真の夜明けに向けて

～世界経済の成長のための政策と課題

Toward a True Dawn

-Challenges and Policies for the World Economic Growth

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

Occasional Paper No.27

IIMA
Institute for International Monetary Affairs

はじめに

いよいよ米国で、世紀に一度の危機への対応として始まった超金融緩和が出口に向かって動き出しました。世界の投資センチメントが変化する可能性がある一方で、実態としてはベースマネーはしばらく増え続けます。日本では日銀の異次元の金融緩和が中間点に差し掛かり、インフレ率2%の達成まで約1年となりました。もちろん、その前には消費税の引き上げがあり景気展開は予断を許しません。インドは、昨年米国の金融政策を巡る市場センチメントの影響を受けたエマージング諸国の代表格であり、これからは潤沢なグローバルマネーを前提としない経済運営を求められます。ユーロ圏は、銀行同盟という一段と強い超国家レベルの統合に踏み込み、中国は市場に資源配分の決定的な役割を任せることを決めました。どの国の政策当局も国民も、来たるべき変化への決意を新たに2014年を迎えたのではないでしょうか。

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、「真の夜明けに向けて～世界経済の成長のための政策と課題」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、国内外から著名な専門家をお招きし、各国経済の現状、政策対応の適合性、他の地域への意図せざる影響の有無、そして個々の政策がうまく進んだときに、グローバル経済はどう変わっていくのかを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。

2014年7月
公益財団法人　国際通貨研究所

Preface

At the beginning of the year 2014, it seems the world economy is struggling to find an economic dawn. The Federal Reserve Board has at long last begun tapering extraordinary monetary easing in the United States. This could impact investment sentiment around the world although the monetary base still keeps increasing for a while. Meanwhile, Japan's extraordinary monetary easing policy has been implemented for one year, and another year remains in the target timeline for achieving an inflation rate of 2%. The consumption tax hike in April from 5% to 8% will be a substantial hurdle to a smooth economic path in 2014. India is typical among emerging countries whose currency has been affected by collapsing market sentiment as speculation of US tapering has built and economic policymakers in India are girding for significantly less global liquidity. Eurozone has made a bold decision in establishing a banking union to step into further supranational integration. China has surprised the world with an historical decision to allow markets to determine allocation of economic resources. Countries around the globe face 2014 knowing that this is a year of challenges that will lead to a new equilibrium. Then how will they face these challenges?

To forecast their developments, prominent panelists from Japan and abroad broadly discussed in our symposium the appropriateness of the present policy responses, policies to be taken in the future, possibility of their unintended effects on other regions and how the global economy is changing if these policies are successful.

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

July 2014
Institute for International Monetary Affairs

パネリストの略歴／Profiles

ハン・デ＝ヨン
ABN アムロ銀行　チーフエコノミスト

Han de Jong
Chief Economist,
ABN Amro Bank

1981 年アムステルダム自由大学を卒業後、ABN AMRO 内外で各種の職務を経験。2000 年から同アセット・マネジメントで投資戦略チームを統括。2005 年から同銀行のチーフエコノミスト。また、アムステルダム自由大学ではマクロ経済学の教鞭をとる。

Mr. de Jong is Chief Economist of ABN AMRO Bank N.V., in the Netherlands. Prior to taking up this position in 2005, he headed the Investment Strategy team at ABN AMRO Asset Management for five years, and held various positions inside and outside ABN AMRO before that. He is a graduate of the Vrije Universiteit in Amsterdam where he teaches macroeconomics.

高　海紅
中国社会科学院世界経済政治研究所 教授・ダイレクター

Gao Haihong
Economics and Politics,
Chinese Academy of Social Sciences

1986 年北京大学卒業。北京大学経済学修士号および英デューラム大学国際金融投資修士号を取得。1989 年中国社会科学院世界経済政治研究所入所、カリフォルニア大学デービス校等で客員研究員を経て、現在は同研究所ディレクター兼中国社会科学院大学院博士課程指導教員。

Dr. Gao joined the Institute of World Economics and Politics, Chinese Academy of Social Science (CASS) in 1989 and once was a visiting scholar at University of California at Davis before taking present post. Currently she is a director and professor of Graduate School of CASS. She obtained MA from Peking University and M.Sc from Durham University in the UK.

