 percent. But considering the developing stage of its economic status, China may want to run a deficit rather than a surplus. If that is the case, I suppose some adjustment needs to be made.

Along with the exchange rate adjustment, China wants to accelerate the scheduled reduction of both tariff and non-tariff barriers and eliminate special incentives currently given to exporters to help balance the nation's current account and so mitigate foreign pressure. The U.S. election is getting closer and there is a danger that protectionist sentiments may have a resurgence in the United States. Again, from the political economy point of view, I suppose China tries to help reduce, to some extent, the U.S. current account deficit. I do not know how much China can contribute, but at least it makes an effort to help prevent the resurgence of a protectionist environment and mood in the United States.

Since I have taken too much time, I will stop here, and maybe later on I will have the opportunity to entertain any question.Thank you very much.

5. The Challenge of China

Jesper Koll
Chief Japan Analyst and Managing Director
Merrill Lynch Japan Securities Co., Ltd.

Good afternoon, Mr. Gyohten, Sankei Shimbun and Keizai Koho Center members. I want to thank the audience very much for coming inside to today's symposium despite the fine and clear autumn weather outside. Clearly, the emergence of China is a very important topic with many unanswered questions and uncertainties ahead. I will be brief in my remarks and must apologize for still having some sort German accent in my Japanese language.

I work for a major U.S. investment bank. So I would like to talk about money and markets. That's what I know best. This year, the growing participation of China in the global economy and in global money flows has emerged as a key discussion topic in global markets. Everybody talks about this, telling anecdotal stories about foreign investment inflows into China or export competition from China. For some, China is a threat, for others an opportunity. From an analyst perspective, one thing is certain : China is definitely the biggest catalyst for change and corporate restructuring in the industrialized world. It also fuels an increasingly heated policy debate. Essentially, China forces Japan, Europe and America to speed-up their transition towards post-industrial societies and post-industrial economic structures. This transition is politically painful and therefore brings with it increasingly vocal calls from the advanced industrial countries for China to change its foreign exchange rate policy.

Personally, I think that the liberalization of the Chinese currency is not likely at all at the present juncture. Indeed, it would be particularly bad policy advise for China to open its capital account and let the exchange rate float. This is because China has a very weak domestic banking system with a huge non-performing loan problem. China already has non-performing loans of over 20％of GDP. This is more serious than even the Japanese banks' problem at its worst. And unlike Japan, where non-performing loans are finally starting to decline, in China, the bad loan and bad asset problem may actually get worse from here. I am not the only analyst who is seriously concerned about the possibility of China's current real-estate bubble poised to collapse soon and cause major problems.

Make no mistake - if China opens its capital account before its banking system is clean and stable the likely result would be capital flight and a sharp depreciation of the Yuan. First a stable and reliable financial system must be build in China. Only then can we discuss the opening up of China's balance of payments and currency float.

So how should we think about the impact of China on the global economy? The big headlines all focus on the deflationary impact of China on the world. But actually, from this summer, the facts point to exactly the reverse direction. Demand-pull from China is actually the single most important source of global inflation. Commodity prices are surging. China's domestic inflationary cycle is pulling in more imports at an astounding pace, with imports up more than 45％this year and China's global trade surplus dropping fast as a result. That is working as an inflationary factor in Asia. In fact, even highly industrialized Japan is a pulling out of deflation because of China.

Data confirms that Japan is now running a trade surplus with China. If we look at "true China" trade, we need to add Hong Kong and the Peoples Republic together. In the real world, still a lot of products enter China via the port of Hong Kong. Until the autumn of 2002, Japan ran a trade deficit with this “true China”. Since then, Japan has started to run a sizable - and rapidly growing - surplus. The demand-pull from China is the cause of it. Indeed, it is Japan’s industrial base that is the main beneficiary of China’s demand pull : steel exports, Chemicals exports, paper exports, general machinery exports from Japan to China are the reason for Japan’s “true China” trade surplus. In other words, it is the “low value added” part of Japanese industry that is now benefiting from China’s demand pull, much more so than the “high value added” industrial products.

Of course it would be wrong to assume that Japan can thus depend on just another export-driven economic recovery. The current upturn is good news, but it it poised top be primarily cyclical. To get the future right and prepare for lasting prosperity, we have to think about the structural impact of China’s involvement in the global economy.

To start, let’s look at history. China is developing into the factory of the world. This has happened before, albeit with different countries. In 1881 there was a change the U.S. emerged as the factory of the world, overtaking the U. K. It was in 1881 that US product output surpassed UK product output for the first time in history. At that time the basic wage cost difference - actually I’ve used the per-capita income gap - between the U.K. and the U.S. was something like 1.21. In other words, it was 1.2 times more expensive to produce something in the UK than in the US in 1881 - when America became the factory of the world.

The next turning point occurred in 1979. At that time, Japan became the factory of thew world. The cost difference was 1.4 times - it was 1.4 times more expensive to produce in America than Japan when Japan became the world’s biggest supplier of manufactured products in 1979.

Last year, in 2002, China became the world's factory. The cost difference, however, was not 1.2 times or 1.4 times. It was about 32 times. It is true - China's emergence as the factory of the world is on an unprecedented scale. It marks a quantum leap.

What is the significance of it? Everyone thinks this means more and more cost competition. Of course, that is true, but for corporate managers and policy makers, the impact is much more far-reaching and forces a fundamental re-think. In fact, I think the real significance of China's emergeance is the End of Cost Competition. China is so big, so cheap that we can all build the lowest-cost factory now. Whether you are Sony from Japan, Samsung of Korea or Siemens of Germany. China forces even greater globalization and breakdown of national corporate identities.

In terms of competitive edge, any company or country has its competitive edge determined by two fundamental factors - price competitiveness and brand or intellectual property competitiveness. So in my view, China marks the end of cost competitivness and therefore the true China challenge for business leaders and policy makers is an increasing focus on building and expanding brand value and intellectual property. We all have to cost compete, but the winners amongst us will be the brand and "soft power" builders.

Let me give a concrete example from Japan, UNIQLO, or Fast Retailing. Its founder Yanai-san is a pioneering businessman. He established sort of big factories in China before anyone else did. But unfortunately, he didn't succeed to add brand value to his company. So for a couple of year, his company was a star because of its cost-competitivness, but before only its started doing poorly as competitors imitated its cost strategy. In contrast, Benetton of Italy has a very high brand added value, although it is a latecomer in China. It's not as cost-competitive as Uniqlo, but makes more than up for it by having a very powerful global brand. Cutting costs is getting easier and easier and the more stable, the more credible and trustworthy the Chinese domestic market becomes, the easier it will get. In contrast, building lasting brand power is becoming more and more difficult. Trhat's what I mean when I say that the true significance of China is the End of Cost Competition and the Start of more fierce global Brand competition.

For a national economy, the key implication of this is an ever increasing need for a better educated workforce. Only ediucated, only creative and stimulating people can create lasting brand value. In Japan's case the track record is mixed. Globalization of Japanese human resources is rather low in comparison to other countries. Statistics of university graduates confirm that less than 2 percent of Japanese university students have the experience of studying at an American graduate schoolIn China, the number is 9 percent of China, 17.4 percent in Hong Kong. Relatively speaking, these other countries send more university graduates to American graduate schools.

So these facts make you wonder about the true internationalsation of Japanese human resources? To what extent are they globalized, internationally capable, with the know-how, tolerance and curiosity to actually think and invent and manage for all of the world, rather than just for Japan. How can they create brand with that international strength? This might be the most serious challenge for Japan, I think ; the human resources and brand enhancement.

There is now a key word, "Cool Nippon." Lots of foreign people now think that Japanese products are cool. The young people say they play Japanese games and game machines. But what about their added value and brand? How are they perceiving Japanese brand to be cool? Again, data confirms that in Taiwan, Hong Kong and Bangkok people perceive Made in Japan products to be cool. But in the big Chinese cities, the gap to American or Korean products is already very narrow.

