Occasional Paper No.22

混迷するグローバル経済

ーコンフィデンス回復への道筋を探る

Seeking Paths to Restore Confidence in the Global Economy

公益財団法人 国際通貨研究所
Institute for International Monetary Affairs

IIMA
Institute for International Monetary Affairs

はじめに

大震災からの復帰に希望を託した2012年が始まりました。しかし、世界を見渡すと深刻化する欧州のソブリン危機は未だ出口が見えず、米国の景気回復もたどたどしい足取りで、先進国経済は重苦しい空気に包まれています。高成長を謳歌した新興国も、インフレ･リスクが残る一方で、先進国の需要低迷の影響を回避しきれず、成長神話にかげりが出てきています。こうした現状認識のもとで、市場のコンフィデンスを呼び戻し、世界経済を再び成長軌道に乗せるため克服すべき課題、政策、行動は何なのでしょうか？

このような問題意識に立ち、公益財団法人国際通貨研究所は、国内外から著名な専門家をお招きし、2012年3月15日に経団連会館において「混迷するグローバル経済ーコンフィデンス回復への道筋を探る」と題する国際金融シンポジウムを開催致しました。本シンポジウムでは、グローバルな視点で先進国、新興国、日本のとるべき政策、果たすべき役割について幅広く議論していただきました。

本稿は、同シンポジウムにおける各パネリストのスピーチおよびパネル・ディスカッションの議論を記録にまとめたものです。ご関心のある皆様方の今後のご考察への一助になれば幸いです。

2012年7月
公益財団法人　国際通貨研究所

Preface

The world economy has been under severe strain, with no clear sustainable solution yet in sight to the European sovereign debt crisis, which continues to deteriorate, even as the US economy remains fragile and close to faltering. What policy measures should the advanced countries take to revive confidence in the world economy and achieve greater cooperation among governments and key institutions? What actions need to be taken by emerging countries that have now become important players in the global economy?

To address these questions, the Institute for International Monetary Affairs (IIMA) held a symposium titled **"Seeking Paths to Restore Confidence in the Global Economy"** at Keidanren Kaikan in Tokyo on March 15, 2012. A number of prominent experts joined our symposium panel to share their views and opinions on these globally challenging issues.

We sincerely hope this record of the symposium will help give you much inspiration in your business and academic considerations.

July 2012
Institute for International Monetary Affairs

パネリストの略歴／Profiles

ブレンダン・ブラウン
三菱 UFJ セキュリティーズ・インターナショナル
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Brendan Brown
Executive Director
Mitsubishi UFJ Securities International plc

1972 年ケンブリッジ大学卒業、シカゴ大学で MBA、LSE で経済学博士号を取得。外資系証券会社を経て、90 年から三菱 UFJ セキュリティーズ･インターナショナル、エグゼクティブ･ディレクター。「ユーロクラッシュ」（近刊）、「ドルはどこへ行くのか」（2006）など多くを出版。

He graduated from Cambridge University in1972 and obtained MBA from University of Chicago and PhD in Economics from LSE. After joining a big securities company in Europe, he is now executive director/head of economic research at Mitsubishi UFJ Securities International, plc based in London. He has published many books including “Euro Crash” (2012), and “What Drives Global Capital Flows”(2006).

高　海紅
中国社会科学院　世界経済政治研究所
シニア・フェロー

Gao Haihong
Senior Fellow, Institute of World Economics and Politics,
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1986年北京大学卒業。同大より経済学修士号および英デューラム大学より国際金融投資修士号取得。1989年に世界経済政治研究所に入所後、カリフォルニア大学デービス校等で客員研究員を経て、現在は同研究所シニアフェローでCASS大学院の博士課程指導教員も務める。

Graduating from Peking University in 1986, she obtained MA from Peking University and MSc. from Durham University in the UK. She joined the IWEP, CASS in 1989 and once was a visiting scholar at University of California at Davis before taking present post. Currently she is a senior fellow of IWEP and also a doctoral advisor in the Department of World Economics and Politics of the Graduate School of CASS.

伊藤　隆敏
東京大学　大学院経済学研究科 兼 公共政策大学院教授

Takatoshi Ito
Professor, Graduate School of Economics and Graduate School of Public Policy,
The University of Tokyo

1973 年一橋大学卒業。ハーバード大学で経済学博士号取得。ミネソタ大、一橋大、ハーバード大、東大などで教鞭を取る一方、IMF 調査局上級審議役、大蔵省副財務官を歴任。2004 年より東京大学大学院経済学研究科兼公共政策大学院教授。

After graduating from Hitotsubashi University, he earned PhD. in Economics from Harvard University. He has taught extensively both in the United States and Japan, including at University of Minnesota, Hitotsubashi University, and Harvard University. He also served as Senior Advisor in the Research Department, the IMF (1994-97) and as Deputy Vice Minister for International Affairs at Ministry of Finance, Japan (1999-2001) before taking present posts in 2004.

中尾　武彦
財務省　財務官

Takehiko Nakao
Vice Minister of Finance for International Affairs,
Ministry of Finance

1978年東京大学経済学部卒業後、大蔵省（現財務省）に入省、94－97年のIMF出向、2005－07年の駐米大使館公使勤務を含め、主税、証券、主計、国際金融局等で要職を歴任。09年7月国際局長、11年7月より財務官。カリフォルニア大学バークレー校で経営学修士号取得。
After graduating from the University of Tokyo in 1978 (BA Economics), he joined the Ministry of Finance and served in a variety of bureaus such as Tax, Securities, Budget, International Finance, before taking present post in 2011. He also worked for the IMF from 1994 to 97, and served as Minister at the Embassy of Japan in Washington, D.C. from 2005 to 07. He obtained MBA from University of California at Berkeley.

ギジェルモ・オルティス
バノルテ・イクセ・フィナンシャルグループ会長
前メキシコ中央銀行総裁

Guillermo Ortiz
Chairman, Banorte-IXE Financial Group,
Former Governor of Bank of Mexico

1971年メキシコ国立自治大学卒業、スタンフォード大学より理学修士号、経済学博士号を取得。IMF理事の後、94-97年財務公債大臣、98—2009年メキシコ中央銀行総裁を務める。BISの議長を務めた後、現在バノルテ・イクセ・フィナンシャルグループ会長。
He graduated from National Autonomous University of Mexico in 1971 and obtained M.Sc and PhD in Economics from Stanford University. After being Executive Director at the IMF, he served as Secretary of Finance and Public Credit in the Mexican Federal Government from 1994 to 1997. Then he was Governor of the Bank of Mexico from January 1998 to December 2009. He was also Chairman of the Board of the BIS. He is now Chairman of Banorte-IXE Financial Group in Mexico.

(アルファベット順／In the alphabetical order)

行天　豊雄

国際通貨研究所　理事長

Toyoo Gyohten

President, Institute for International Monetary Affairs

1955 年東京大学卒業後、大蔵省（現財務省）に入省、国際機関出向、銀行・国際金融局等を経て 1986 年財務官。1990 年プリンストン大学およびハーバード大学客員教授を務め、92 年東京銀行会長に就任。1995 年より国際通貨研究所理事長。

He graduated from the University of Tokyo in 1955 and joined the Ministry of Finance. Serving in a variety of bureaus including Banking and International Finance, and at international organizations, he was Vice Minister of Finance for International Affairs in 1986. After retiring from the MOF he taught at Princeton and Harvard Universities in 1990 and was assigned as Chairman of the Bank of Tokyo Ltd. in 1992. Since 1995 he has been President of the IIMA.

渡辺　喜宏

国際通貨研究所　専務理事

Yoshihiro Watanabe

Managing Director, Institute for International Monetary Affairs

1970 年東京大学卒業後、東京銀行入行，多くの海外勤務を歴任。2005 年三菱 UFJ フィナンシャルグループ専務取締役を経て、08 年国際通貨研究所専務理事。日印経済委員会常設委員会委員長を務め、ABAC の日本委員でもある。

After graduating from the University of Tokyo in 1970, he joined the Bank of Tokyo and served for many overseas businesses. He was Senior Managing Director of Mitsubishi UFJ Financial Group in 2005. He took the present position in 2008 and now also chairs at the Standing Committee of Japan-India Business Cooperation Committee and is a member for Japan of the APEC Business Advisory Committee（ABAC）.

目次／Contents

本シンポジウムは主に英語で行われました。日本語版は英語での記録を当研究所で翻訳したものです。
The English version is based on the transcript of the speeches and discussions which were mainly conducted in English.

英語版

English Version

Occasional Paper No.22

The 21st International Financial Symposium

Seeking Paths to Restore Confidence in the Global Economy

March 15, 2012 Keidanren Kaikan

Institute for International Monetary Affairs

Contents

1. Opening Remarks
Yoshihiro Watanabe, Managing Director, IIMA

Good Afternoon Ladies and Gentlemen. Thank you very much for joining our symposium. We are pleased to welcome many distinguished participants. I wish to express our sincere gratitude for the support and encouragement you have given to our Institute. We also thank the 5 prominent panelists for sparing their valuable time to join us in this event.

Today's symposium is entitled "Seeking Paths to Restore Confidence in the Global Economy" It will be moderated by our President, Mr. Gyohten. We will be listening to our panelists' presentations and discussions on the stage during our two sessions. For the first session, we will have presentations for the first 45 minutes, to be followed by 40 minutes of discussion. After a 15-minute coffee break, we will have the second session with 30 minutes of presentation and 40 minutes of discussion. Our symposium will end at 5:15.

Before we start the first session, I would like to pick up several points that have relevance for today's discussion.

The first relates to how we should view the present calmness in global markets. The second is about structural change. The third relates to the difficult challenges facing the global economy. And the last focuses on how confidence can be restored.First, how should we view the current situation in the global economy and markets, which seems to be calm?

We all welcome the recent stock market recovery and the breathing space provided by the pause in the yen's appreciation. These developments seem to reflect some positive news – agreement on the 2nd rescue package for Greece, the calming effect on money markets of a huge injection of ECB funds, and an improvement in US employment figures, which many are hoping to be a signal of the real economy's recovery. We are also seeing fears of uncontrolled inflation subsiding, which could enable developing economies to loosen monetary policies once again.

Unfortunately, we cannot ignore the clouds on the horizon. Housing markets in the US remain depressed, and it may take a longer time for them to recover. In Europe, it is not clear how financial institutions can dispose of the bad debts associated with the continent's sovereign debt crisis and bad debts caused by housing market decline. The implementation of the Greek rescue package remains in doubt. The huge liquidity provided by central banks could still ignite inflation, particularly in natural resources and energy prices. We are facing the prospects of market instability breeding unexpected outcomes that will be difficult to control. Governments have been slow to respond to the present crisis. What will happen when we begin to face one new crisis after another?

Are we repeating the errors of the 1930s? I am afraid what we are seeing is a false dawn. As we navigate confused through uncharted waters, the prospects of finding a good exit are not bright. The initial response to the crisis was concerted fiscal stimulus and tighter regulation of financial institutions and markets. This seemed at first to be like the morning star, until fiscal stimulus led to the sovereign debt crisis.

This crisis has spread to all corners of the globe. While the sovereign debt crisis raged in Europe, in Asia we suffered from a massive appreciation of the yen, rising energy prices and declining exports. Now we are facing grave unintended consequences of tighter financial regulation. Widespread use of advanced technologies and more integrated markets have heightened the interconnectedness of all market players. As a consequence, the impact of the crisis has spread instantaneously, like a large spider web.

Can we rely on a regional safety net as a strong firewall to insulate our region from crises elsewhere? Can such a regional safety net function well in coordination with the global framework?

We cannot ignore the fact that the global economy is now increasingly being supported by emerging markets. The late Angus Maddison has predicted that by 2030, Asia will account for more than half of global GDP, driven by the resurgence of China and India. The consequences of this prediction, which seems to be coming true, need to be understood. How will the rise of China, the leading emerging market, change the fundamental structure of the global economy? What will be the course of its resurgence and the future role of the Renminbi?