黒田　東彦
日本銀行　総裁

Haruhiko Kuroda
Governor,
Bank of Japan

1967 年大蔵省（現財務省）入省。主税局課長、国際局長等を歴任し、99 年財務官に就任。2005 年アジア開発銀行総裁、2013 年 3 月より現職、オックスフォード大学より経済学修士号取得。

Mr. Kuroda joined the Ministry of Finance in 1967 and assumed various senior posts in Tax Bureau and International Bureau before he became Vice Minister of Finance for International Affairs in 1999. Prior to taking up the position of Governor of the BOJ in 2013, he served as president of the ADB. He earned a Master of Philosophy in Economics from the University of Oxford.

ヴィンセント・ラインハート
モルガン・スタンレー　米国担当チーフエコノミスト

Vincent R. Reinhart
Chief US Economist,
Morgan Stanley

フォーダム大学卒業後、コロンビア大学で哲学および文学修士号取得。1983 年ニューヨーク連邦銀行に入行、以後 2008 年に AEI に移るまで、01－07 年の公開市場操作委員会事務局長を含め、連邦準備制度内の要職を歴任。11 年からモルガン・スタンレーの米国担当チーフエコノミスト。

Mr. Reinhart joined the Federal Reserve Bank of New York in 1983 and held several positions there and senior positions in the Federal Reserve including as Secretary and economist of Federal Open Market Committee during 2001-07. He joined Morgan Stanley in 2011 after serving for the AEI as a resident scholar. He received a M.Phil. and M.A. from Columbia University.

ドゥヴリ・スバラオ
インド準備銀行　前総裁

Duvvuri Subbarao
Ex-Governor,
Reserve Bank of India

1972年 インド工科大学卒業後、インド財務省、アーンドラ・プラデシュ州財務長官等の政府部門を歴任、94－2004年には世界銀行リードエコノミストを務める。2007年 インド財務次官、2008年から2013年までインド準備銀行総裁を務めた。1998年 アンドラ大学より経済学博士号取得

Dr. Subbarao was Governor of the Reserve Bank of India during 2008-13. Prior to that he was Finance Secretary to Government of India (2007-08), Secretary to the Prime Minister's Economic Advisory Council (2005-07) and Lead Economist in the World Bank (1999-2004). He was alternate Governor on the Boards of Governors of both the World Bank and the IMF. He studied at the prestigious IITs in India and at MIT in the US and earned his PhD from Andhra University in 1998.

(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。

Mr. Gyohten 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 became Vice Minister of Finance for International Affairs in 1986. He taught at Princeton University and Harvard University before he was named 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 年以降三菱 UFJ フィナンシャルグループ専務取締役、日印経済委員会常設委員会委員、APEC Business Advisory Council（ABAC）の日本委員を務めた。2008 年より国際通貨研究所専務理事を務める。

Mr. Watanabe graduated from the University of Tokyo in 1970 and joined the Bank of Tokyo and served for many overseas businesses. He was Senior Managing Director of Mitsubishi UFJ Financial Group in 2005. He was also Chairman for the Standing Committee of Japan-India Business Cooperation Committee and a committee member of the APEC Business Advisory Council (ABAC) representing Japan.　Since 2008, he has been managing director of the IIMA

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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.27

The 23rd International Financial Symposium

Toward a True Dawn

\- Challenges and Policies for the World Economic Growth

March 19, 2014 Keidanren Kaikan

Institute for International Monetary Affairs

Contents

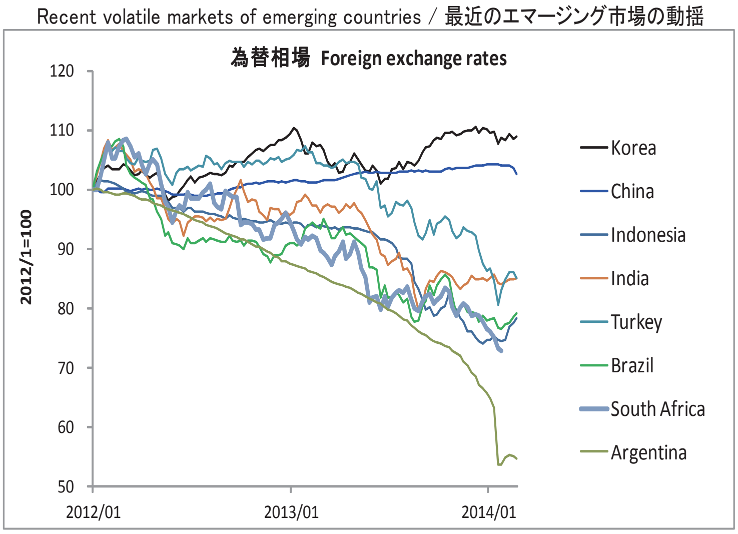
1. Opening remarks
Yoshihiro Watanabe, Managing Director, IIMA