China is a big challenge. To meet it, each country, each nation must have a truly co-ordinated national strategy. In many respects, Japan lags behind here. In my personal opinion, Japanese official bureaucratic and political assessment of China is very reluctant, still very much concerned with the history legacy rather than forward-looking to seize opportunities. In contrast, corporate leaders are very forward looking in their assessment of China. There is a big gap : public policy viz-a-viz China is still cautious and pre-occupied with national history issues, while corporate policy and action is progressive and highly focused on cross-boarder opportunities and synergies.

In this respect I would like to make some recommendation. A truly coordinated national policy could emerge if the politicians start pushing seriously for a Japan-China Free Trade Zone. Korea and Japan are talking about that, but maybe tripartite, three party free trade zone should be discussed. Another forward looking step would be the start of cross-boarder national projects. Build an Aisa Air Bus, with the engines made in Japan, the wings in China and the cabin in Korea, for example. Nothing brings nations together like working together. And finally, how about building an Asia Hollywood. To build brand competitiveness, image and image manipulation is key. To build an all-Asia consumer, a unified image factory would be key.

So I think my time is running up soon. So I will have to end my talk at this point. Thank you.

6. GE Strategy in China

Yoshiaki Fujimori
President and CEO, GE Asia Pacific

Good afternoon, ladies and gentlemen. I would like to talk about GE Asia strategy to make inroads into the Chinese market and our strategy in the Asian region as a whole.

To start, here is GE portfolio which has 8 Industrial businesses including Aircraft Engines, Power Systems, Medical and Engineering Plastics and NBC the Broadcast station and 4 Financial Service businesses focusing on Non-Bank operations. GE Asia is Y2T business operating in Japan, China, Korea, SEA, India and Australia.

We have three-prong strategy in Asia. 1) Participate in a big market and win with customers, 2) grow low cost sourcing and local manufacturing to support Company's productivity and 3) utilize intellectual capital mainly in India and China for GE's global operation. Just to explain Intellectual Capital in India, we have 12,000 employees to do the backroom support for the United States and Europe. When someone places a phone call in US or Europe, it would be connected to India's Call Center or IT Help Desks and respond to the inquiries and complaints. We started India's Research and Development Center 4 years ago and also do the IT outsourcing, both of which save a lot of expenses for the company.

So, what is our strategy for China? We want to achieve $5B sales and $5 B purchase by year 2005. Not only that, but also we want to develop technical expertise for Research and Development including technical support for our suppliers and customers, and we want to grow capability to support backroom operation of Japan and other Asian countries. This map shows how widely we are spread in China. In Beijing and Shanghai, we have Chinese headquarters for various businesses. Many Asian business headquarters that used to be in Japan or Singapore have been shifted to there as well. Our new Technical Center is in Shanghai and Call Center is located in Dalian. In more than a dozen cities we have our operations such as manufacturing and engineering. So, just like other Japanese manufacturers, by diversifying our business locations in China, we can be efficient in terms of tax and risk management.

The way we play and the way we win in China is different dependent on the type of the business, products and their strength. We won China's bundle buy in their billion dollar power generation projects. We won most of their aircraft engine selection for their regional jet development and airplane expansions... again billions of dollars. Key success factor here is the technology excellence, of course no Chinese competition, and service capability. Why we win in China is very much the reason why we are number one in the global market. It's simply an export of technology products to China. We have other way to be successful in China. That is to become a local player and win with customers by providing products of their needs supported by local engineering, manufacturing, distribution and service capabilities. In Medical case, our next local competition is far ahead of local competitors. We can do everything they can do and on top of it, we have a lot of things they cannot do ... fundamentally technology and strength of brand. There is another way we can win. That's low cost sourcing. We leverage China's cost advantage in components and final products and distribute them in a global market. Appliance and Lighting are good examples of it. We play only where we can differentiate ourselves i.e., our brand strength in USA and cost competitiveness through China sourcing. So, these are the three major approaches that we have taken in GE to expand our business.

Let’s talk about a little soft side of our growth in China. We have just started Shanghai R&D Center in May this year and are working on MR permanent magnet technology, Specialty material Science and Chemical technology, Power Electronics, Advanced Manufacturing and so on. We will expand the number of researchers to 1200 next year. Our expansion of R&D in Asia is not just in China. Our center in India started 4 years ago and we now have 2000 researchers working on Simulation, SW, Modeling, display technology, Mechanical dynamics, System reliability, Electronics reliability, Engine Analysis and so on. Of course, Germany, the home country of Mr. Koll, is a country that we believe we have to make inroads into with the establishment of Research Center there, but basically, the direction at the moment is more or less towards China and the Asian region.

In education area, we established the Corporate Learning Center in Shanghai to develop employee’s skills and competencies and develop next generation Asian leaders. In Dalian, we have a Support Center for Japan operation with more than 1000 Chinese employee who all speak fluent Japanese. They do order processing, billing, call center operation, IT helps desk, Accounting, Payroll, etc. and save tons of money for the company.

So, our activities in China are very extensive in expanding the market, to low cost sourcing and to creating intellectual capital.

In Summary, for a big market like China, we have to build a self-sufficient business model just like we do in Japan. We have manufacturing, engineering, technical center, operations center, and education facility, just like the local Chinese companies. We should be self-sufficient in China so that we can continue to deploy our growth strategy. It’s capability in China, for China, and for our growth in China. Just like the local companies in

China, we should be as competitive on its own. As a result, we want to achieve five by five, that is, 5 billion dollar revenue and 5 billion dollars sourcing by 2005.

Well, the exchange rate discussion is more of a political nature. As a business manager, our concern is how we can generate profit neutral to exchange rate, i.e., we should try to be efficient as much as possible with the fluctuation of the foreign currency exchange no matter where we are in the globe. Our revenue and expenses should be well matched and thereby we can create a natural hedge with the currency risk. China is a huge market for us and an important area for low sourcing and building intellectual capital. With a proper management on risks including a currency risk, we can sustain profitable growth in China.

Thank you very much for your attention.

7. Toyota's Global Strategy and Exchange Rates

Fujio Cho
President, Toyota Motor Corporation

Thank you very much for your kind introduction. My name is Cho of Toyota Motor Corporation. In the interest of time, I would like to start my presentation right away.

Please refer to the short resume distributed to you. The theme of today's symposium, the matters relating to currency, is indeed a very important matter for us, because we are exposed to the risks of daily fluctuation of currencies through our business worldwide.

Today I would like to describe how we are deploying business and how we are addressing the issue of exchange rates from the perspective of a non-financial firm.

First, let me explain to you the basic philosophy in deploying business in various parts of the world. So, please turn to page 2 of the handout. Fig. 1 shows how we have realized the growth in the past decade by increasing unit sales overseas. The automotive industry is sometimes referred to as a matured industry, but I am confident that automotive industry will continue to be a growth industry even during the 21st century. Asia including China, Central and Eastern European countries are yet to fully take off in terms of the market growth. Even in the United States where the population is forecasted to grow, the market is also expected to expand further. We would like to continue growing by offering products that can really meet the customer needs in the 21st century.

Next I would like to share with you Toyota's philosophy relating to production and procurement by referring to Fig. 2 of page 2.

Our most basic philosophy is to "produce where the demand exists." Toyota's overseas production that stood at a little over 700,000 in the early part of 1990s has expanded substantially in keeping with the sales increase overseas. This year out of 6 million Toyota cars produced worldwide, 2.5 million units are likely to be produced overseas.

On the other hand, we intend to keep a certain level of production in Japan to supply for the domestic market as well as having that as a buffer against demand and price fluctuations globally, and also as the heart of technological innovation and upgrading. So, we will keep a production of 3 million to 3.5 million here in Japan. However, since the demand expansion is expected to occur overseas, the relative share of overseas production is expected to grow even further.

With respect to the overseas production, in addition to the philosophy of "producing where the demand exists", we implement a new project from the viewpoint of "which location can produce which product most efficiently from the global perspective." A concrete example of such an approach was announced in August last year, the project called IMV internally. It stands for "Innovative International Multi-purpose Vehicle".