The future of the euro holding on to its position as the world's second reserve currency is coming under increasing scrutiny. Recently, the People's Bank of China has floated a possible three stage plan for the internationalization of the Renminbi, based on a review of the present market. This has led to discussions on whether the Renminbi can become the world's third reserve currency in the not-too-distant future.

The World Bank and China's Development Research Center has just completed a report that proposed six recommendations to ensure sustained high growth. The report called on China to strengthen the market-based economy, foster innovation, promote green growth, provide social security for all, improve the fiscal system and seek mutually beneficial relations with the world. This report was published last February 27.

After reading this report, I am inclined to believe that while Maddison's forecast for Asia is very encouraging, the road to achieving it is a very difficult one. The ADB's report on Asia 2050 proposes that Asia is now at an important crossroads, where it must choose its path. The difficult path leads to the Asian Century. The easy path leads to a decades-long middle-income trap. Which path will Asia choose?

I believe a key issue that will determine Asia's future is how it can achieve natural resource security through regional cooperation and a common growth agenda with the rest of the world. Peace is a crucial element in the future of China and the successful internationalization of its currency.

The recovery of advanced markets will also support the rise of China, but this is not likely to happen soon. I am looking forward to the views of our panelists on the prospects for the developed economies.

Let me come back to Europe in relation to our theme of pathways to restore confidence. Putting Greece back on track toward sustainable growth will need to involve European fiscal union. In the case of the Latin American debt crises, the private sector accepted haircuts and provided new money only after structural reforms have been put in place and the recovery of creditors' net worth following the disposal of bad debts. It took a long time for Latin America to return to growth. In the case of Greece, haircuts are being imposed even before reforms have been completed. With such deep haircuts affecting their net worth, financial institutions may not be in a position to support Greek recovery. Despite its efforts, the probability of Greece's expulsion from the Eurozone and from the Union is becoming progressively less unthinkable.

The Asian Century will most probably have to wait a long time for the new global and regional financial architecture and currency regime to emerge. The transition is likely to be unstable, and the private sector will keep on searching for a strong safety net in the face of unexpected outcomes.

In conclusion, I would like to invite the panelists to share with us their views on the possibility of the CMIM expanding to become an Asian Monetary Fund and other forward-looking measures, such as promoting the internationalization of the renminbi. In addition, I also look forward to their comments on the US' financial stabilization measures, the European Financial Transaction Tax and short-term recapitalization, which are major concerns of private financial institutions.

Thank you for your kind attention.

Part I How to overcome the Euro Crisis

2. A Note on the Euro Crisis (Latin American Lessons?)

Guillermo Ortiz, Chairman, Banorte-IXE Financial Group,
Former Governor of Bank of Mexico

Let me first express my deep appreciation to Toyoo-san for his invitation to be with you at this symposium of the Institute of International Monetary Affairs. I was asked to talk about the Euro crisis and some lessons that could be drawn from other crises, particularly in Latin America. I was asked by Toyoo-san to speak freely, now that I am unconstrained by public service. So I shall do that.

Since 2009 European authorities have constantly been "behind the curve", implementing policy measures mainly as a reaction to episodes of market stress. As a result, what started as funding pressures for some countries (mainly Greece) has now morphed into the question of the very existence of the euro. In short, Europe's handling of its sovereign-debt crisis has been disastrous.

Let's fast forward to today. The situation seems to have momentarily improved. The tail risk of a credit crunch in Italy, Spain and France has been significantly reduced thanks to the ECB's three-year long-term refinancing operations (LTROs). The 3Y LTROs were a game changer for Europe that bought time, created confidence in the financial system and in the economy at large, and increased the scope for action.

After December's and February's auctions, total ECB refinancing operations now stands at an all-time high of EUR1.2 trillion. Nonetheless, the supply of credit within the real economy will not automatically increase, and for any recovery to occur in 2012, bank lending needs to restart.

What is next? There are basically two arrangements in the pipeline. The first one is the reformed Stability and Growth Pact—the so-called "fiscal compact"—that would bring a more rigorous surveillance and would trigger corrective measures earlier than under the previous regime. For instance, countries are obliged to limit the structural deficit at 0.5% of GDP, except under "exceptional circumstances" outside their control. Under regular circumstances, if significant deviations are observed a correction mechanism is automatically triggered. These rules must take effect in the national law of the different countries (preferably by amending constitutions). Additionally, countries must reduce any debt that exceeds the 60%-of-GDP benchmark by 1/20 each year, and to report ex-ante on their public debt issuance plans to the Council of the EU and to the European Commission.

However, for the fiscal compact to enter into force, it needs ratification of at least 12 Eurozone member states. Ireland already decided to put this deal to a referendum. A lot of uncertainty may still emerge at national levels during the transition towards the new fiscal architecture in the euro area. Moreover, the effectiveness of the new system will depend crucially on whether a sufficient number of governments support the European Commission in implementing it.

The second plan that is underway is the new Greek bailout. On February 21, Europeans managed to reach a provisional agreement to provide a second loan programme to Greece. Default seems to have been averted, at least for now. Nonetheless, markets are still nervous as the risk of the new programme going off track remains high. Markets are not the only ones with doubts; the IMF itself described the Greek program on the last *debt sustainability analysis* as "accident-prone" and with "questions about sustainability hanging over it".

In my view, the programme is too fragile to work. First of all, even if Greece manages to reach the 120% debt-to-GDP target (helped by a "successful" PSI)[6], this is still a very challenging level that does not guarantee that the country will be able to return to the markets in 2020. An interesting question is why the 120% target was

[6] Greece announced that it will activate the collective action clauses (CACs) forcing some investors to take part in the exchange, and allowing it to clear a 90% target rate for participation.

chosen to begin with. Because it is close to where Italy's debt currently is and agreeing on a lower target would automatically imply that Italian debt is unsustainable. 120% is a political number that lacks economic justification. The truth is that no one yet knows what constitutes sustainable debt or what Greece's "real" GDP is. What is more, by the end of this year the cumulative decline in real Greek GDP may hit 20%. And obviously, recovering growth is essential for lowering the debt-to-GDP ratio and eventually achieving sustainability of fiscal stance.

In addition, the programme is brutally intrusive. The IMF has always sought that programs are "owned" by the countries implementing them. This is not the case with the Greek deal. First, the Eurogroup has "invited" the Commission to strengthen on-site monitoring, and work in close and continuous cooperation with the Greek government. Second, a mechanism to ensure that the next quarter's debt payments are in a segregated account under the monitoring of the Troika was established. The IMF probably should have stayed on the sideline of this programme that is truly controlled by the Troika. It is only risking damaging its reputation by intervening in a package in which it does not even have faith.

This programme is set to fail. It is only a matter of time for a new bailout to be needed. Then, what should a successful package contain?

What is required is a programme that recognizes that the process of adjustment and reform will extend over a long time horizon (probably around ten years). This gradual adjustment needs to be supported by the European Union, and should acknowledge that markets are likely to remain shut to Greece and that lots of long-term official finance will be required. Also the debt-exchange should include all debt (private and official) and should, of course, be conditioned on the attainment of fiscal goals and structural reforms. The plan should be similar to the debt relief observed under the Heavily Indebted Poor Countries (HIPC) Initiative. Of course, the income level and many other features of those countries are not comparable to Greece. However, the structure of the program is what is relevant here.

The HIPC program was launched in 1996 by the IMF and the World Bank. The objective was to enable each country to exit the process of constant rescheduling and resume normal relations with its creditors, the true measure of debt sustainability. The initiative involved a two-step process. First, the IMF and the World Bank provided interim debt relief; then, when a country met certain commitments, full debt-relief was provided (including reductions of debt owed to official multilateral institutions—the

Fund, the World Bank, and the regional and sub-regional development banks).[7] The same should have been sought for Greece: a debt-exchange program that includes both private and official creditors and leaves the country with a sustainable level of debt (around 30% or 40% of GDP).

The truth, though, is that Europeans from the North are not feeling too "European" lately and are inclined to expel Greece from the Monetary Union. Some countries seem convinced that Greece is dragging its feet on implementing the economic and fiscal reforms and want it out of the Eurozone. Among the German population, bailing out Greece is increasingly unpopular. A recent poll published in the *Bild am Sonntag* newspaper shows that 62% of Germans were against the €130bn rescue package while 33% were in favor. In a similar poll last September, 53% were opposed and 43% in favor.

In light of the current European debt crisis, it is revealing to analyze how Latin American countries faced the debt crises of the 1980s. Basically, they took three steps:

1. Fiscal adjustment;
2. Structural reforms; and,
3. Debt relief.

In the 1980s, the first response to the debt crisis was to implement IMF-sponsored stabilization programs—the so-called IMF Stand-By Programs. These conditioned additional access to international finance on a significant level of fiscal adjustment, tighter monetary policy, and slimmer public sectors. The adjustment resulted in higher primary surpluses. But this response was not enough. Deep recessions were triggered by fiscal adjustments, debt-to-GDP ratios continued to rise, while lower creditworthiness led to capital outflows and higher interest rates.

So, in order to complement the fiscal consolidation, Latin American countries implemented structural reforms that would eventually enhance growth. Mexico, for instance, transformed itself into a much more open economy through extensive trade reforms, the privatization of most public sector enterprises, and financial market liberalization. In a few years, Mexico went from being mainly an oil exporter to a country focused primarily on manufacturing exports. Brazil, Argentina and Peru followed similar strategies.

[7] For instance, Angola went from having a debt-to-GDP ratio of 222% in 1995 to 89.9% in 2000 and to 59.8% in 2003.

Clearly, the real exchange rate depreciation helped to recover competitiveness. Also, devaluation and inflation were instrumental in realizing external transfers. This was a vital step for eventually achieving medium and long-term debt sustainability; however, it is not an avenue open today to European countries. In addition, external demand conditions were then favorable for export growth; this is not the case today.

The third step taken in Latin America was debt relief. But debt relief took place when fiscal adjustment was already realized and a credible structural reform program was underway. The Brady Plan was the closure that market participants needed to set the stage for higher growth in the ensuing years.[8] More than the haircut by itself, it was the change of regime that allowed Latin American countries to restore creditworthiness and debt sustainability.

Even if the Latin American experience is relevant for today's European dilemmas it is not the model for Greece. First, debt-to-GDP ratios in Latin America were considerably lower than Greece's: for instance the average debt-to-GDP ratio during the 80s was 45% for Argentina, 32% for Brazil, 46% for Mexico and 67% for Peru.[9] Second, Latin American countries did the required adjustment, including both the fiscal consolidation and the structural reforms. And third, the Brady Plan relieved the debt burden of countries whose indebtedness was primarily commercial. It did not cover countries whose outstanding debt was mainly official creditors.

On fiscal adjustment, Greece has a long way to go. Greece managed to reduce its primary deficit from 10.4% of GDP in 2009 to 5.0% in 2010, and probably to 2.4% in 2011 (*this number is a projection from the IMF*). But it still needs to achieve ambitious fiscal consolidation targets and return to a primary surplus as from 2013 according to the new programme.