Honorable panelists and audience, good afternoon! Thank you for joining us in our International Financial Symposium. Your presence here is very much honor and pleasure for us. Today's title of discussion is "Toward a True Dawn-- Challenges and Policies for World Economic Growth --." We would like to confirm if the global economy is finally coming back to the normal phase.

Before we listen to the speeches and discussions of the panelists, I would like to present a brief overview of the global economy so that we can have a common background of discussion.

1. Market reaction to the US tapering

Recent volatile markets of emerging countries / 最近のエマージング市場の動揺

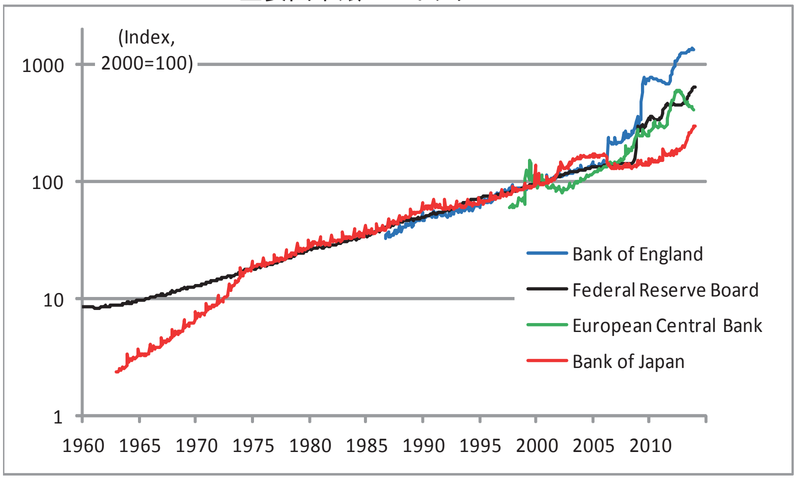


(Source) Datastream

The year 2014 has made a shaky start. The first news was a bad one from Argentina. Its currency dropped by 20% in a few days in January. Although weakness and problems are different by country, this caused many currencies of emerging markets to fall rapidly. Such uncertainty in the financial markets is often associated with the change of the US monetary policy, so called "Tapering."

2．Extraordinary monetary easing and its intended effects

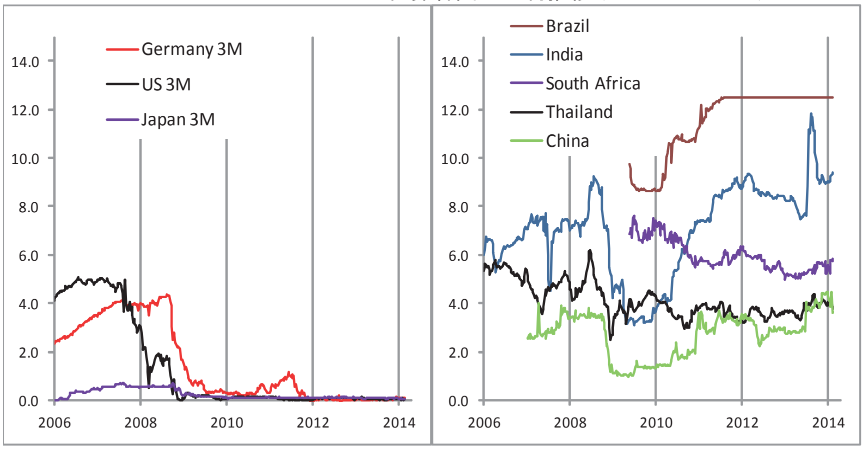
Monatary base of Major Central Banks
主要国中銀のマネタリーベース