As shown in Fig. 6 of page 3, this project tries to establish a system of concentrating production of pickup trucks multipurpose vehicles and major components for them mainly in ASEAN, especially in Thailand to be supplied worldwide. To us this represents a new challenge. And through those activities we would like to buildup the optimal production system on a global scale.

With respect to research and development, as shown in Fig. 7 of page 3, we will have R&D Center in each region, so that we can come to grips with needs of each region. But we will have the research and development of core technology in Japan to be applied worldwide.

Furthermore, as the basis for global business that I have just described, we have cherished fundamental values of Toyota as symbolized by KAIZEN (the continuous improvement), GENCHI GENBUTSU (to be on the spot) and see for oneself for TEAM WORK. Such concepts have been articulated in what we call the Toyota Way so that those concepts can be shared with our team members worldwide.

Next, I would like to explain some concrete examples of overseas activities. Please go back to Fig. 3 of page 2. North America is the vanguard of the global business at Toyota. The unit sales including both passenger cars and commercial vehicles have grown very steadily and the long felt annual sales target of 2 million is being reached.

Together with that global business the local production has expanded steadily. Currently over 60％of cars sold in North America are actually produced in North America. Furthermore, parts used for overseas production are increasingly sourced locally rather than exported from Japan. For example, in the case of Corolla produced in North America, 80％of the parts used for Corolla are locally procured in North America.

Let me move onto the major theme of today’s presentation, “Our Activities in Asian Markets”. In China, motorization is progressing very rapidly. Some say by 2010 the Chinese market will reach between 8 million to 10 million units, surpassing the size of the Japanese market. China represents one of the most promising markets on which we place priority. In

August last year, we announced the partnership with the First Auto Works located in Chan-chung, one of the three major car makers in China. Since then we initiated the joint production and establishment of a sales company, and implementing the project steadily.

If you could refer to Fig. 8 of page 4, this includes only the projects announced already, but as you see here we are going to start new projects one by one. Centering on partnership with FAW, we would like to increase the market share, which the stands at around 2%currently, to 10%in 2010.

In other Asian countries, we have been expanding production and sales since earlier and established a solid position as the top brand in major markets. Going forward, we are likely to expand production in Asia especially particularly in Thailand, which is the major production location in the context of IMV project that I mentioned earlier.

Next, I would like to refer to the exchange rate related issues. In the context of our strategy, the exchange rate volatility has a very important impact upon operations. As the procurement and sales increase overseas, how to manage exchange rate risks is a major managerial challenge. Confronted with this challenge, as I mentioned earlier, we have first of all expanded the local production and local procurement, so that we can realize the earning structure less susceptible to the impact of currency fluctuations.

Please turn to Figs. 4 and 5 on page 2. Up until the first half of 1990s, we relied on exports for the most part of overseas sales, which put our earning structure easily affected by exchange rate volatility or movements. In order to improve the structure, based upon the basic policy of “producing where the demand exists”, we have steadfastly expanded local production since 1990s.

With respect to our Chinese business, we will increase local production in keeping with the demand increase in China. Therefore we do not expect exports from Japanese to China to increase substantially. Rather, China as an export production base is something that we will consider in the future. But as of today being a late starter we would like to dedicate our primary efforts to the sales in the Chinese domestic market. Therefore in terms of the trade with China we are less vulnerable to the risk of RMB fluctuation.

With respect to another aspect of the problem, that is to say, how to control the residual exchange rate exposure in a business strategy. As I mentioned earlier, the research and development of core technology will stay in Japan to a certain extent and a certain level of production will be conducted here in Japan. Furthermore, as illustrated by IMV project, we may increase concentration of production in certain regions within foreign area. And therefore, some exchange risk will remain as the residual risk.

We have been selling Toyota vehicles in some 170 countries with different sizes. However, we are not dispersing all functions including design, procurement, and production to each of the regions where demand is, in order to minimize the exchange rate risks. Because certain functions can be most efficiently pursued when they are concentrated in certain locations.

So, therefore, a certain amount of the exchange rate risk will remain. How can we control that? Let me first of all explain to you how we are managing that. We carry out netting of credit and debt on the global basis including subsidiaries. We also use forward contract to hedge against foreign currency fluctuation risks.

In addition we have been trying to increase earnings through operational efforts such as cost reduction and improved production packaging, to lessen the impact of foreign currency fluctuations on our earnings. So, we have been making various efforts to address currency fluctuations. Since many experts of currencies and exchange rates are in the symposium, I would like to share with them some of our views concerning exchange rate fluctuations or currency regime from the viewpoint of a business firm based on experiences.

In the case of the automotive industry, it is an industry that requires a long-term vision. Automobiles consist of numerous and diverse parts and it requires sophisticated advanced technology. And therefore, it is vital that fundamental parts supplying industry be nurtured. Furthermore, logistics networks to procure many parts or sales networks to provide the after-the-sale service are required. Establishment of these networks requires a long-term approach including accumulation of know-how. A certain amount of time is required to acquire the know-how for local production or for employees to upgrade their skills.

In addition to the characteristics of automotive industries, when we decide on the strategy, we do so based upon the long-term vision of achieving our own growth by contributing to those countries. Therefore, even if there may be temporary instability of currencies, we simply cannot withdraw from the market once we have invested. This may apply to other industries to varying degrees.

In this regard, the stability in the long run is required. Therefore, we have been stating that it is most desirable for exchange rates to evolve stably reflecting fundamentals. If exchange rates fluctuate gradually in keeping with economic conditions, impacts stemming from such movements can be absorbed through operating efforts. However, a sudden change in the value of currency by several dozens of percentage, it will serve as a significant drag on company’s operations.

It is also very important to have an ability to use financial actions such as the forward contract freely and flexibly to be ready against currency fluctuations. It is only in a few countries in Asia where such forward contract can be freely used. It is desirable that various regulations be dismantled in keeping with the stage of development.

In Asia, moves are afoot through FTA agreements, and as a business firm we welcome such moves. In the case of the automotive industry, logistics cut across many countries. Through freedom of movement of goods and capital, higher efficiency needs to be pursued.

From the viewpoint of optimal production and optimal procurement on the global basis, tariffs, customs procedures with respect to goods and for financial resources, foreign currencies remittance, inflow, netting of credit against debt, foreign currency exchanges, or capital transactions, if those are subjective to cumbersome regulations, it will serious constrain business activities.

In pursuing global business, movement of people across borders increases. Regulations impeding the flow of people such as inability to obtain visa or time consuming process, these regulations need to be relaxed.

Asia, I think, is very promising with the huge world potential as the production base of the world. We hope that economic development of the entire region be further facilitated through freedom of movement of the people, goods and capital as well as intensified collaboration.

In terms of the financial activities including currency transactions, I sincerely hope that the market be developed by expanding market participants or trading volumes through deregulations. The stability of the exchange rate or the currency regime can only be realized with continued efforts toward such economic development. Once it is done, I suppose the Asian position in the business strategy will be further enhanced.

I just shared with you some of our business experiences as well as some of the desires that we would like to see and hope to be realized in the future.

Thank you for the attention.

8. Searching for a Stable Currency Regime in East-Asia

Haruhiko Kuroda
Special Advisor to the Cabinet

It is a great pleasure to speak at yet another symposium organized by the Institute for International Monetary Affairs. In the past, the IIMA organized many interesting symposia, in which I often participated, and this time the IIMA has come up with a particularly interesting and timely topic. I would like to congratulate its President, Mr. Gyohten, for his imagination and leadership.

Today, I will first speak about the present Chinese currency regime and its implications on the Chinese as well as the global economy, and then discuss a possible medium-term solution for a stable exchange rate relationship in East Asia.

Chinese Currency Regime and Its Implications

The Chinese currency regime, a de facto dollar peg system, is coming under increasingly severe criticism from the international community including the U.S. and some Asian countries, who argue that the yuan is significantly undervalued and the competitive advantage China gains from the undervaluation is hurting their industries. They also argue that the fixed exchange rate regime for the yuan hampers the international adjustment process.