Regarding growth, the slow progress so far in delivering politically unpopular structural reforms is not reassuring. According to the Global Competitiveness Index (GCI) published by the World Economic Forum (WEF), Greece fell 12 places in 2010 and another 7 places in 2011 in the ranking, remaining the lowest-ranked country of the

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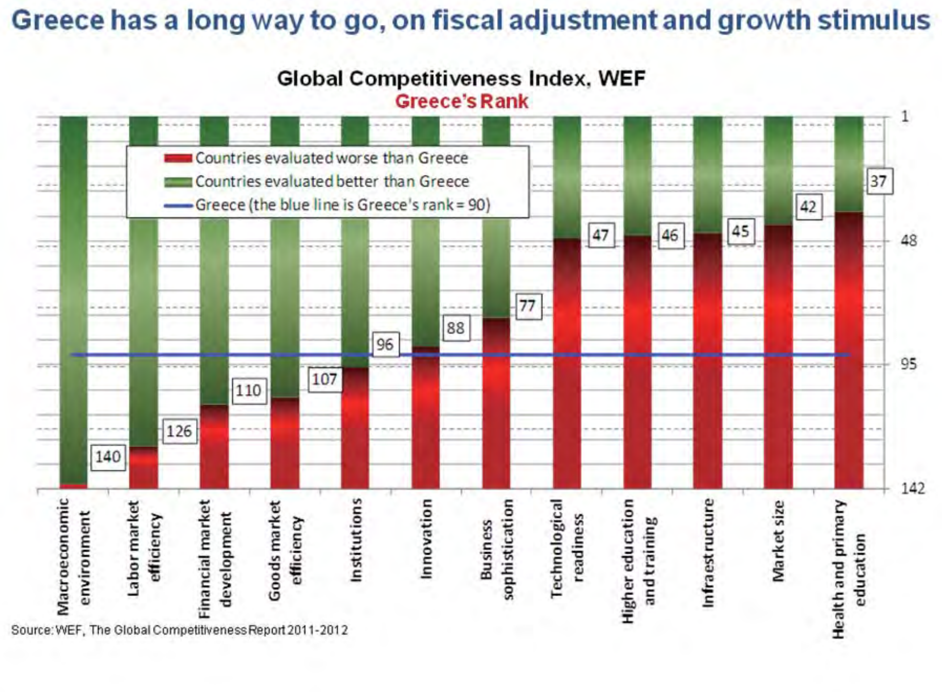
[8] Japan's help during the Brady Plan preparation was extremely valuable. The debt reduction packages involved "enhancements", both the principal and the interest payments for 18 months were guaranteed by money set aside by the IMF, World Bank and Japan (Mexico also dedicated $1.3bn of its own reserves to the funds providing the guarantees). The enhancements are not gifts but loans.

[9] Also, when the Brady Deal was announced in the different Latin American countries, their debt-to-GDP ratios were all below 85% while Greece's currently is above 160%. In 1989, in México and Costa Rica the debt-to-GDP ratios were 59.8% and 77.0%, respectively. In 1990, Uruguay's and Venezuela's debt was 56.1% and 55.6% of GDP. In 1992, Brazil's and Argentina's was 84.0% and 38.5%. Finally, in 1995, Panamá's and Peru's debt was 60.6% and 36.8% of GDP, respectively.

European Union.



The GCI is, in turn, an average of twelve sub-indexes that point to the main culprits responsible for the low levels of competitiveness of Greece.

- Of course due to the ongoing sovereign debt crisis and investors' low confidence, Greece continues to fall in the "macroeconomic environment" and "financial markets" sub-indexes.
- Two other major areas of concern for the country are its "inefficient labor market", which continues to constraint Greece's ability to emerge from the crisis, and its "public institutions" (e.g., government efficiency, corruption, undue influence).

However, Greece has also a number of strengths to build upon, like a rather well-educated workforce, skilled at adopting new technologies that could help increase productivity.

Some analysts suggest that, given the grim outlook, it would be better for Greece to exit the Eurozone and reinstate the drachma. They often cite Argentina's exit from its currency board in 2002 as evidence of the benefits that would accrue to Greece if it reintroduced its own currency. However, an analysis of the costs incurred by Argentina after it abandoned the currency board strengthens the case for Greece to remain within the Eurozone. Some of those costs were:

- A bank run, that would be much more destructive and widespread for Greece given European financial integration.
- A collapse of large private corporations with access to international financial markets, because their foreign-currency liabilities could not be redenominated.
- Endless violations of contracts that left an enduring stain on the investment environment.

Devaluating, and thus exiting the EMU, is not an option for Greece. This strengthens the case for establishing a ten-year programme and a coordinated official debt relief (like in the HIPC Initiative) that effectively leaves Greece with sustainable public finances and a stronger foundation for continued economic growth.

If the European leaders succeed in healing Greece and other periphery countries, what will happen next? Will the Eurozone survive? In my view, the Eurozone needs, besides tighter fiscal integration (that apparently is already underway), "convergence". Unless sustained convergence of productivity and growth is reached, the composition of the European Union will probably change.

Another serious issue for Europe is that institutions, with the exception of the ECB, are not designed to make decisions, but to deal with processes. Thus, they are ill-equipped to face a financial crisis. Only the ECB has the power and ability to make decisions, but the mandate and scope of the bank is limited to monetary policy and financial stability.

The question regarding the effectiveness of policy making—or lack of it—in the Eurozone has to do with the absence of political mechanisms (and perhaps political leadership and political will) designed to tackle problems which are essential to its viability. This dysfunctional decision-making process, lack of political union and lack of productivity and growth convergence, unless corrected, will most likely put an end to the European Union as we know it. For me, the survival of the Eurozone in its present form is today a big question mark.

3. European Debt Crisis: Perspectives from Asia

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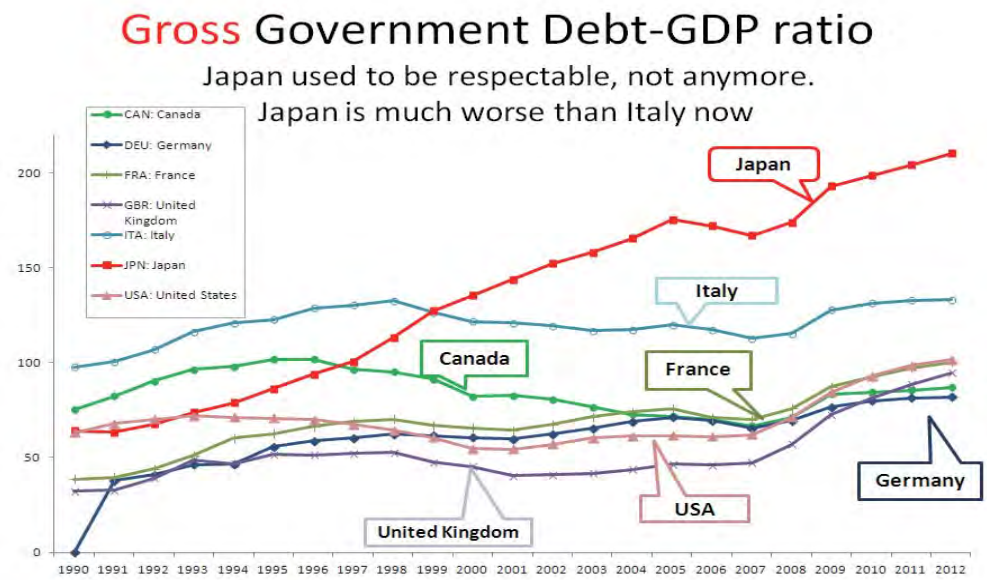
I am really happy to be here and present my views on European debt crisis, and also its relationship to Japanese and Asian problems, which may occur in the future. So first, I will talk about the European debt crisis, and then review some historical crises and some conventional views about how we differentiate the epicenter and contagion, and give my views about how the European sovereign debt crisis should be solved.

Just as a brief overview, I am sure all of you are very familiar with what was happening in the last almost three years in Europe, starting with the Greek problem that they revealed their fiscal deficit was falsified in statistics, that was in October 2009. And in May 2010 there was the first package that the IMF tried to organize for Greece with very optimistic assumptions on economic growth, just like Mr. Ortiz mentioned about current time. But if you go back to May 2010, you see very optimistic projections, which, of course, didn't materialize. Then last year, we had a series of debt reduction talks, starting with 21% of the haircut. It became 50% of the haircut, and now the private sectors agreed 76% of the haircut. The market was surprised by those announcements many times, and every time the market and the Euro went down. The natural question is: Why couldn't Greece, the EU and the IMF solve this crisis more quickly? Why did it drag on for two years and a half? And, of course, while it dragged on, the crisis spread to Ireland, Portugal, Spain, and Italy. So it seems that failing to solve the Greek problem early made those other countries face at risk. And finally, as Mr. Ortiz mentioned, now we are sort of in a calm stage that it seems that Greek debt reduction is done, and the LTROs recovered the calmness in the Italian and Spanish bond markets. So it seems it's okay, but maybe it's only just buying time until the next surprise announcement next year, or maybe two years from now. And again we will have to repeat the whole process of surprise and contagion and "what to do about it" kind of debate.

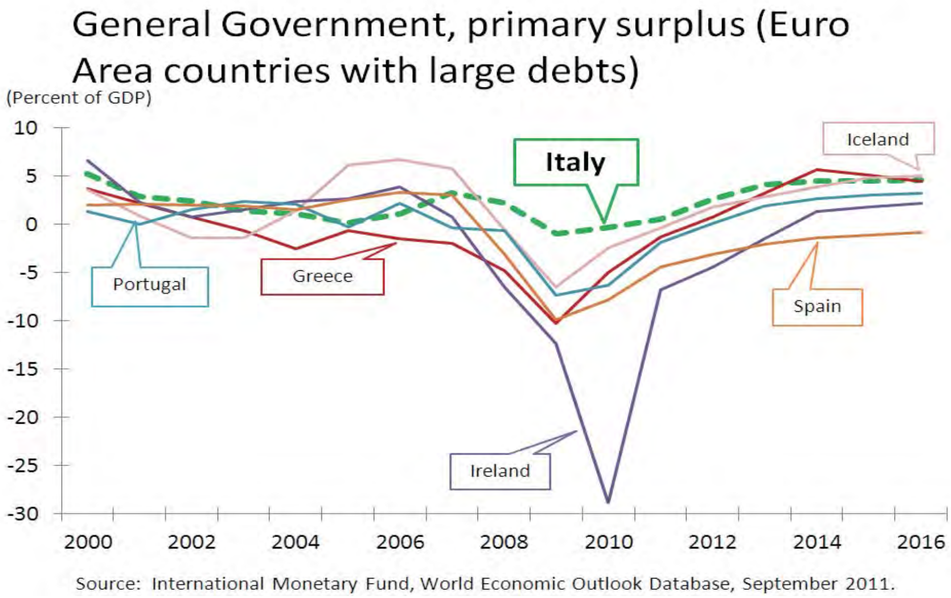
So they are still trying to build up ring-fencing and safety net, and hopefully they will be in place when the next surprise comes from probably Greece, again. I'll



give you some statistics. The point of this is that I am going to make a case that Italy is fundamentally a healthy country which suffered contagion from Greece. So I'll make the case that Italy is very different from Greece. Some of you agree immediately, but some of you want to see numbers. By the way, Japan is much worse than Italy, as all of you know that, in this debt-to-GDP ratio, Japan surpassed Italy around year 2000. Its present debt-to-GDP ratio is twice as much as Italy. Some people say that Japanese government has much financial assets, so let's subtract it. But looking at the net debt-to-GDP ratio, Japan again surpassed Italy in 2008. So if we think Italy is a sick country, Japan is a sicker country. It's lying in the bed.

Let's look at the primary surplus, and Japan is the worst among the G7 together with the U.S. and the U.K., and, look at Italy. They have the primary balance surplus, and it's much healthier than Japan and the other G7 countries. Let's confine to the European countries. As the following chart shows, Italy and Iceland are primary surplus country, and Italy is the best, followed by Iceland, and projections seem to point that Italy will be running huge primary balance surplus. Spain actually is very bad in terms of primary balance. And Ireland has a very specific problem by taking over the private sector banking debt. So that's a very different situation. Projections show again that Greece debt problem is very high, actually the second is Italy. So, if you are looking at the debt-to-GDP ratio, Italy looks bad and Spain looks good. But, going back again, looking at the primary surplus, Italy is the best and Spain is the worst. So whether you look at the stock number or flow number, your conclusion may be different.

That's the overview of Europe, and I think Italy is the best in the primary balance, so many Italian policy makers are saying that “we’ve done much fiscal reform, and there is not much we can do or we should do on the fiscal front”. And they are now talking about structural reform and growth agenda. So Italy is very different from Greece.



The second subject is historical perspective. If you remember Mexico in 1994, maybe Mr. Ortiz feels some pain talking about 1994, but I think that’s the start of the so-called 21st century-type crisis. We had a lot of those cases in the 90’s, and until Argentina, as Mr. Ortiz mentioned.