(Source) FRB, BOJ, datastream

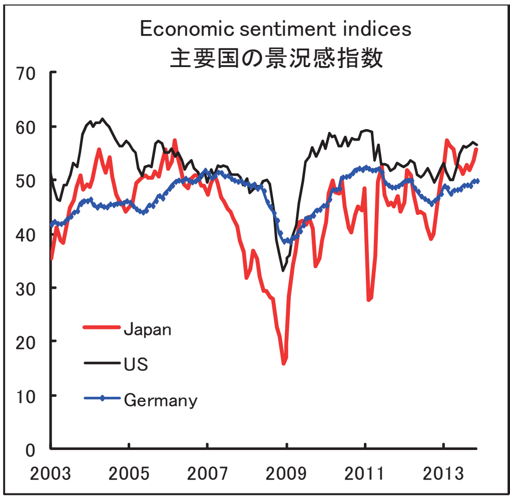
Central banks of the US and Europe made big steps to increase the supply of monetary base in unconventional ways. As you see on the chart, they started extraordinary quantitative easings several years ago and Japan joined this trend since last year.

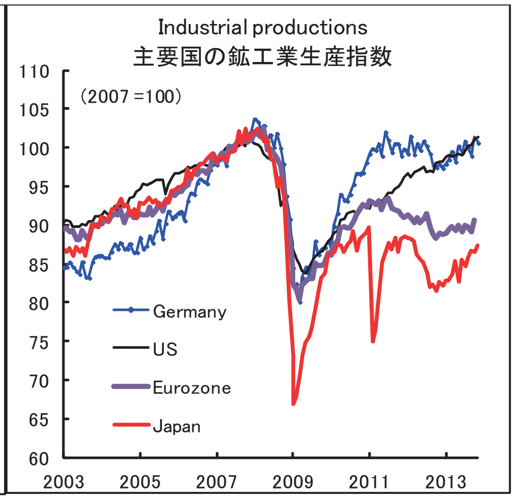
Interest rates of the world / 世界各国の金利推移 (Interbank 3M/S)



(Source) Datastream

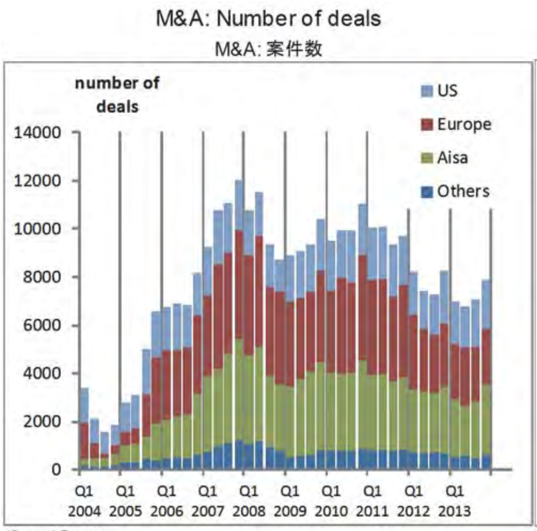
The result is that hard currencies such as the US dollar, the Euro and the Yen have been supplied to the world at historical low costs, while emerging countries are trying to find appropriate levels of interest rates to steer the economies, seeking for a desirable balance between growth and inflation.





(Source) Datastream

Thanks to the central banks' efforts of advanced countries, "recovery" has been observed in many indicators. Consumer confidence is coming back to well above the crisis year. Corporate activities in Germany and the US are almost the same level as in the pre-crisis time. The Eurozone and Japan are half way back to the pre-crisis level.



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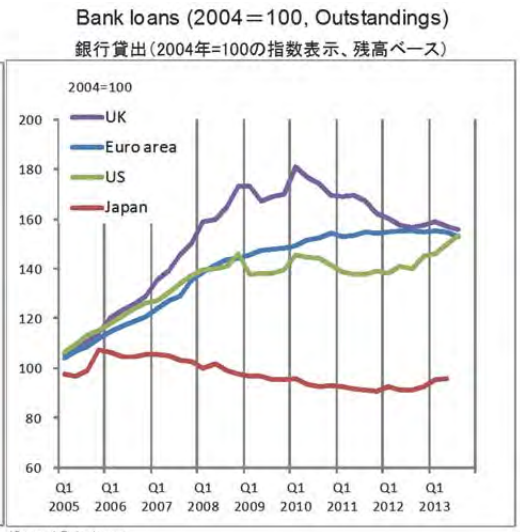