When China's official exchange rate was unified with the market rate and devalued by about 30% against the official rate in early 1994, the yuan may have been already undervalued. In any case, China's rapid growth of about 9% a year over the past ten years and its low rate of inflation since 1996 must have caused the currency to be significantly undervalued. Although economists are divided as to the extent of its undervaluation, the currency, at the current rate of 8.28 yuan to the dollar, may possibly be undervalued on the order of 30 to 40%.

The Chinese authorities support the fixed exchange rate regime through extensive capital controls and massive exchange market intervention. This year, the current account surplus may decrease sharply from the last year's $35 billion because of the overheating economy, but the capital account will show a huge surplus, reflecting the strong foreign direct investment of more than $50 billion and other capital inflows. Although capital outflow controls could be relaxed, the "leads and lags" through the current account could hamper the authorities' ability to control market pressure. Consequently, the authorities might be forced to further increase exchange market intervention, which has already resulted in foreign exchange reserves growing by more than $110 billion in the first ten months of this year.

The implications of ever-increasing exchange market intervention will be twofold: on the one hand the authorities will face huge exchange risk in the future, and on the other hand they may lose monetary control. The money supply is increasing by more than 20%, and real estate prices are rapidly rising, showing early signs of an asset bubble, though serious inflation is unlikely at this time. It was only natural that the central bank recently raised reserve requirements for commercial banks. However, it is unclear whether the central bank can effectively sterilize exchange market intervention under the fixed exchange rate. If the current exchange rate regime is sustained, there might be a huge asset bubble or serious inflation in the future, and in the end the regime might be abandoned, damaging the economy further with steep appreciation.

The international implications of the undervalued yuan are more complicated. Many Asian economies are benefiting from China’s high rate of growth, which has certainly been accelerated by the undervaluation of the yuan. At the same time, most of them are suffering from the loss of foreign direct investment to China. Some U.S. and Japanese industries have been seriously affected by the price competition from Chinese companies utilizing the undervalued exchange rate, but many Chinese companies are actually owned by or affiliated with U.S. or Japanese companies.

However, it may be argued that the significant undervaluation of the Chinese currency would pose a serious threat to the smooth trading and investment relationship between China and its trading partners, and could result in substantial misallocation of resources both in China and the rest of the world. Also, if the Chinese economy is to experience boom-and-bust cycles, hyperinflation, or a sharp currency appreciation, the global economy will be seriously affected.

Medium-Term Solution for a Stable Exchange Rate Relationship in East Asia

In order to avoid future risks to the Chinese and the global economy, China needs to start exchange rate adjustment sooner rather than later with a medium-term strategy. There are basically three ways to do so. One solution is to immediately float the currency and abolish capital controls. But this can be quite dangerous because the exchange rate might greatly overshoot, damaging the Chinese economy. The second solution is to revalue the currency in one stage and peg it to a basket of major currencies that should include the dollar, the euro, and the yen. This will be a safer option since capital controls would be retained. But large appreciation necessary for such a one-stage adjustment might hurt the Chinese economy in the short run, while still being insufficient in the long run.

The third option, which I recommend, is to allow the yuan to adjust upward gradually, perhaps by 7 to 10% annually at the most over the next several years. (If an upfront revaluation of 15% is made, then only a 4 to 6% annual appreciation would be needed.) Such a gradual adjustment could be realized through a wider band with occasional adjustments, frequent revaluations, or a crawling peg. I prefer the crawling peg system, but it is a technicality to be decided by the authorities. In any case, capital controls must be maintained in order to mitigate the interest rate parity condition. This gradualist solution may not be particularly easy to manage, but it would avoid any shock to the Chinese economy, and consequently to the global economy.

After the necessary exchange rate adjustment is completed, the yuan could be floated with appropriate management to avoid excessive fluctuations, and capital controls could be removed step by step. At that time, China should participate in the G7 Finance Ministers and Central Bank Governors Meetings to jointly monitor the exchange market and cooperate as necessary. By then, the Chinese economy will have become much larger than the German economy and be an integral part of the global economy.

In the meantime, in East Asia, further financial and monetary cooperation should be promoted, probably hand in hand with trade and investment cooperation. With the intensified interdependence among East Asian economies, intra-regional exchange rate stability will be strongly needed. A common basket of major currencies may well be used as a reference to manage their exchange rates, and even a common currency might be possible in the long run. For the time being, however, increased consultations on exchange rate issues among ASEAN+3 countries may be the best way to approach to a stable exchange rate relationship in the region.

Thank you.

9. Questions and Answers

MODERATOR : We have just listened to the presentations by seven panel members. Needless to say, there have been very extensive areas covered by different presentations, those in-depth presentations. I am sure all of you in the audience are quite satisfied with what you learned. But we went overboard with the time. We only have 30 minutes left in the symposium.

During the presentations, actually many people submitted questions, and with the prerogative of a moderator with due reference to all of you, we somehow sorted out questions. I have selected one question per speaker. The selection is based upon my own independent judgment, which may be biased or which may sound a bit self-serving, and some of your questions may not be introduced, for which I would like to extend my apologies in advance.

So let me start the question right now, the question and answer session. I would like to pose one question each to all seven panelists.

I would like to start with Mr. Chen Yuan. The question is : "The importance of development of western China you presented was very impressive. However, my question is, although the amount of capital needed for the development must be really enormous, and also the fact that at least at present the return on investment in that region must be lower than in the investment in other regions, now under that circumstances, I think it would become very important to attract private capital both from domestic and foreign. What kinds of policies or incentives are you planning to introduce in order to attract more private capitals for the development of western China?"

CHEN : The western part of China to some extent is really underdeveloped. With the great amount of money injected into the western part, the economic development gradually picked up, but the return on investment so far cannot be as high as the east part. There are two major constraints in the western part on their economic growth.

The first is the economic size of the western part. The structure of the western part is very, very weak. The manufacture base in the more value added production is much less than the material production and the labor-intensive production. Also the infrastructure investment in this part is lagging behind. This is the economic development constraint.

Another constraint, as I mentioned, is the institutional constraint. That is both the market sentiment and the understanding of the financial discipline and principles under the market economy, under the institutional organizations, is relatively weak than in the east part. This is also a big constraint for the future development. If the western part of China has a strong market mechanism understanding and good institutions, it will significantly facilitate the growth. So, that is my answer to your questions.

"Will it be possible to introduce more private fund, equity fund and securities fund to the western part of China?" I think that a good potential relies not only on the economic size but also on the institutions. Good institutions and good market financial system will greatly facilitate the introduction and accession of foreign and private, equity and other funds into that area.

If the market development is behind and slow, and slow under the real sector development, there will be great impediment to the western part development. So, I think the best combination is combining of government fund, domestic fund, private fund, and foreign fund. They will complement with each other. Because the government fund---the fiscal fund---government bonds, and CDB loans will be the backbone for the major infrastructure and low revenue generating risk. In the medium or long run, the government fund will play the high role. In the middle and late stage of the development, some of the projects come to the mature stage, and can generate sufficient cash inflow, and there will be more opportunity for the private fund and equity fund to join the capital market to play a more important role.

The Chinese government also gives incentives in tax reduction and other favorite treatment but is not giving the general background of WTO assumption. There are basically eastern and western China for many things giving the same treatment. The accession that the government gave toward the favorable consideration from the government side is more the government fund and CDB fund. I think together with the joint effort there is also a great opportunity for a private fund. So, I think this may be the good way for the western part development.

MODERATOR: Thank you very much, Mr. Chen. The next question is addressed to Madame Zhang Yanling.

"I understand why Chinese government is unable to introduce full floating system for RMB now. However, in view of the large external surplus and rapid increase in reserves and also foreign direct investments, I believe that it is undeniable that RMB is undervalued at the current level. My question is, if such misalignment is maintained for too long, it will create difficult problems for the Chinese economy itself. In a short run it may generate inflationary pressure on the economy. Also in the medium and long term such misalignment may result in a distorted industrial structure of China, i.e., excessive concentration of resources in export industries and also heavy and excessive reliance on foreign direct investments. I would appreciate if you can share your view on such risks in the medium and long term."