If you look back, there are many types of crises, and some of them are really fundamental crises of the government bonds, some of them are banking crises rather than the government bond crises, but became government bond crises later, and some of them are contagion, and I think that the Korean crisis in December, 1997, is the closest to the pure liquidity crisis that we can think of. And the parallel here in Europe is Italy. It’s like Korea in the sense that something really bad happens in a nearby country, which is Greece, and Thailand in the Asian case, and Italy is suffering from contagion and liquidity crisis by common lenders or financial channel, and so on. So we cannot bundle those so-called southern European countries. We really have to differentiate each country.

In academic taxonomy, some of them started out as currency crisis, or balance of payment crisis、and some of them started out as fiscal crisis. The European crisis now is mostly fiscal crisis, but some of them started out as banking crisis because of the bubble and burst. In the European case, Ireland is actually a banking crisis which developed into a fiscal crisis. So there are transitions of one type of crisis into another, and again we have to differentiate when we talk about what is the cure, because we need to know the reason why the countries are in a crisis when we write our prescriptions. We should write our prescriptions to correct the fundamental cause of the sickness. By the way, the IMF wrote very wrong prescription to Asian countries. That's why Asian crisis got complicated later, but that's history.

We know when a crisis happens in one country that affects other countries with various channels: trade channel, financial channel, currency channel, stock price channel, and so on. So the policy prescription to the epicenter, the origin of crisis, should be very different from the prescription to the contagion countries, the countries that were affected by spillover.

Similarly we sometimes differentiate a fundamental insolvency crisis from a liquidity crisis. If a country is insolvent, like when a bank is insolvent, then debt reduction is necessary. You have to reduce the debt for the country, or the company, or the bank. But if you are suffering only from a liquidity crisis, then there is a reason to give some temporary help and liquidity to that country, just like we sometimes extend liquidity to commercial banks from central banks. So if we can differentiate what is an insolvency crisis and what is a liquidity crisis, maybe we can apply different solutions to different kinds of crises. And I'm going to make a case that Greece is under an insolvency crisis, Italy is liquidity crisis, and Portugal, Spain, and Ireland are somewhere in between. Some may put Portugal with Greece, and Spain with Italy, but those three countries are somewhere in between. So if we agree that a liquidity crisis should be helped by liquidity provision, then, who's going to do it? And how much should we do it? Then, the regional funds idea comes in. We proposed Asian Monetary Fund after Thailand's crisis was solved with the first financial package in 1997. And before, when something happened in Indonesia and Korea, Japan proposed and ASEAN countries agreed that we should have regional funds. But it was shot down by the IMF and the U.S. Treasury.

Now in Europe, similar thinking has developed that maybe we need regional funds. So first they created the EFSF, which is a sort of guarantee mechanism to issue bonds and help the country and banking system. Now they are talking about the ESM, which is a more permanent structure to have the regional funding mechanism, which is very similar to the AMF. With fifteen years apart, Asia and Europe are coming to the same conclusion that you need some regional funds, maybe complementary to the IMF.

Since the IMF has limits, the regions should have a right to have this kind of regional funds. So maybe AMF idea was too early in history, but I think it sort of vindicated that we had the right idea at that time.

I think there are many people who would agree that this fundamental insolvency crisis should be dealt with differently from liquidity crisis because there is a contagion, through trade channel and financial channel, and so on. Some critics would say it is very difficult to differentiate in gray zone between insolvency crisis and liquidity crisis, but if we can differentiate, we should apply different solutions.

Let's take Italy for example. Looking at its primary balance number, some people say that Italy is a liquidity crisis, and lender of last resort is justified. Why didn't they provide lender of last resort much earlier? They waited until last December. As Mr. Ortiz mentioned and showed a graph, the LTROs that came from the ECB reduced the bond yield sharply. I would say that the LTRO is actually a lender of last resort in disguise. Of course if you go to the ECB and talk of this to them, they would deny that. "No, this is not a lender of last resort, this is a financial stability mechanism." But to me, it's a lender of last resort. So there is a solution if the central bank acts to provide liquidity to a liquidity crisis, not a fundamental crisis, But when I went to Berlin, Germany six weeks ago, I talked about this idea to Berlin officials, but they said, "no, it's not liquidity crisis. There is a structure problem in Italy. There is a north-south problem. Right now it looks good in Italy, but that's owing to the Monti government, and when Monti government disappears after the next election, which is in spring next year , we don't know what's going to happen. That's why we need a fiscal compact. We need an iron rule to have the fiscal rule. Once we relax the screw, they would have the moral hazard." I thought there was an agreement in Europe, but apparently there is a disagreement even for Italy among European officials.

I think I am running out of time, so I'll just read through the last slides. There is a parallel between Asia and Europe, and there is a parallel between the AMF and the EFSF. What the U.S. Treasury and the IMF objected to the AMF ideas were such reasons like soft conditional, duplication, and that region-wide crisis cannot be helped. I think those questions should be directed also to the EFSF and the ESM, and they should be answered. I am not critical of the IMF or the EFSF, but the explanation should be given what they are doing to the regional funds. And Asia still has IMF stigma. If you go to Korea or Indonesia, going to the IMF is absolutely no option. They don't even think about it. Will Europe develop a similar IMF stigma? My answer is probably not. It seems that the IMF is a softy among the Troika, which is the IMF, the

EU, and the ECB. The EU seems to be the toughest among the three, and the IMF seems to be the softest among the three. Thank you very much.

4. A radical Reform needed for the Euro

Brendan Brown, Executive Director, Mitsubishi UFJ Securities International plc

I want to express my gratitude to the institute for inviting me to be here today alongside such distinguished speakers.

When I was writing the second edition of the "Euro Crash", I came across a cartoon dating back to early 1960's of President De Gaulle of France and Chancellor Adenauer of Germany on the occasion of the French-German treaty with De Gaulle saying to Adenauer, "Hurry up and sign, neither of us are eternal," and they were both at that time in their eighties. But if you think back to 1962, the question comes if only at that point France and Germany had signed up the Monetary Union between the two countries, how much better that would have been. After all the objective of having peace in Europe only depends on France and Germany being in the monetary union, and at that time the whole world was on a dollar standard, and it would have been a very simple thing to organize a monetary union between France and Germany, you wouldn't have even needed European Central Bank.

In Europe, we are coming up to the 15th anniversary of the launch of European Monetary Union. ECB officials tell us European Monetary Union has been a great success because inflation has averaged only 2% per annum and slightly better than the 20-year record of the old Bundesbank. What they failed to tell you is that that record of the old Bundesbank included a decade when the inflation rate in the other principle countries was nearly 10% per annum. Some German politicians claim that the euro saved their country from a huge currency appreciation which would have happened if the Deutsche Mark were still in existence. German exporters mainly agree with German politicians on that score. On the other hand, many German consumers would not agree with that. German consumers, especially those who are bearing the burden of taxation, have to look forward to a burden to pay for European transfers, which already exceeds what Germany ever paid in reparations after World War I, relative to the size of their economy.

The French policy elite celebrate in private for the destruction the German monetary hegemony and the erosion of US hegemony which EU has brought. At an individual level, there have been big and less big winners for the European Monetary Union. The investors and borrowers in Spain, Portugal and Greece have enjoyed the benefit of using a world currency rather than their previous currencies, which suffered the disadvantages of being a second class local money. And we shouldn't overlook the fact that even though Greece, Portugal, Spain, and Italy may now be in deep problems, during the heyday of European Monetary Union, during the credit bubble period, many did very well in those countries. And, of course, if you look at Greece, half the money in the Greek banks has exited either under the mattress or to the banks in Germany, and people had been able to do that at no devaluation, all thanks to the large support and contributions from other European governments. In Eastern Europe, there have been several years of boom although that turned into a bust. That wouldn't have occurred without European Monetary Union because Germany had to agree to EMU in exchange for France agreeing to the extension of the EU into Eastern Europe.

In sum, there have been many gainers, and it is now becoming clear that these gains came at considerable cost, albeit potential losers are different people from gainers. The costs and disappointments of Monetary Union in Europe were of such a dimension that I can only imagine a bright future for the euro if there is a radical reform of the whole project. And I must tell you I am not pessimistic about the prospects for radical reform of European Monetary Union, but these depend crucially on political dynamics, most especially in Germany, France, and, very importantly, the United States.

A key tension which could determine the future of the euro would be between Berlin, meaning the German government, and Frankfurt, meaning the Draghi ECB. There was a cartoon in the front of German Handelsblatt last week which showed the Bundesbank president at a desk, wearing a helmet, as if he were fighting the rest of the world. The rest of the world means Draghi ECB printing money, Bernanke Fed printing money, and now perhaps Shirakawa-san BOJ printing money. So the idea is that the Bundesbank is on its own in the last hideout of monetarism.

But the problem goes deeper than that. When the ECB makes its loans on LTRO 1 or LTRO 2, or whatever the next prescription is, it's acting as transfer agent, it's taking money from Germans, Dutch, and taxpayers in the strong countries and essentially handing it out for the weak. If you look at this from a German point of view, there are only three possible outcomes from this process of the ECB massively expanding its Bad Bank balance sheet. One, funds would eventually have to be transferred to ECB by German taxpayers and Dutch taxpayers to cover the huge black holes which are going to emerge. Secondly, the ECB prints money and creates inflation to close those gaps, or, thirdly Germany walks away from the European Monetary Union and the system breaks up, and all the countries sharing the losses of the ECB.

Another key factor determining the euro's future is the extent of US monetary instability. When I talk about US monetary instability, I don't mean whether the U.S. is reaching an inflation target of 2% per annum. Monetary stability really has to be seen in much broader terms. A key element of monetary stability is an absence of asset price inflation. When we look at the history of US monetary instability over the last few decades, we had a series of giant asset bubbles and busts around the world, created by US monetary policy through long periods when interest rates have remained below neutral. Asset inflation has spread through various other countries not wanting to see their currencies depreciate or appreciate too much against the US currency. In an imaginary world where the Federal Reserve had pursued a stable monetary path and Washington refrained from launching a successive number of currency wars, most of the world including the European countries would have loosely remained on the dollar standard. The need for the European Monetary Union always came from U.S. monetary chaos.

If you go back to the origins in the modern time of US monetary instability, which was in the late days of the Martin Fed in the late 1960's or under the Arthur Burns Fed in the 1970's, the first response in Europe to US monetary chaos was disjointed. Of course, the country which chose the best way at that time was Germany. The old Bundesbank under Dr. Emminger launched a monetarist revolution and created the hard Deutsche Mark. The success of the Deutsche Mark was such that many other European countries decided that their best course of action was to become satellites in the German monetary area. Holland, Belgium, and Luxembourg, all joined up to the German monetary area. Of course, this was totally an anathema to the French political elite, who resent one fact more than U.S. hegemony, and that's German monetary hegemony.

So we had the long journey to European Monetary Union which had its ultimate destination, the transformation of the German monetary area with its array of satellites into a supranational currency zone under a European central bank. This transformation which had been a great success in terms of monetary stability in the Eurozone was deeply flawed. Most of all the monetary principles which had made the Deutsche Mark great were jettisoned. The ECB designed a monetary framework which in many respects was indistinguishable from that of the Greenspan/Bernanke Federal Reserve. There were the same key elements of inflation targeting, deflation phobia, manipulation of interest rate expectations, removal of monetary base from the pivot of the monetary system and ignoring of asset price inflation. All of that went into the design of the European monetary framework under Prof. Issing.