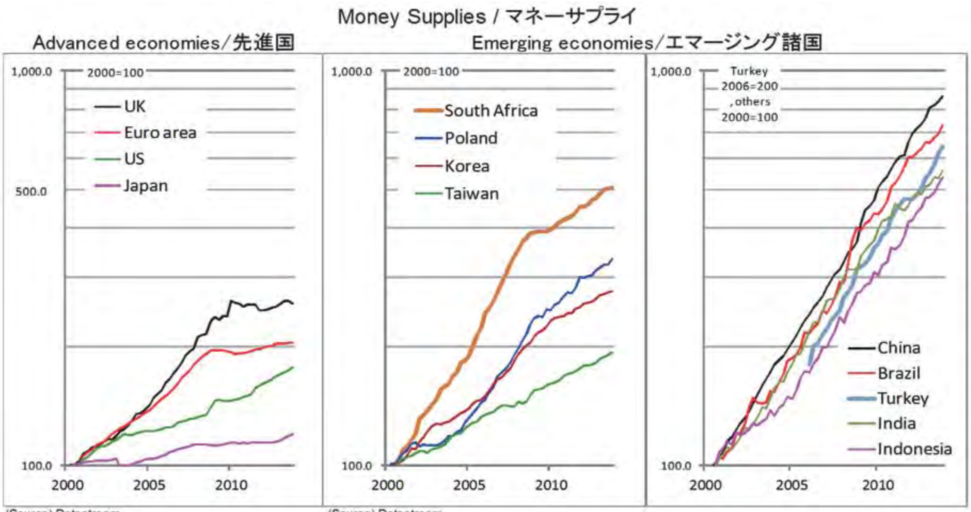
(Source) Datastream

Revived corporate confidence and financial function are reflected on the recent increase of M&As almost all of the world. Unfortunately, banking sectors in Europe are still in a process of de-leverage. US and Japan banking sectors have been picking up since almost two years ago.

3. Its unintended effects

Now, let's move to the emerging countries. After the initial impact of the Lehman

Brothers shock in 2008, emerging currencies have been appreciated in general. Behind such a market development, there were a sufficient supply of cheap money and an optimistic expectation for a strong economic growth of those economies.