In addition to this question, in view of Mr. Kuroda's very explicit view on RMB issue, I think Madame Zhang will have much to respond to these questions. So, I would like to give floor to you, Madame Zhang.

ZHANG : They are very difficult questions. After having taken so long time, I think just add my speech I have talked about. I just want to tell that the government has taken some progress about this. Because I have answered this question before, the main one is to carry out reform in the management of current account and to loosen restrictions on the corporations keeping more foreign exchanges. So, I think so many corporations such as GE know that.

Secondly, it is to simplify the procedure of reconciling the foreign exchange quota for imports and exports. Before it was about 30％but we can take more. The third is reform of the management of foreign exchange purchase and payment of the multinationals of non-trade purpose to meet the demand of their operations. All the foreign companies can buy more foreign exchanges.

The fourth is to optimize the management of foreign exchange purchase and payment to promote the international trade of services.

The fifth is the changed policies of foreign exchange purchase by individuals, to satisfy the reasonable needs under current account. You know now so many Chinese people are outside in the world. The purchase/selling before was US $3,000, but it is now up to US$5,000 for these people. The seventh is launch of Qualified Foreign Institutional Investors（QFII）, and the push forward started to open up the capital market to carry out the reform in the management of foreign exchange for investments abroad, to gradually widen the channel for the capital outflow. I remember there are about ten methods.

MODERATOR : Okay, thank you very much, Madame Zhang. Mr. Chen, you have some comments you want to add?

CHEN : As far as the foreign exchanges are concerned, I think the currency issue is a part of the whole financial system and the monetary system. The exchange rates are just the reflection of the major economic fundamentals and the reflection at which stage is the development of the financial system as well as the monetary system.

So, I think that people from outside give a lot of positive and even active comments and criticize the Chinese foreign exchange and financial system. That is basically a reflection of the current Chinese problems as well as foreign parties' concerns. I think the government and the monetary authority in China have basically already taken up these necessary parts into their consideration.

In the future,in the general direction, full convertibility in the current account as well as in the capital account will play a very active role not only for the enterprises in China but also for the investment and trade. Facilitating the internationalization of the Chinese companies in a fully integrated manner is also taken into account. So I think that the current Chinese foreign exchange system and reform will go to gradual relax of the control basically on the capital account side, but also for individuals, there will be a gradual move toward the direction to further facilitate not only the trade sector but also the investment activities for foreign participation in the Chinese market. So, I think that in general the direction is correct.

We fully understand and remember the very painful process for the Japanese exchange rate movement in 1970s and 1980s. So, China is quite cautious on full liberalization or radical liberalization of the exchange rate.

But we should further understand that the direction must be clearer and we will move on that direction. The issue I emphasize on is to have good institutions and good financial systems, which is just one of the ways to deal with the exchange rate and make the exchange rate more flexible. If you don't have a strong domestic corporate sector, financial sector and a strong currency, you have to get some cushion on the exchange reserve side. So, with the full liberalization and modernization on the institution and financial system as well as the market oriented reform we will get more leeway and more rooms for the exchange rate movements in the future.

MODERATOR : Thank you very much, Mr. Chen.

Here is one very simple and technical question raised to Madame Zhang.

"In Japan when the Ministry of Finance intervenes in the market they raise yen fund by issuing short term treasury bills. The question is : In China when the authorities intervene, how do they raise the necessary yuan funds for the intervention?"

CHEN : Because I was in the Central Bank for quite a long time, I can answer. So far the Central Bank doesn't have to raise fund from the market, because the market itself is quite underdeveloped. The China Central Bank basically plays the role as the inter-bank market, that is a very narrow market. Basically it is a money market. The capital market in China is also underdeveloped. It is outside the Central Bank's jurisdiction. So, the Central Bank basically can, through commercial banks, purchase the foreign exchange to inject the base money to the commercial bank. The commercial bank generates sufficient credit and, so, it is really up to the market development. And in the current state the Central Bank just does it very directly.

MODERATOR : Thank you very much. The next question is to Dr. Il SaKong.

"I fully support your emphasis on the importance of closer cooperation among Northeast Asian powers, i.e., Japan, China, and Korea. However, as is demonstrated in the case of the European unification, the strong political will of the highest level is crucial for this kind of international collaboration. However, it seems to me that in the case of these three Northeast Asian countries there are some risks. One of them is the inevitable rivalry between Japan and China, and also, as you mentioned, this problem of historic legacy could be included in there. The second risk is : how should we treat the role of the United States in this picture? The United States has played a very significant role in Asian issues and I think the US is determined to stay in the Asian issue. So, what would be your view on this point?"

SAKONG : That is a very, very important and relevant question. Actually, the US does matter even in our regional cooperation. So it is very important to persuade the US that this regional cooperation is not exclusive, that this is not to discriminate against outsiders, and that the operational base of regional cooperative institutions will be consistent with the existing multilateral institutions.

For example, concerning the Northeast Asian Development Bank, we already have the Asian Development Bank, where the US participates. But, of course, it is this region that plays a leading role. Within the Northeast Asian Development Bank, too, I think we can somehow have US participation, so that the US can make sure this regional development bank will be consistent with the principles of operations of the World Bank, Asian Development Bank and other multilateral institutions.

As for the Asian Monetary Fund, let's call it something else if the name "Asian Monetary Fund" has bad connotations. But with this monetary facility, again, we have to make sure that the principles of operation are consistent with the principles of the IMF. That is, the conditionalities should be consistent with those of the IMF.

Here is another example. I was in Latin America some time ago talking about our regional monetary facilities. My Latin American friends asked, "You people in East Asia have all the foreign reserves. You can afford to have that kind of facility. But we do not have much reserves. What should we do?"

I answered, "That is exactly the point that will help you. If we have our own facility and take care of our own regional problems, then you will get two benefits. First, the IMF, with its limited funds, would be able to fully concentrate on your problems. That is one thing. Secondly, since we live in this age of contagion, if we take care of our own problems in our own region, then there will be less chance of your region becoming contagious." As long as we have multilaterally consistent operative mechanisms and principles, this will be good for all.

This point is very important. When Mahatir came up with the EAEC, it had a kind of exclusive connotation to it. If we have any sort of vision of cooperation, we have to really pay close attention to this and persuade outsiders. The Chiang Mai Initiative is a really good beginning, and we can move toward establishing a regional monetary facility with others' understanding.

The thing is, as I emphasized in my presentation, unless we have mutual trust and respect, this won't work. We have to give up some of our national policy autonomy and even, to some extent, sovereignty. How can you do this unless you really trust the leading country? How could the EMU and EMS in Europe work? Germany had the leading role, and the German deutsche mark was the anchor currency. In this region, of course, Japan has the capability and the economic strength, perhaps. But, to be candid, at this point we just don't have mutual ground for trust and respect. Without that, I don't think it is really possible. At this point, we are not able to establish a monitoring and surveillance system for the Chiang Mai Initiative. What we have now is an informal deputies' dialogue process, instead of an institutionalized monitoring and surveillance system.

That is why I said we have to do our ground work, so that we can move on to the next stage. Thank you.

MODERATOR : Thank you very much, Mr. Il Sakong. Now, the question to Mr. Jesper Koll.

"Although you are a German, I would like to pose a question to the representative of an American financial institution. Thinking of the recent fluctuation of the dollar and increasing external deficit of the United States and the increasing intra-regional trade and financing in Asian region, it seems that the role of dollar at least in the Asian region is deemed to decline over time. From the American financial institution's position, how you are going to cope with this situation? Do you think that dollar's role will be in a decline? If that is the case, what will be your strategy to cope with the situation?

KOLL : There is a very simple answer. American companies will be at the very core of building the new 21st century Asia. They will become Asian. If you look at the banking and financial flow intermediation, whether you like it or not, American financial institutions are really at the very hub of not just managing the flow of funds or global money but also at the forefront of developing institutional framework, ensuring checks and balances, ensuring transparency accountability. Right?