And what was the result? Europe became immersed during the first decade of the 21st century in a credit bubble at least as great as that in the US. I would like to stress that European sovereign debt crises didn't come essentially from fiscal profligacy. These sovereign debt crises are in fact the European version of a credit bubble. The fact that investors and banks were ready to pile into Greek debt in the middle part of the last decade at only 50 or 100 basis points above German government debt was a testimony to the effect of seriously below neutral interest rates being pursued in Europe as in the US. The fundamental blame for that bubble goes back to the policies and monetary framework pursued by the ECB. In Europe, the asset price inflation generated by monetary instability didn't just affect the sovereign debt. It also affected the Spanish real estate market, Spanish banks, and wider private equity, and ultimately some of the lending into Eastern Europe. All of this is now history but it is not a history that has permeated into European political debate. If you look at the U.S. political debate, a few years ago Senator Bunning famously hurled a comment at Bernanke "You are the systemic risk." But in Europe, you would never hear somebody attacking the ECB President as being the source of a monetary instability or the source of a credit bubble.

Yet strangely, I am optimistic about the euro project's future although some of you might be disturbed by the path I outline along the way to that hopeful destination.

First, I suggest that in the US there will be growing revulsion in coming years against the Bernanke Federal Reserve. Its deliberately created asset inflation and interest rate manipulation will be the catalyst to monetary reform, or at least monetary debate. Revulsion will show itself up not just in the political arena but also in the academic area. There should be contagion from this revulsion into Europe. I mean good contagion, not bad contagion.

Second, in terms of how the European monetary reform process is going to move forward, I expect a very tumultuous period ahead in European monetary scene. At some stage there will be another wave of capital flight. I think that wave will emanate from Greece and Spain.

In the case of Greece, I think we need to look at German politics and realize that for Chancellor Merkel, facing elections in September 2013, her best chance in winning the re-election is to get Greece out of European Union. That will be hugely popular in terms of the German public. I don't think Germany can be seen to be pushing Greece out, but if Greece needs more funds, which is more than likely, there is a great chance Germany is going to say, “No.” And that would be the end of Greece’s membership in the European Monetary Union.

The Spanish case is much more difficult. When and if Spain becomes a huge crisis is hard to predict. But if you get a wave of capital flight out of Spain, the big question is going to be what the tolerance in Germany is for ECB lending into Spain. Is Germany going to tolerate a further mass of expansion of ECB bad bank into Spain? Or are they going to phone up Draghi and say that has to come to an end? Of course, if you say it has to come to an end, it is the end of Spain’s membership of European Monetary Union. And when we get to a Spanish crisis, if not before, then I think we can imagine the key negotiation which has to take place.

If anything serious happens in Spain, the future of European Monetary Union is in doubt. The only way the European Monetary Union in that circumstance could be kept alive, I believe, is for the French President and the German Chancellor to meet and decide that they are going to pursue a new type of monetary union with no bailouts if possible. This meeting has most chance of success if it is held after the German general elections of Autumn 2013 (and the French presidential elections of Spring 2012). And success depends on recognizing one of the big fictions about how European Monetary Union exercises. You do not in fact need fiscal union, or any sort of transfer union to keep the Monetary Union going. After all we had Monetary Union under the gold standards with no fiscal unions, no transfer payments.

What you need to keep Monetary Union going is an exit route. If there is an exit route, Monetary Union can survive without any transfer union. You have to have a set of means for countries to leave the Monetary Union. And that has to be the key element of any re-negotiation between France and Germany.

I leave you with a hopeful scenario of the leaders of the two countries will sign a new monetary treaty even though it will be in very dire circumstances. And this isn’t for fiscal treaty which is being talked about in Brussels at the moment, but a meaningful slim down monetary treaty, with a core being France and Germany.

Thank you.

5. Panel Discussion Part I

Gyohten: Thank you very much. Well I think we learned a lot, maybe a little bit too much. I have been wondering how best to organize this very complicated discussion in a limited time. After all, it is quite obvious that in order to write an appropriate prescription, we need to agree on the cause of the crisis, first of all.

Listening to all those remarks, I thought there are considerable nuances among them. So what I am going to do is to pose a very simplified question, focusing on Greece. After all, this whole crisis is focused on Greece. So, I'll put this question in a very blunt form. Do you think Greece is a rotten egg, or a stray sheep, or a victim? If Greece is a rotten egg, can it be plucked out without causing chaos in Greece and in the Eurozone? If Greece is a stray sheep, does it have adequate economic, political, and social stamina to carry out the needed structural reforms? And how the outside world can and should support their efforts?

If Greece is a victim, then who are the villains? Are they the subprime loan fiasco in the United States, stupid central banks, or flawed structure of the Euro project? And are they solvable problems or not? Well, I don't want to ask every panelist to answer this bit crazy questions, but I think it would be interesting to ask, first of all, to other two panelists who did not participate in the first round. So which one of you, Ms. Gao or Mr. Nakao? They are both Asians, and they are very polite. Nakao-san?

Nakao: First of all, I am really honored to be here again in two years, and I am a little bit nervous again now, because I am the only government member in this group, and I cannot make imprudent remarks, and also Mr. Gyohten was my boss, director of the division when I joined the Ministry in 1978. That kind of relationship prevailed over years and I cannot challenge it.

About your questions, I think Greece is all of the three characters. I would like to touch a little bit from the perspective of a government official. There are many issues about causes, and the efforts of the European countries have made so far. About the international response which was discussed at G20 Ministerial Meeting in February in Mexico, there was a consensus that if Euro countries can make further efforts; they have been making a lot of efforts including front loading the ESM, European Stability Mechanism, which is a permanent one, and LTRO, Long Term Refinancing Operation. There is a lot of dispute over it, but still I think it made progress so far. And government has been strengthened by the new factor and very difficult efforts by Greece and Italy and Spain. So there have been a lot of efforts but if the IMF and the international community as a whole want to come into the rescue of European issues, Europeans must make further efforts by strengthening the ESM and combining the ESM and the EFSF together. Of course there is a capping over 500 billion Euro combined capacity, although the EFSF itself has a 400 billion Euro capacity and the ESM has a 500 billion Euro capacity. So review of that cap is one condition for the IMF to consider further quota increase.

Europe has a special situation compared to the emerging economies. Prof. Ito discussed the difference between Asian crisis and Europe. But very important difference is that Euro members have its own central bank of issue. So if they issue a currency they can solve many problems on their own. They are doing it although there is a problem about it. And also those are very high per capita income countries, so it means that once we start rescuing those countries it costs a lot because financing gap from big per capita economies is very large. And also because of a free flow of money between countries, financing gap caused by the free flow of money which lacks a kind of moral, because of private sector's very inadvertent investment in Greece and so on, it costs a lot. So it means that the IMF cannot come to rescue the European countries as in the case of emerging economies. In essence, it is more like a single country in which there are poor problem areas and there are very wealthy areas. So that is the first point I want to make.

The second point is about Japan. Japan is prepared to support European countries if they make an effort. Actually after the Lehman crisis in 2008 in the fall, Japan initiated $100 billion of lending to the IMF general resources to support the IMF operations to, again, help emerging economies from this crisis. So Japan is prepared to do that. And also the Ministry of Finance using the reserve has invested in the EFSF bond by $ 3 billion already, about 14% of the total issue of the EFSF. So Japan is not saying that we don't do this, but what I want to emphasize here is that we want to see more concrete efforts by the European countries.

Gyohten: Thank you very much. Now, Ms. Gao.

Gao: First of all I would thank you for inviting me again and I am really happy to be here again. This is a really tough question. Actually I've done some case study, field work a few months ago when I visited Greece. It was a very small sample. I have two Geek classmates when I studied in the U.K., and I had a chance to see them when I was in Athens. I posed the question, "Do you think Greece should be leaving the euro?" One said yes, and the other said no. Each of them had enough convincing reasons. I agree with Mr. Nakao's answers: it's probably a combination of the three situations. I think no matter Greece leaves or not, there is one consequence that all the outsiders will take. That is, if you look at the QE 1, QE2 and twist operations in the U.S., and LTRO 1 and 2 in Euro area,, all those policy options released liquidity. The central bankers are taking a partial fiscal responsibility. It, actually, is monetization of public debt. For the emerging economies, as the receivers of liquidity, they have to deal with risks of capital flows. Some will choose the capital control, and others will suffer inflationary pressure. That was what I am worried.

Gyohten: Thank you very much. Will anyone of the speakers like to jump in and say something about my question?

Ortiz: I think I agree with Mr. Nakao that almost in every crisis we have over-indebtedness. They all look alike, usually there is a bubble period, credit expansion, asset appreciation, etc., that is pretty much the case in almost every crisis. Of course the manifestations are very different. Some are blown open by balance of payments problems, some are blown up by banking problems, but more or less the root causes are similar. And I think that as always, it takes two to tango, as they say. In the case of Greece when I was a public official, I asked my European colleagues whether they were worried about excessive spread compression between Greece, Spain, and Germany and the answer was, "no, no, this is what we want, this convergence to a single market". So in many ways Europeans were not worrying but encouraging, this convergence, this spread compression. When asked about excessive imbalance of countries like Spain which reached 8, 9% of GDP, they would say, "who cares, what the balance of payments of California is." Those were the kind of answers. Obviously in hind sight, as it has been pointed out by other speakers here, there was a fundamental flaw of design, and also it's human nature "when times are good, one tends to think they will continue to be good."

Gyohten: Thank you. Ito-san?

Ito: I think the difference between a rotten egg and a stray sheep would depend on the growth potential of Greece. To have the competitiveness back, you need real effective exchange rate to be depreciated. There are two ways to do it; one is to depreciate nominal exchange rate, which means exit from the Eurozone, and another way is deflation. So if you can achieve, 20% ~ 25% of deflation, which is wage cut and price cut in Greece, maybe there is a chance. That's what Latvia did. So this is a Latvia solution to have the Greek competitiveness back. I have some doubts whether there is a stomach for this 20% deflation in Greece. So looking at those street riots and general strikes, and jailing the statistics officials who were sent from the IMF, signs are not encouraging that Greece is moving forward. So it may become a rotten egg rather than a stray sheep.

Gyohten: Thank you. Brendan?

Brown: I'll just say that even if it's a black sheep in this situation, I think it's the EU and ECB high officials who signed the documents saying that Greece was eligible to come into European Monetary Union, and if the European Monetary Union or EU is ready to move forward in terms of confronting what went wrong, there should be a Truth commission to establish how Greece ever got into the Monetary Union.

Gyohten: Thank you. Well, at this point I would like to make a bit of an off the track question, one to Guillermo and one to Brendan for the sake of the audience interest and benefit. Guillermo, you gave us a really enlightening account on the experience of Latin American crisis, and we are very much impressed about the success you have made in the occasion. Now, do you think, or am I right to presume that on the basis of that success story and structural reforms you have done in Latin America, is

Latin America in general on the track of stable, sustainable growth path now? I am asking this because there are still some people who are a bit wary about the lack of a solid middle class in the Latin American countries. And also there are people who are still worried about the risk of the so-called middle income trap. So can you enlighten us about these Latin American prospects?

Ortiz: Thank you, Toyoo. I think this is a relevant question, these are questions we are discussing every day. I would first make a distinction. There are some countries in Latin America that do not fit the mold, like Venezuela, and others. But talking about mainstream Latin American countries including Brazil, and to some extent Argentina, they are following, in my view, policies that eventually may become sustainable as well as Peru, Columbia, Mexico, etc. I think that the continent has come a long way. First, twenty-five years ago, few of these countries were truly democratic. Today they all are, again with the exceptions that I mentioned at the outset.

Second, I think we have a much stronger macro framework. For example, debt-to-GDP ratio in these countries average between 30 and 40%. Brazil is a little higher. But most of the debt now is locally held, and all the indicators including inflation, are sound. The combination of inflation targeting and independent central banks, they have produced, I think, a pretty workable and solid macro framework, which has proved to be resilient to the crisis. I mean if you look at Latin America during this great crisis, Mexico has suffered GDP contraction because of its close links with U.S., high dependence on trade, but interestingly enough, none of these countries suffered a domestic financial dislocation as a consequence of the global crisis.

So, in general I would say that the macro framework has already been achieved, but that's a necessary but insufficient condition for the second part of the question that you asked. Is Latin America on the path for sustainable growth? I would say, yes, if some of the basic reforms that are needed in Latin America are implemented. The most important ones relate, for example, to the strengthening of the institutions, the rule of law. It's true, I would say, the authority of competition, education levels. That's really worrying, because Latin America spends a lot of money on education in terms of GDP, but the results of standardized tests conducted by OECD usually produce very low scores for Latin America. So the emphasis on education, and opportunities to create jobs, those are the elements that need to be in place in Latin America for long term growth. I think that achievements which have been huge in terms of solid macro framework are just the basis. But I think it is the solid basis for the future.

Gyohten: Thank you, Guillermo. Brendan, can you tell us what the U.K.'s posture towards Euro is? Last December you vetoed this introduction of the fiscal package. Well, at that moment we thought that, at last the United Kingdom had decided to stay away from the Euro. Where now is U.K. heading? Are you contemplating the creation of North Atlantic Union, or are you planning to resurrect the Commonwealth? And what would be the future of the pound sterling? And the City of London? Tell us.

Brown: I think there are two or three contradictions, as you are sort of hinting at. First of all, it's sort of bizarre that British policy has been to encourage the so-called "big bazooka" in its approach inside the European Monetary Union to save it, rather than forging a direct alliance with Germany and intimating to Germany that Britain understands the problems and why Germany would hesitate to become more and more engaged in bailing out the rest. And that contradiction applies also in the case of U.S. policy which has been very much based on pressing Germany to agree to bailouts, rather than directly concentrating on German point of view and coming to an understanding with Germany. That's point number one, I think.

Second question of British monetary policy…the great disappointment over the last ten years has been Britain outside the Monetary Union. Why hasn't it done so much better in terms of monetary management? But in fact U.K. ended up with even bigger credit bubble than Europe or the United States. This has been a huge opportunity missed. If Britain had managed to pursue and develop a stable monetary policy, and become the big Switzerland of Europe, it would have done so much better. But again, as I discussed earlier, the absence of political debate about monetary policy in Europe, has been unfortunately reflected in an absence of political debate about U.K. monetary policy, unlike in the U.S. where Bernanke and monetary policy has been a central theme in the Republican primary elections. It's not a central theme in any U.K. political debate.

Gyohten: Thank you. Guillermo wants to step in?

Ortiz: Just a question, do you think there is any part of the explanation of the U.K.'s monetary policy, as you mentioned, in the last decade, that had to do also with the simultaneous aim of consolidating the City as the major financial center?

Brown: It's very difficult to see that. One puzzle, of course, in the last two or three years why the U.K. hasn't been much more pro-active in terms of driving forward the City. I mean, given that amount of financial regulation that's coming about in the

U.S., it would have been a very obvious strategy in the U.K. to do the opposite, and give U.K. and London a big competitive advantage. But really, if you look at the way things have worked out, U.K. has been very enthusiastic about regulation. And it's difficult to see how the monetary policy has actually encouraged or stimulated U.K. as the financial center. It ended up bankrupting half of the bank system.

Gyohten: Okay, time is just up for the first session, so we'll have a 15-minute break now and come back for the second session. We will focus our attention to how to revitalize global economy. Thank you very much. Please give a big hand to all the panelists.

Part Ⅱ Toward the Revitalization of the Global Economy
-The challenges for the Asia-Pacific Region as a Growth Center of the World

6. China's contribution to the world economy: Short-term Concerns and Long-term Challenges

Gao Haihong, Senior Fellow, Institute of World Economics and politics, Chinese Academy of Social Sciences

I am asked to talk about China and China's contribution to the world economy. It's a too wide topic, so I'll concentrate on China's short-term concerns and long-term challenges.

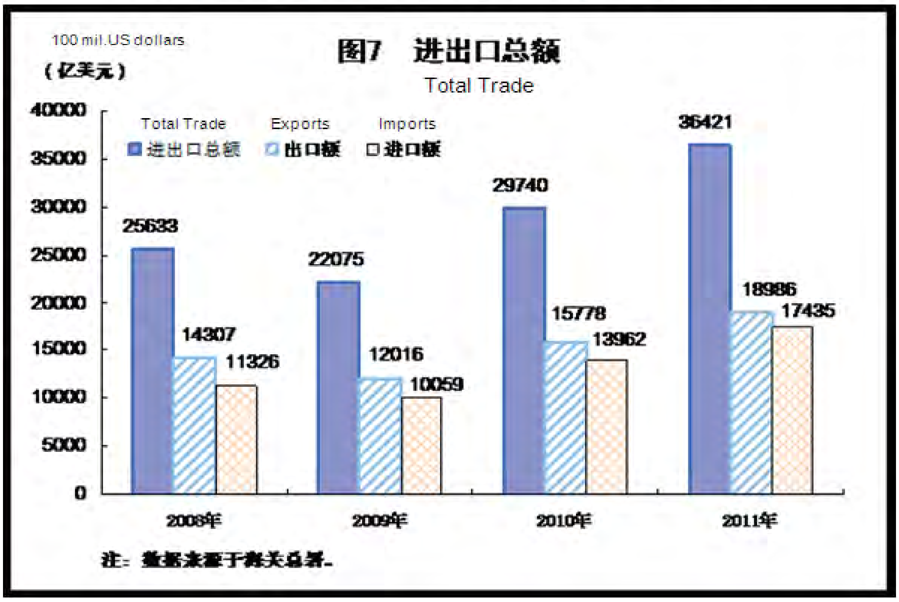
What are China's short-term concerns? One is uncertainty. Uncertainty is the key word for this year. Scenario analysis is so popular now, because there are so many things we are not sure of. So we have to give different numbers, even for very short-term predictions, based on different situations.

One argument is: which is worse, the U.S. economy or the Eurozone economy? In China there is a very interesting metaphor for this: U.S. is having a cancer and Eurozone is having a heart attack. Both are ill, but which is worse? That is very difficult to judge. China is in an integrated world with this kind of uncertainty and China has to deal with it.

Another uncertainty is market opinion. When the market doesn't agree, the governments can hardly get what they want. In that sense, the market is always right, and the governments tend to lag behind the market. However, market opinion has strong psychological and spillover effects which affect the stability of the financial market. This is the risk for China and also for many emerging economies.

The second concern is "soft landing", though some people may disagree with the wording. Just a few days ago, Premier Wen, in the National People's Congress meeting, laid out a set of targets for 2012: growth rate is expected at 7.5%, CPI inflation will be under 4%, unemployment will be less than 4.6%, and trade will increase by 10%. The policy options will be "fine-tuning", that I think, is a quite subtle word which may include monetary easing and fiscal reform. Is there any problem to achieve the 7.5 % growth target? I have no doubt, and many Chinese believe that there could be a buffer behind it. Nevertheless, that doesn't mean it's problem free. What I am worried about are the followings.

Total trade Attributed to import Surplus narrowed



First, trade issue. China's export slowed down. This slide shows a chart of trade starting from 2008 to 2011. In 2009 there was a big contraction, but afterwards the trade improved. However, in 2011 the increase of the total trade was less than that of 2010, which means that it was a minus contribution to China's GDP in 2011. Furthermore, the imports increased faster than the exports in 2011. The surplus narrowed down to 2%. This trend could continue for 2012. There are talks from the U.S. side against China: fair competition, currency manipulation, stealing jobs, etc. I think the danger of protectionism is rising in the U.S. because the U.S. is in the political cycle this year. I hope those are just political propaganda. Europe is a different case. Because Europe is China's largest trade partner and China is Europe's second largest trade partner, the shrinking demand in the Eurozone will have a significant negative impact on China.

Inflation target is 4% for 2012. Is it optimistic or not? I think this is debatable. To achieve that target, it has to assume that the price of energy and commodity does not soar. Actually that is the major cause for China's imported inflation. The rising labor cost is also a very important element for the general price level in China.

Monetary easing is probably the major theme for 2012. One of such worries as related to monetary easing is the property bubble. I think the Chinese government has been trying very hard to curb the bubble. However, with limited investment opportunity in China the released liquidity will very easily be flowing into property market again. This is something really worrisome. As for banks, the released liquidity would tend to be used for expanding holdings of local government bonds. This also poses a problem, since it is likely to accumulate new non-performing loans for banks.

Compared with the monetary policy, the fiscal reform is more welcomed in China, including minimum wage raise and also reform on tax system. In 2011, 24 provinces have increased minimum wage with an average of 20% hike, which is a big step. Actually China is trying to learn from the experience in Japan. There is much room for tax cut in China, and many people believe it is time for the government to transfer the wealth to the households which can eventually increase private consumption.

Another short-term concern is financial stability. With its capital control in place, financial stability is assumed to be less of a concern. However, the Chinese government can never be relaxed because there are a lot of loopholes in FDI and trade channels.

Furthermore, the RMB internationalization adds complexity because we have offshore market in Hong Kong. The offshore market signals back to the onshore, and that also stimulates arbitrage. It brings money in and out sometimes in a disturbing manner. China is also not free from global liquidity concern which is pro-cyclical with huge spillover and psychological effects making capital control increasingly difficult. I think autonomy of monetary policy is at risk.

The foreign exchange reserve management is also facing difficulty. With the large size of foreign reserve in China, unstable euro is actually a nightmare. No matter how the Chinese government tries to maneuver, capital loss is unavoidable.

Now I turn to the long-term challenges. First one is structural reform. Yesterday Premier Wen gave a press conference, and some journalist counted how many times he used the key word "reform". It was twenty. As this episode shows it's a major long term priority. For the structural reforms, the growth pattern needs to change. In 2011 the contributions to the GDP were the following: consumption 54.2%, fix asset investment 51.6%, and net export a minus contribution. Thus, it is fair to say that China's growth is more or less consumption and investment driven. However, there are some concerns about this growth structure.

First of all, the investment: the question is how to make it sustainable when investments make a huge consumption of energy and the problem of pollution. As for the consumption, the issue is how you can ask people to spend when they don't have money, especially the poor farmers? How can you ask them to consume without a social security net, without a guarantee for their future? Those are the issues incorporated in the agenda of the Chinese government for the next five years.

Now the tough issue: reform enters deep water. You might have read a lot from the media's coverage on this issue. One is inequalities between regions and between people. I think this is something that the government is really worried about. To deal with it, it is urgent to have reforms on social security, pension, health insurance, and education.

Fiscal reform, as I mentioned before, was very successful in 2011, and I think China will continue to pursue the reform in order to achieve wealth redistribution and to strengthen the middle class.

The state-owned sector verses the private sector is a more difficult area to touch upon. Watanabe-san in the opening remarks mentioned about the recent World Bank report "China 2030". Reform of state-owned sector is also the key word in the World Bank report. It's a very tough and complex issue in China and I think it wouldn't be solved overnight.

Another long-term challenge is the strategy of the Chinese currency's internationalization. I think currently in China the step-by-step approach is the consensus. A brief summary of the current usage of the RMB is the following.

use of RMB

Private use	**Public use**
Trade settlement (no limit)	Currency Swaps between central banks
Bank loans (in Hong Kong)	Swaps under Chiang Mai Initiative
Bond (in Hong Kong)	Reserve for central banks
Equity (QFIIs, RQFIIs)	Anchor for currency baskets
Direct investment (ODI)	
Money market (few banks)	

Small steps: 6.6% trade settlement; 0.9% transaction in global FX market

The private use actually went quite well. Basically there is no limit for any enterprises from any areas to use the RMB in trade settlement. There is a large pool of bank loans in the RMB in Hong Kong. RMB bond issuance in the RMB in Hong Kong and new equity market in the RMB for RQFIIs started to open. So is direct investment. As for money market, this is something very brave, and some banks are allowed to transact in the RMB in money market.

For the public use, the RMB is used as payment currency in bilateral swap arrangements between central banks, so far 17 in total among which 3 extended. The RMB is also used as a payment currency in swap arrangements under the Chiang Mai Initiative, as reserves for central banks in some ASEAN countries, and also as an anchor or part of currency baskets. Therefore, I think that the RMB gained some ground in the international arena. In 2011, 6.6% of China's total trade was settled in the RMB, and in the global FX market, 0.9% of turnover, starting from zero two years ago. However, these are still very small steps compared with the Japanese yen.