I think that actually the process in Asia of financial integration, of building institutions that are trustworthy is actually moving along very, very nicely. You rightly pointed out you had the crisis in 1998. That was a strong wake-up call. And China took the leadership of ensuring whatever will happen we will keep our currency stable, so that the other Asian countries can work out their problems without being disturbed by excessive volatility in the foreign exchange market. This I think was very, very important and showed the American money managers or American investments that there was an anchor in Asia pacific. Now you have moved to the second stage where the Asian countries have surpluses and the question is, what will you do with these surpluses? Can you use them constructively to build an institutional framework that allows more transparent and more coherent management and dialogue? And American investment banks and American policy-makers, whether you like it or not, will be very, very proactively involved in the whole process.

Just look at the reality, I think it was just three years ago that actually some wonderful gentleman from the Bank of Japan for the first time suggested that maybe the RMB is overvalued. That was kept quiet, but it was basically a year and a half ago that the Americans started to take issue that actually the whole framework of debate became much more solid, and most importantly became more multilateral. It was not just one voice in one country, but it was because of the American's ability to actually consolidate opinions, because, whether we like it or not, they are the biggest player. And the process is actually being helped on.

But as far as the response from the American Investment Banks, from the American money center banks - remember in my presentation I talked a little bit about comparative advantage. What is it that your country is good at? Well, with of course the exception of some of the things that GE manufactures in America, America does not really build anything. But America is fantastic, absolutely awesome at developing financial services, then actually provide solutions, to allow corporations like Toyota, to allow corporations like GE, to allow corporations like Samsung, to actually manage their currency risk more effectively and allow them to focus on their core business and develop, like Toyota is leading so excellently, a very long-term commitment to the development of human resources, capital and the global strategy.

MODERATOR : Thank you very much. I would like to now ask Mr. Fujimori a question.

"For a company like GE, a multinational corporation, there should be various risks other than the currency risks that you have to manage especially in markets like China and India. What would be the major risk that needs to be addressed and what kind of risk management approach does your company take to cope with these risks?

FUJIMORI : Well, there are two types of risks, Country Risk and Commercial Risk. Whether it is China, Japan, or Brazil, or anywhere, we cannot avoid country risk, but basically the country risk is something we have to face to go after the big market and it is very much political anyway. So, what we focus then is the commercial side of the risk, the private venture risk or consumer risk or company risk. This is where GE can win with our strong know-how of the risk management. This is why GE Capital and our Industrial businesses are successful globally. Rather than worrying too much about what we cannot control, we focus on where we can control.

MODERATOR : Next question is addressed to President Cho.

"For the purpose of economic development of a country, the nurturing and development of automotive industry is very important, it is generally believed and said. In this part of the world, Asia, many countries wish to have their own indigenous automotive industry. They have been endeavoring to realize their own automotive industry. Toyota, being an internationally powerful company, has been occupying a prominent position. And what happened to the indigenous local automotive industry in different countries?"

CHO : That is a rather difficult question. But to date, as I mentioned in my presentation earlier, when we invest in certain countries we do business, we contribute to the economic development and technological development of the country in which we make investments. That is the part of our basic philosophy.

So, in the case of ASEAN countries or even in the case of China, we need to have a strong and solid supplying industry. Without that no automotive industry can be viable. So, we make every effort to nurture and develop suppliers, transferring technology. That is the area that we have been dedicating a lot of efforts. In the final analysis, if the indigenous automotive industry of a country can be established, it means that there can be the fundamental basis of the supplying industry as well as the materials supplying industry. But only in a few countries such a foundation or basis is in place.

Malaysia has its own government-run automotive company. But other than Malaysia, no country seems to have truly indigenous automotive industry except for China, no one in Southeast Asia.

Once such an automotive industry emerges, well, they will be a rival to us. But I guess we will rather welcome their emergence. But prior to their emergence, we ourselves may have become a Thai automotive maker or a Philippine car maker. That is to say, we will have to become a truly locally based car maker in different markets. I am not sure whether this answered the question.

MODERATOR : The final question is to Mr. Kuroda.

"Your position on the RMB was very clear. I now have a clear understanding of your position. What about the Japanese authorities? Well, with regard to the yen, to prevent further appreciation of the yen they have intervened markedly. Japan's situation is similar to China. I think it now enjoys the trade surplus as well, which is significant. So what about the future outlook of the Japanese yen? What is the prospective of that? Do you think the yen should go up further?"

KURODA : Well, there are several points to that. First of all, with regard to the RMB of China in the last ten years, it has been almost fixed. On the other hand, the yen has been floating in the last few decades. Sometimes the intervention has been made, but let us see the volume or the level of intervention. In the market it is only several percent of daily transactions. But in China this year, the authority probably purchased 70％of the foreign exchanges according to some market estimate. It is due to the fixed exchange rate system. So almost unlimited intervention is necessary in a way, because of the inherent nature of the system, while the Japanese yen/dollar/euro system is a floating system. So, inherently the system itself is different between the floating system versus this de facto fixed system.

The second point is that the Japanese foreign exchange reserves are high in a way, slightly high. But the Japanese economy's scale is four times the size of the Chinese economy taking into account the current exchange rate. Japan has about 600 billion dollar worth of foreign exchange reserves. China has 400 billion dollar worth of reserves. Relatively speaking you can see how high the Chinese foreign reserves are.

The third point I would like to make is that currently we suffer from deflation in Japan. In addition, it has been a long-term problem that we have had large excess saving. In the matured economy people save and that is the situation. Amid such an environment how can we prevent this excess appreciation of yen? We make efforts in that environment. On the other hand, what about the situation in China? It is a young economy. So 8 9％of annual growth will be likely to continue in China for a while.

As Mr. SaKong mentioned, China is an emerging economy and yet it has the current account surplus. That may not be really appropriate. Maybe more introduction and utilization of foreign capital is necessary for the maintenance of the economic growth. Maybe that will be a better solution for China, as well as for the global economy.

On the other hand, Japan’s economy is already matured. Potential growth rate is now around 2％. Then people have saved. There is the surplus saving against the investment level. In that legacy the current account surplus may continue to be 2 3％against GDP. So that is of inherently different nature or characteristic from the young economy like China.

As to the future of the Japanese yen I would say nothing. As to the RMB, upward adjustment is necessary for the merit of the Chinese economy per se, otherwise the economy might suffer from an asset bubble or inflation, and they will have more problems in the future due to those. So, at an early stage the Chinese authority should take these actions.

MODERATOR: Thank you very much.

We came to the end of the session. However, before declaring the conclusion of the discussion, is there any panelist who wishes to make the last and urgent remark? Mr. Kuroda? Yes, please.

KURODA: Just one point. I do have a prepared statement both in English and Japanese versions. So, if you are interested, please pick up a copy of that. Thank you.

MODERATOR: I think it was a very fruitful day today and I hope everybody would join me in appreciating the tremendous contributions made by all seven panelists here. We would like to express our deepest gratitude for your contribution. We learned a lot and I wish all of you prosperous days ahead, and for those who took trouble of traveling long distance to come to meeting, we wish you a bon voyage and a happy air trip back.

By saying that, please join me in making a big applause to express our appreciation. (APPLAUSE) Thank you.

Appendix

(1)　Power Point Slides for Mr. Jesper Koll

中国の脅威

Merrill Lynch Japan Securities

Chief Japan Analyst

Jesper Koll

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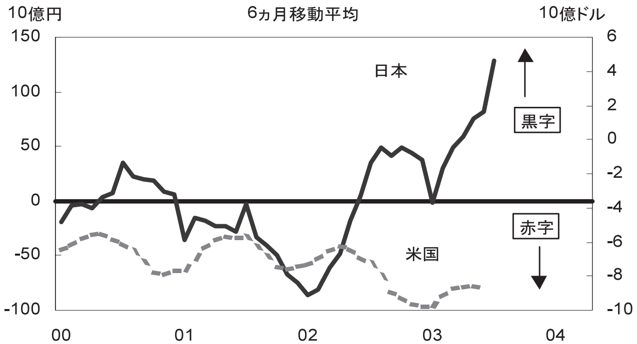
Japan is Back:
対中国貿易収支は黒字に転換

真の対中国貿易収支は黒字に戻った - 真の対中国貿易収支とは、中国と香港を合わせた輸出入を指す; 米国の真の対中国貿易収支は巨額な赤字を続けている。



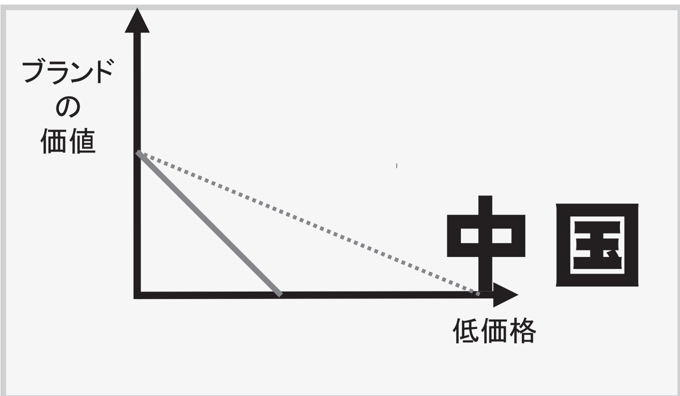
中国の脅威

これまでに君臨してきた経済大国と比べると、中国の脅威は格段に大きい・・・だが問題は、誰が一番安くモノを作れるかということだけではなく、どこに買い手がいるかということだ。

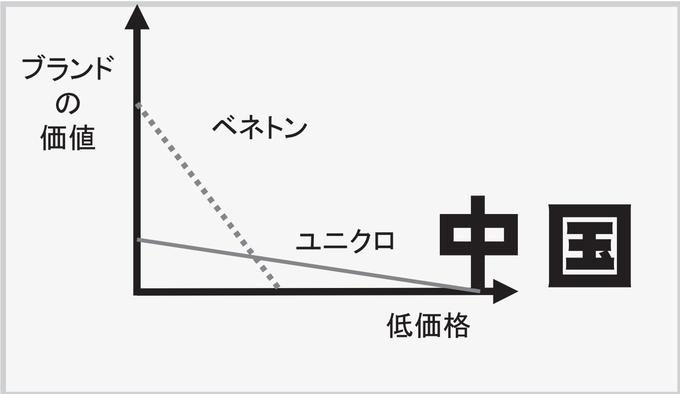
	所得格差	人口格差
英国 vs 米国		
1881	1.21 （英国は米国の1.21倍）	1.61 （米国は英国の1.61倍）
米国 vs 日本		
1979	1.37 （米国は日本の1.37倍）	0.51 （日本は米国の0.51倍）
日本 vs 中国		
2002	32.5 （日本は中国の32.5倍）	10.1 （中国は日本の10.1倍）

出所: IMF

中国の挑戦:
価格競争の終焉



中国の挑戦：ブランド競争の始まり



日本の人的資源 どれだけ企業家精神があるか、どの程度グローバルなのか？

海外で学ぶ日本の学生は2%以下

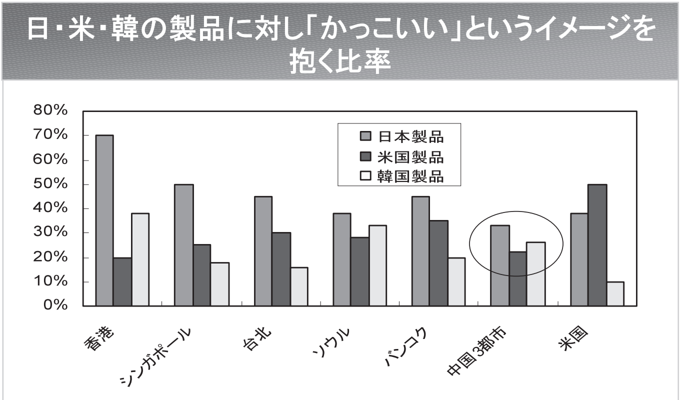
自国の大学を卒業した後に米国の大学院で学ぶ学生の割合

Economy	Percentage Studing in the U.S.
Japan	1.7
China	8.9
Hong Kong	17.4
Taiwan	19.6
Singapore	18.6
Korea	9.3
Malaysia	20.8
Thailand	8.2
India	3.4

（出所）: National Science Foundation (2002), Institute of International Education, Open Doors (2002).

Note: The numerators are the number of graduate students in all fields from these economies studying in the United States in 1998-99 academic year. The denominators are tertiary education enrollment in these economies.

"Cool Nippon"



（出所）日経新聞

（注）中国3都市（北京、上海、広州）

国家を超えた政策

- 日本－中国自由貿易ゾーン
- アジアの国家プロジェクト
  - –航空機 --> **Asia Air Bus**
  - –エネルギー供給 / パイプライン
  - –**Asia Hollywood**

時代遅れの経済構造

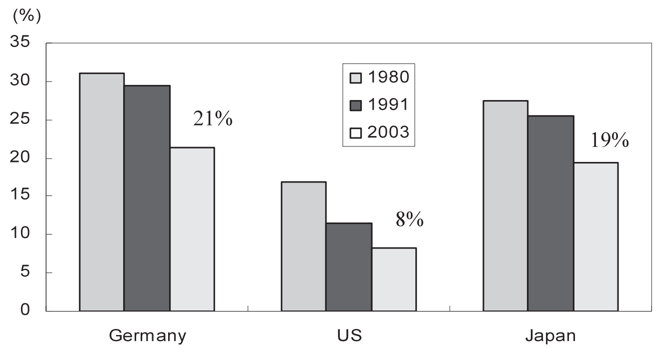
付加価値の業種別構成比（%、全体に占める比率）

	米国	日本
農業/鉱業	3	5.3
製造業	15	20.3
公益事業	1.1	0.6
建設	6.7	10.2
卸売り/小売り/飲食店	20.7	22.9
運輸/通信	6.1	6.3
金融/不動産/企業向けサービス	12	9.3
個人向けサービス	35.4	24
その他		0.6
全体	**100**	**100**

（出所）内閣府、メリルリンチ

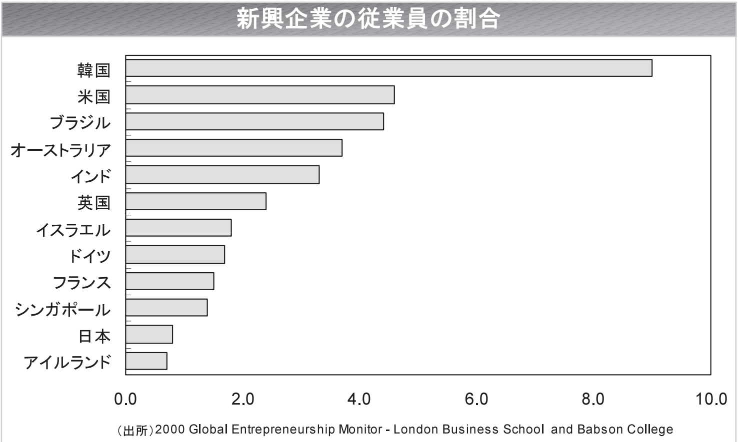
USA Inc：A Post-Industrial Superpower

Industrial Employment as % of Total



Source:

求む企業家



Job Creation Since 1991 (millions)