The last issue for the long-term challenges is China's role in the International Financial Institutions. I think it is very clear that the Chinese government is searching for a collective voice of the emerging economies at various cooperative platforms, such as G20, IMF, World Bank, etc. China is participating in the discussion on global financial safety nets which is an urgent task for both emerging economies and developed economies to prevent the instability of the financial market.

Bilaterally, China actually contributes a lot in bilateral swap arrangements starting with Korea in 2008. Regionally, China is a great contributor to the Chiang Mai Initiative Multilateralization arrangement, equivalent with Japan, and very active in promoting regional co-operations. At global level, China's quota in the IMF and the World Bank increased which I think was realized to match the increasing weight of China's economy in the world economy.

So let me conclude. China is big. In terms of total numbers, it is big. But if you look at per capita, China is not so big. The world is expecting China's growth, and China is expecting the world to be back on track, and that really needs collaborations and consensus.

7. Challenges in International Finance and Japan's Responses
Takehiko Nakao, Vice Minister of Finance for International Affairs, Ministry of Finance

I'd like to speak on the four issues in this section: the world economy, Asian financial safety net, how to promote the usage of Asian currencies including the RMB and yen, and about exchange rate issues, including Japanese exchange rates. I have so many things which I want to speak but time is limited, so I prepared the full text. (This text is available on IIMA's homepage.)

First, about the world economy. The overall world economy is now recovering from the very severe shock of Lehman. In 2009, the advanced economies recorded a negative growth of -3.7%, but it is now recovering. Nevertheless, there are so many issues which we should face appropriately.

Regarding Japan, last year was also a very tragic year. Tragic, because of the earthquake, tsunami, nuclear, and unlucky because of the supply chain disruption after the earthquake and also by the flood in Thailand. Our economy was affected very much, but it is now recovering because of resumption of consumer confidence, the shortage of electricity was not as severe as initially thought, and the supply chain is now being rehabilitated. Furthermore, we will be spending about 18 trillion yen which is equivalent to around 4 percent of Japan's GDP incorporated in a series of supplementary budgets as well as the FY 2012 budget. It will help the recovery of Japan.

Because of the European issues, we face risks. Risks come from the credit channel which is deleveraging, the trade channel, and the confidence channel. However, I want to stress the strength of the overall Asian economies, even in the face of these difficulties. At the time of the Lehman crisis, there was a question whether Asian economies could be decoupled from the troubles in the United States and Europe.

Many people say that even if the intra-regional trade is very large among Asian countries, the final destination is always the U.S. and Europe. However, the Asian growth is now becoming more and more dependent on their own domestic demand instead of the external demand in the U.S. and Europe. And, of course, Japan itself is a very important destination of trade for ASEAN countries. In 2011, the share of

ASEAN's exports to Japan is 9% which is slightly below the EU's 11% and 10% of the U.S. As for China, their dependence on the EU is 20%, and on the U.S. is 17%, and on Japan is 8% in terms of export destination. Overall, I think Japan's contribution to the growth of Asian countries is often not mentioned well enough.

In any case, what I want to stress here is that Asian growth is more and more becoming dependent on their own domestic demand. If you look at China, for instance, in 2011 there were about 19 million car sales in the Chinese market as compared to about 14 million in the U.S. market. This shows that China is not just producing, but it is also consuming a lot. After I became Vice Minister last August, I visited most of ASEAN countries, India, so on, and I found that there are so many direct investments from Japanese companies targeted to consumption in those countries. For instance, in Indonesia there are many new plants such as for cosmetics, motorcycles, and also for instance, for paper diapers. Once people start using paper diapers instead of traditional ones, they can never give up using them. As we experienced in 1960' and 70's, once people start using very sophisticated items, and once they start loving the behavior of more sophisticated consumption, they can never stop it. In that regard, I think Asia now has a very strong demand in itself, and also it has a strong production power, including very strong production network connecting industrial clusters within Asian region. Therefore, I would expect a strong endogenous growth in Asia in coming years, even if there may be a spillover from Europe and other countries. Overall I think there is a strong impetus in Asia.

Regarding Japan, we are close to Asian countries and we already have enjoyed a stronger demand from China and Korea and others in terms of trade, but also in terms of tourists and students studying in Japan, and so on. At least as far as Asia is concerned, Asia can continue to be a growth center of the world.

The second point I want to mention is the need of promoting the financial safety net in the Asian region. Especially ASEAN countries and Korea which relied on financing from European banks are now suffering from the deleveraging of European banks. If we look at the statistics by the BIS, from June to September in 2011, the lending of European banks to major ASEAN countries plus Korea was down by 8% in these three months. If you look at the French banks, they decreased the lending by 25% to those ASEAN countries plus Korea. It's an enormous reduction. On the other hand, during that same period, Japanese banks whose share of lending in the region is about 15% increased their lending by 5% to these countries. Still in total, there was a decrease of lending to those countries by 3%.

What I want to say is that deleveraging is happening in Asia, and it is now having an impact on the Asian countries very acutely especially in Korea. As the result of deleveraging, the Korean won depreciated and stock prices went down towards the end of September in 2011. Under such circumstances, upon request from the Korean authorities, we decided to have a large swap arrangement in October 2011, which is to increase the maximum amount of bilateral swap arrangement from USD 13 billion to USD 70 billion.

A part of agreement is a new U.S dollar-Korean won (and U.S, dollar-Japanese yen) swap arrangement with the maximum amount of USD 30 billion between the Ministry of Finance of Japan and the Bank of Korea. This is slightly different from the Chiang Mai Initiative's crisis resolution type swap arrangement because Korea can withdraw the U.S. dollar at any time under this arrangement without liking to the IMF program. It is more flexible arrangement to support stabilizing the Korean financial market.

Actually we received a lot of blames from people on the street: "Why do we need to support Korea while there is a territorial issue.", for instance. The reason we concluded this arrangement is because after the Lehman crisis the yen kept appreciating while the won kept depreciating due to Korea's dependency on external finance. Stability of the won should be supported if the won continues to depreciate. To stop the depreciation of the won is not only for the sake of Korea but for our own sake. Japan also agreed on increasing the maximum amount of the bilateral swap arrangement with India last December.

Another issue on the financial safety net in Asia is the strengthening of the Chiang Mai Initiative Multilateralization (CMIM) by ASEAN+3 members. We are now considering doubling, at the maximum, the size of the CMIM from the current USD 120 billion by the time of May 2012 ASEAN+3 Ministerial Meeting. In addition to that, we are planning to increase the de-linked portion with the IMF program which is currently 20%. We have now the surveillance unit which is called ASEAN+3 Macroeconomic Research Unit Office (AMRO) located in Singapore consisting of about 30 economists. Since AMRO has already started working, we think we can conduct rescue operations in Asia by ourselves as the IMF de-linked portion increases. We are also thinking of having preventive measures like the IMF's Flexible Credit Line and Precautionary and Liquidity Line. Funds under these arrangements can also be withdrawn de-linked with the IMF program. I think this is a major step towards something closer to the Asian Monetary Fund which Prof. Ito mentioned.

The third point I want to emphasize is about the further promotion of the usage of Asian currencies. When I attended this annual symposium two years ago, I said that the U.S. dollar's status as the international key currency wouldn't be challenged so much by the euro because although it is a single currency, financial instruments such as government bonds are separated. I didn't expect euro crisis would happen in two years. Nevertheless, from that time I thought the euro has a certain limitation as a key currency, so I thought the U.S. dollar would remain as the key currency in the international community for a foreseeable future, because of its strong financial sector, very large economy, and also what we call network externality: once people start using it, it's easier for others to use the same thing. Therefore, I was a rather pessimistic about the future of the use of Asian currencies including the Japanese yen.

However, when I visited many Asian countries after becoming Vice Minister, I encountered very strong wishes on the part of Asian countries to promote the usage of Asian currencies, because of this crisis. After the Lehman crisis and also the latest euro crisis, we have experienced shortage of the U.S. dollar liquidity. Then, smooth financing for trade and investment in Asia is hindered and the real economy is negatively impacted even if very good policies are in place, just because of difficulties in U.S. dollar liquidity.

This is the background for a resumed demand for the promotion of Asian currencies. That is also the background when Prime Minister Noda and Premier Wen of China agreed on cooperation for the development of financial markets of both countries. The agreement includes (1) promoting the use of the Japanese yen and the RMB in cross-border transactions between the two countries; (2) supporting the development of direct exchange markets between the yen and the RMB; (3) supporting the development of yen- and RMB-bond markets; (4) encouraging the private sector to develop yen-dominated and RMB-dominated financial products and services in overseas markets. We have already started the Joint Working Group meeting to promote cooperation in these areas.

When Minister Azumi visited Vice Premier Wang Qishan on February 19, the importance of this agreement was reaffirmed, and we are now making real efforts together with the private sector, because unless the banks in the private sector are interested in this initiative, it wouldn't happen. The Chinese authorities themselves also say that this initiative should be private market driven.

I really want people in this room who are engaged in private sector, banking and securities, to take this initiative seriously, and cooperate with the governments. Actually the Chinese authorities are steadily implementing the liberalization of the capital account following on from the liberalization of the current account, and I think the speed of the liberalization can be even faster than generally anticipated.

As part of the before mentioned agreement between the two leaders, the two countries also agreed to initiate procedures for the Japanese authorities to invest in the RMB-dominated Chinese government bonds, and that a quota of about USD 10 billion has been approved for Japan by the Chinese authorities. Such a ceiling approval is needed because of the capital control by China. The purpose is not intended to diversify our reserve portfolio from the U.S. dollar, which is dominant share in our reserves. It's not to diversify from U.S. dollar because the U.S. dollar is unsafe. This agreement is to ensure mutuality of investment in government bonds, since China has already invested a substantial amount in Japanese government bonds. The mutual investments would promote cooperation between the two countries, and also promote information sharing between the authorities about any subjects including reserve management.

Quickly about exchange rate issues. The yen has been depreciating after BOJ's announcement of February 14 on the enhancement of monetary easing, and progress made towards the Greek second bail-out program. The Japanese government has constantly expressed its strong concerns about the one-sided appreciation of the yen since last summer as not reflecting the real fundamentals of Japan's economy, so we do not feel anything odd about the latest movement in foreign exchange markets.

Many people say that the current yen movement has been within the range of long-term trend in terms of the real effective exchange rate (REER). The yen's REER, however, appreciated by 30% between July 2007 and December 2011, and this is not really absorbable by the private sector, and it's not really understandable when Japan was hit by the earthquake and the subsequent supply chain disruption, and also when we are suffering from a long term slump and deflationary economy with our very large fiscal deficit and the largest outstanding debt. We think this is due to excessive speculative movement.

Actually G7 always states that the excessive movement is not good, and I should read carefully from the September 9 statement of G7: *"We will consult closely in regard to actions in exchange markets and will cooperate as appropriate."* Of course we are always consulting with other G7 authorities, but of the four major dollar-yen interventions in September 2010, March 2011, August 2011, and from the end of October to early November 2011, there was only one collective and coordinated action, but we still think it is necessary to act in the market if we are faced with very excessive movement of exchange rate. Although the recent movement of exchange rate is better, we will continue to watch the market very closely and to act in an appropriate manner if it is needed. This is the official stance of the Japanese government.

8. Panel Discussion Part II

Gyohten: Well, when we think about the revival of the world economy, particularly after the damaging shock of the Euro crisis, the damage from the Euro crisis to the world is obviously channeled mainly through two paths. One is, of course, the credit crunch, and the other is collapse of demand.

So when we talk about particularly Asian Pacific region's contribution to the revival of the global economy, we need to think, in concrete terms, what this region can make in these two broad paths. Listening to what Ms. Gao and Nakao-san talked about, I think that on the financial front, this region, particularly China and Japan, are actually making considerable contribution and also very much determined to continue that. However on the real demand side, I am not sure whether this Asian Pacific region can repeat this great contribution the region made in the aftermath of the Lehman Brothers' collapse in 2008.