	Industry	Total
USA	-1.7	21.6
Germany	-3.2	-0.5
Japan	-3.2	1.6

Appendix

(2)　Tables for Mr. Fujio Cho

「当社のグローバル戦略と為替の考え方」

トヨタ自動車株式会社

代表取締役社長　　張　富士夫

１．当社のグローバル戦略の考え方
・自動車産業は成長産業
・需要のあるところで生産する
・「IMVプロジェクト」
・トヨタウェイ

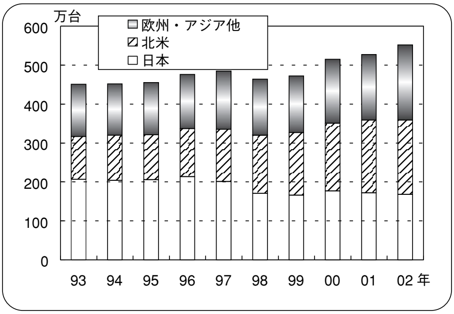
２．当社の海外事業について
・北米市場での取り組み
・アジア市場での取り組み

３．当社の為替に対する考え方
・当社の為替リスクへの対応
・為替安定の重要性
・規制緩和の重要性

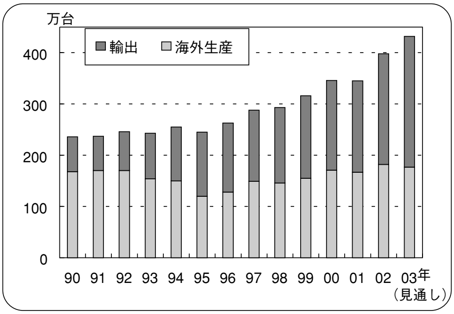
Appendix

(2)　Tables for Mr. Fujio Cho

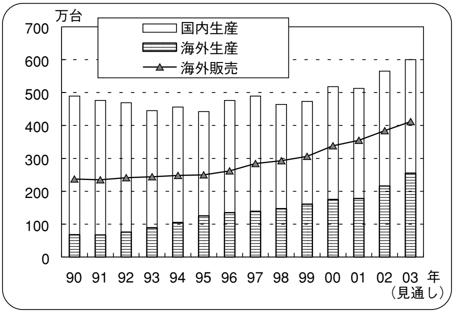
【図1】トヨタ車の販売台数



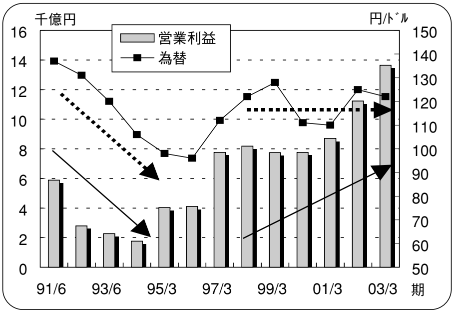
【図4】トヨタ車の現地生産台数と輸出台数の推移



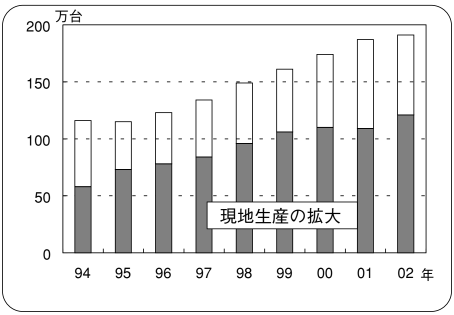
【図2】トヨタ車の国内・海外生産台数と海外販売台数の推移

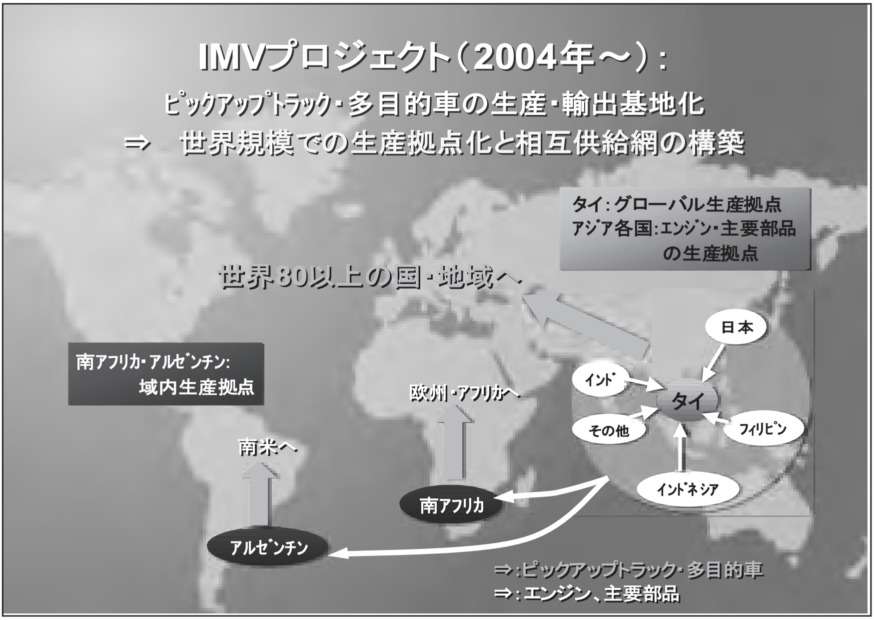


【図5】当社の営業利益と為替レート（ドル円）の関係



【図3】トヨタ車の北米販売に占める現地生産台数の推移




IMVプロジェクト（2004年～）：
ﾋﾟｯｸｱｯﾌﾟﾄﾗｯｸ・多目的車の生産・輸出基地化
⇒　世界規模での生産拠点化と相互供給網の構築
タイ：グローバル生産拠点
ｱｼﾞｱ各国：ｴﾝｼﾞﾝ・主要部品の生産拠点
世界80以上の国・地域へ
南ｱﾌﾘｶ・ｱﾙｾﾞﾝﾁﾝ：域内生産拠点
欧州・ｱﾌﾘｶへ
南米へ
日本
ｲﾝﾄﾞ
タイ
その他
ﾌｨﾘﾋﾟﾝ
ｲﾝﾄﾞﾈｼｱ
南ｱﾌﾘｶ
ｱﾙｾﾞﾝﾁﾝ
⇒：ピックアップトラック・多目的車
⇒：エンジン、主要部品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ＴＭＭＥ研究開発ｸﾞﾙｰﾌﾟ
ED2（仏ﾃﾞｻﾞｲﾝ拠点）
開　発
ﾄﾖﾀ ﾃｸﾆｶﾙｾﾝﾀｰ
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開　発
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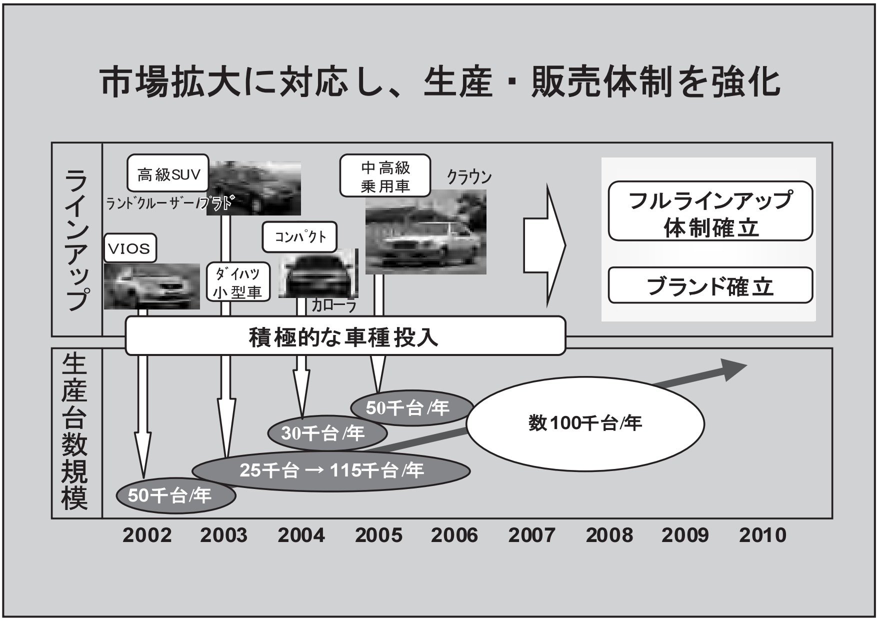
市場拡大に対応し、生産・販売体制を強化
ラインアップ
生産台数規模
高級SUV
ランドクルーザー/プラド
VIOS
ダイハツ
小型車
コンパクト
カローラ
中高級
乗用車
クラウン
フルラインアップ
体制確立
ブランド確立
積極的な車種投入
50千台/年
25千台 → 115千台/年
30千台/年
50千台/年
数100千台/年
2002
2003
2004
2005
2006
2007
2008
2009
2010

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