In that respect, I would like to pose a couple of questions to Ms. Gao. One is exactly on this issue of Chinese contribution to supplement global decline of demand. After the Lehman crisis in 2008, China made a really great contribution to the global recovery by its RMB 4 trillion stimulus packages. However, the problem I see now is, as Ms. Gao exactly mentioned, that this 4 trillion stimulus package created problems in China, particularly in the way of exacerbating some of the structural problems. And also, as Ms. Gao mentioned, now the Chinese government is shifting its gear toward more stable, more sustainable growth path. They set this year's growth target to 7.5%, although as Ms. Gao said, I think that number has a considerable buffer behind it and the actual growth rate would be a bit higher than that. Yet, the fact is that the Chinese economic growth has apparently turned the corner from a very hyper growth period to a more stable, sustainable period. Now, if that is the case, to what extent can we expect China's growing demand to support the staggering global demand? That is one question.

My second question is about the structural reform problem in China. You said it is now in deep water. One of those problems, as you mentioned, is the widening inequality in Chinese economy and society. This has been already discussed for quite some time, and again very much stressed by Premier Wen Jiabao's remarks two days ago. My question is, what do Chinese elites, including yourself, consider the root cause of this widening gap? Why did this thing start and started to aggravate? I would be delighted to hear your frank observation on that point.

My third and last question is that in your presentation, you said that the internationalization of the RMB is one of the major strategic targets in the long run. And you said that you are preparing three dishes: capital account opening, exchange rate flexibility, and domestic reforms. I would appreciate if you can confide with us how soon those dishes will be served. I'll stop here and let you try to answer these very easy questions.

Gao: Thank you for the wonderful questions and I will try my best to answer. First one is domestic demand. I think you are correct. After the Lehman collapse the 4 trillion stimulus package had actually contributed a lot. But somehow, after a while, it tended to be problematic, because we saw the local government debt accumulated, and because the banks were involved, the problems with banks increased. The Chinese government is worried with all those problems.

Now actually we see the major contributors to the growth in 2011, one was investment, the other, consumption. On investment, Professor Jeffrey Sachs explained days ago in a video conference, why China shouldn't stop investment. He said China should invest more. The problem is that it's not about the size of investment. It is about efficiency. You know there is a vast amount of investment in Eastern area, but in the Western area there is a lot of need. And the different sectors are in imbalance. The biggest problems are pollution and a huge and unsustainable demand for energy and water. All those issues are constraints to more investment. But for the time being, investment will still be a driver, especially in the circumstance of external demand no longer there.

Another one is consumption. I think it is very difficult to expect a quick increase because China is in a process of urbanization, which is just in the beginning, and it will take a very long time. Now I think urbanization is about 50% in China, compared with other developed economies with more than 80%, China is left far behind. To catch up will take time. Also the income inequality between the rural area and the urban area is huge. For example last year increase of disposal income in the urban area was 3.5 times of the rural area, which means that the gap is widening.

Regarding the inequality, as I said the income inequality widened. The roots are very difficult to say because in fact China has enjoyed fast growth for the last three decades. I think the very beginning was the Deng XiaoPing's Southern tour, when, probably you all know, he gave a very famous speech. At that time China was in a transitional stage, from planned economy to market economy. It was a very beginning stage. And Deng had a very famous cat theory: no matter whether the cat is black or white, as long as he can catch a mouse, it is a good cat. Also he emphasized that a few people could get rich. I think in certain period of time, this is very correct, because China overall at that time was very poor. If the policy had to choose between efficiency and equality, at that period of time Chinese policy emphasized efficiency. That's why I said now is the turning point. China needs to look back. The words of "deep water" I used mean that further reform will be difficult. This is my understanding, and I believe China can no longer keep this situation going on.

On the RMB internationalization, yes, I put three dishes. I think actually there could be more because it's so big and complex choices for Chinese policy makers. The RMB internationalization, to some extent, had been very successful, but since last year I think there have been more and more doubts. There are critics on this strategy because some people are really worried that it is so dangerous to open capital account too fast, and it is wrong to put the cart before the horse, because the domestic financial reform should be implemented before the opening. So the three dishes, which one should be served first, I think is very clear. Now there is a road map mentioned by an official lately, although it was not put forward in the official way. It was in an interview to a newspaper, with a ten year plan. It's divided into the three phases. It also contained sequencing layout, including some domestic financial reforms, such as, to liberalize interest rates probably in a gradual manner, and further exchange rate flexibility, because the more open the capital account is, the less independent monetary policy becomes. So, what I would suggest is that all the dishes be better served at the same time, not one by one. If there has to be an order, I think the domestic reform could be served first. Thank you.

Gyohten: Thank you very much. Then I think I'll put some questions to Nakao-san.

I think you are quite right that particularly after the Euro crisis, there has been growing aspiration in Asia for the greater use of their own regional currencies, and you mentioned that it is gratifying to see that various initiatives have been put forth and are being implemented. I would like to listen a bit more concretely about that, particularly putting emphasis on the use of the Yen in this whole context. When you see the role of Asia Pacific in the global economy has been growing so rapidly, it is quite natural to ask why this economic progress is not accompanied by the progress in the currency area. In spite of the very significant role the Asian economy is playing in the world today, we are still dependent on the Dollar in the world of currency. So what is your view on this situation? What prospects do you have for the greater international use of the Yen or the RMB in that respect in the coming years? Although Japan has many structural economic problems, yet the Yen is the only hard currency in the Asia-Pacific region, no others. So I think it is quite natural to expect a greater role of the Yen in the expanding Asian economy.

Another a bit minor question is, you mentioned that as the result of the deleveraging of the European and American banks as the result of this crisis, there would be a role for Asian banks, particularly for Japanese banks to supplant this decline of credit facilities extended by European and American banks. Do you think there is a good and sustainable movement in the coming years? I am asking this because, as you recall, and also I think Guillermo would remember that, after the Latin American crisis in the late 80's, Japanese banks also tried to expand their activities in the Latin American market. To a considerable extent, they did. But that development was not really welcomed by American banks. I think at that time the American banks were quite wary of losing their market share, and also they were not terribly happy to see Japanese banks intruding into their own backyard. So I am wondering how do you assess the situation now? I just make these two questions to you.

Nakao: Well, the Japanese Yen is used for the settlement of trade, 25% of import is in Yen and 40% of export is in Yen-denominated settlement. So we have made a progress. But internationalization of the Yen is not as much as we expected twenty years ago. I think it is because the Dollar is such a convenient currency, especially for big corporations which have business in many countries in the world because they can net out their liabilities and assets, and also network externality and a kind of inertia. But I think it is changing because the intra-regional trade in Asia is growing and especially the presence of China is so large. Our trade with China is much bigger than with the United States now, and I think there is a merit that we can use the RMB or the

Yen for trade. So why I am promoting the RMB use is, because by doing that the Yen can be used together with the RMB and also it can promote financial sector in Japan as well as the Chinese market. So we had a talk with Chinese private banks like Industrial and Commercial Bank of China, and the Bank of China. I think this is a good chance because of Chinese big presence as well as emerging strength of Asian countries, including Korea and ASEAN countries.

About deleveraging and Japanese banks' role, as I said, the Japanese banks have already complemented some shortage of lending especially by European banks. When I talked with executives of Japanese banks, they were very eager to take this as a kind of opportunities to expand their business because they get more profit internationally today than before, and I don't think they would make the same mistakes of the 1980's. At that moment they were not prudent about how much they would pay for the asset. Now they are very prudent. Some of them are still waiting for the bottom price. So I hope this time Japanese banks would regain the territory of international banking. I don't think they should take advantage of it. But this is also helping Asian countries, by financing their investment and trade.

Gyohten: Thank you very much. Any other panelist who wish to make any intervention? Professor Ito, please.

Ito: About RMB internationalization, I think there is a proper sequence to do it. I would put the domestic reform first, and exchange rate flexibility second, and capital account liberalization the last. So many countries have had a wrong sequence and ended up in a crisis, so I hope that China does it in a proper sequence. I am a bit worried about this RMB internationalization. After it was launched there was some pushback by some quarters in some domestic political arena that it meant to push the capital account liberalization. So if RMB internationalization means capital account liberalization, those people didn't like it, and there was some pushback. Now it seems that in the recent months the push for internationalization has come back, and my question would be, "do people understand the proper sequencing of liberalization and is it agreed among different quarters of the political arena to do it in a proper sequence and a speedy manner?"

Gyohten: Do you have anything to respond?

Gao: Just a quick response. I agree with the sequence that Professor Ito put forward. I think this is becoming a consensus, at least, in the academic circles. From the policy perspective, it is a little bit complicated because different sectors have different obligations and I think there could be a compromise. It's probably too soon but there is a positive effect which could push the domestic reform faster. So this is the way I see it and I think the sequence is very clear.

Gyohten: Thank you. Guillermo?

Ortiz: From the other side of the Atlantic and also from Latin America, Mexico specifically, I think we have the impression that China wants to have its cake and eat it too. This currency question is not the exception. They would like to be able to control, or manipulate, however you want to call it, the currency, but also to promote the usage of the RMB as the international currency. I think that is contradiction in terms of essence. I think Prof. Ito's mentioning of sequence is absolutely correct; starting with domestic reform, then the flexibility of the exchange rate and finally the opening of capital account. So if you follow this very sensible sequencing and read a little bit about body politics in China, I think we are not going to see this anytime soon, to answer your last question.

Gyohten: Brendan, do you have anything to add?

Brown: The only comment I would add to the whole internationalization question is, if you regard China's economy as in some extent a bubble and after the bursting of the bubble you typically get private saving surplus rising as happened in Japan in the late 1970's and 1980's. It could be that the internationalization of the Yen is linked to deflecting a trade war with the United States, and the way to avoid that is to accelerate lifting the export capital control so that the trade surplus can be offset by private capital outlet. So part of the issue of internationalization is also related to relationships with the United States.

Gyohten: Okay. We have today discussed about Euro crisis and its aftermath impact on global economy. Although we could not reach any clear and simple answer to the solution of the problem, but I think there was a broad consensus that after all this crisis has to be dealt primarily on three fronts. One is, of course, structural reform efforts of the countries concerned, the second is the variety of financial arrangements including debt reduction and all that, and thirdly some sort of deepening of convergence within Eurozone countries. But none of these three efforts is easy and I agree with Guillermo that after all any of these exercises needs to be measured in terms of 10 years or even more. I think that's quite right. So for some time I am afraid Eurozone will need to, sort of say, muddle through. But, of course, when you use this very common expression, the implication could be different depending on which word you place emphasis. If you place emphasis on "muddle" the situation would be quite different from the case when you place your emphasis on "through." Now, looking at some facial improvement many people are tending to think that emphasis should be placed on "through" but I don't know.

But anyway, I think this Euro crisis, together with a series of other crises we had experienced in the recent past, demonstrates that the world is now entering a new paradigm. In other words, the so-called the "Post-War period" is now over forever. During the Post-War period, in spite of all those ups and downs of world activities, yet I think we had a certain kind of stability because of the global structure of political security and economic issues. But that day is now over, I think we have to admit, because of the global power shift and global dominance of finance and information, we are certainly stepping into a new paradigm. In this new paradigm, if I may, I argue, that there must be some framework which will ensure fair sharing of power, fair sharing of responsibilities, fair sharing of burden and fair sharing of benefit. This will ask all of us around the Pacific-rim countries and also in Europe as well clearly much closer and much more frank exchange of minds and I certainly hope that this small symposium may make even a minor contribution to that goal.

Well, I think the time is just up now and I would like to conclude this session by first of all thanking you, the audience, for your very generous participation and very active involvement. And also my thanks go to simultaneous interpreters who have done a tremendous job and all the other staff who have made this event successful. But, of course, I cannot declare the adjournment of this session without thanking all the panelists for their tremendous contribution and I hope our audience also enjoyed this session. I certainly hope you can join me in making a big applause toward the panelists here. Thank you very much. The meeting is adjourned.

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