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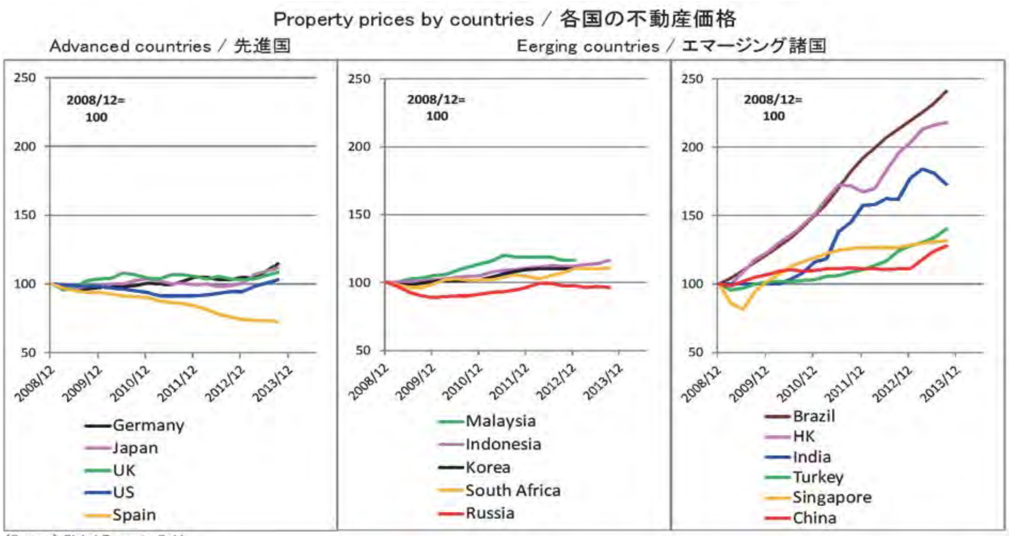
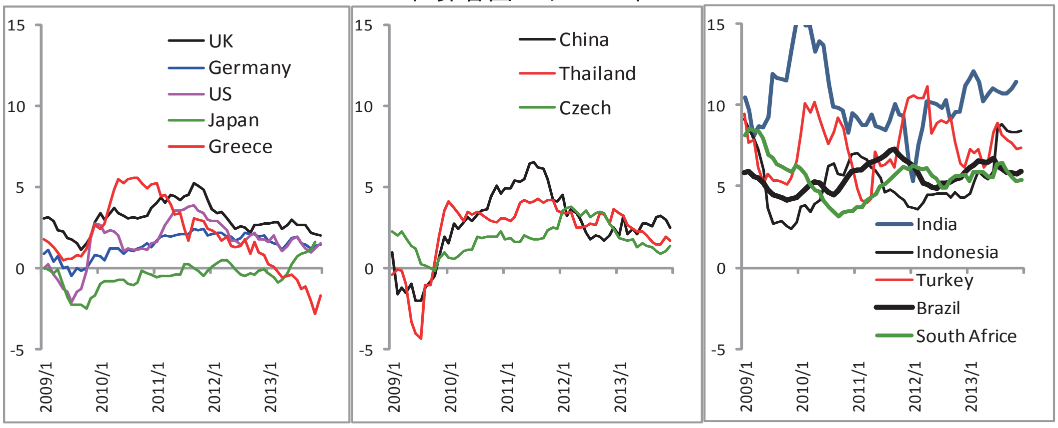
The result was soaring money supplies in emerging countries. This expansionary monetary development has given rise to strong domestic demands followed by increase of money supply again by credit expansion. This positive development of money and demand is now reflected on the prices of property and general cost of living.



(Source) Global Property Guide

Some countries experienced a surge of property prices almost as much as double, while some residential and commercial property markets in the advanced countries have undergone an adjustment.

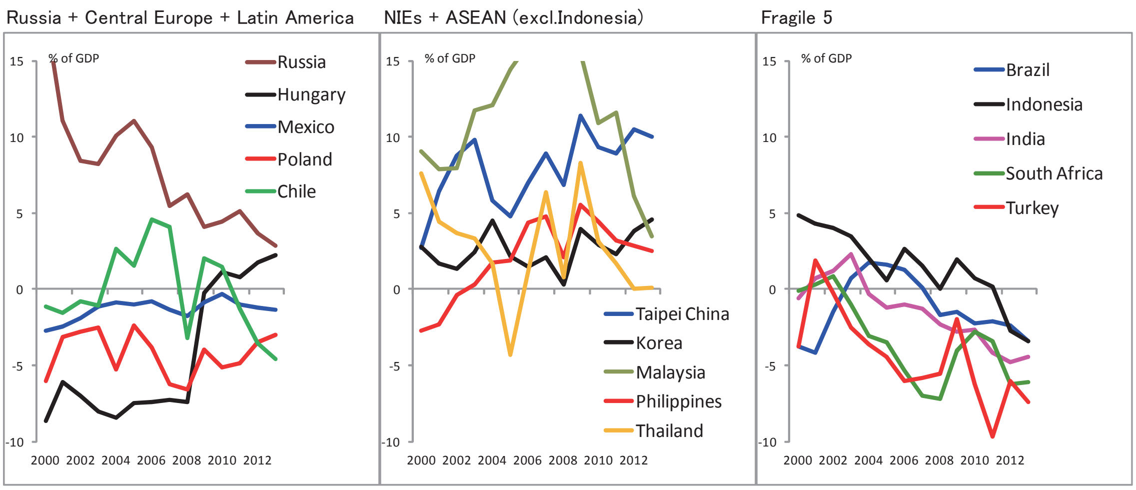
Inflation of major countries
世界各国のインフレ率



(Source) Datastream

Looking at inflation, a clear tendency is that countries with strong monetary growth have a higher inflation rate excluding China. Inflation rate between 5 and 11% are not a hyper one like two decades ago. But compared with a very low level of advanced countries inflation, it is high enough to receive a devaluation pressure on its currencies.

Current Account 経常収支 (% of GDP)



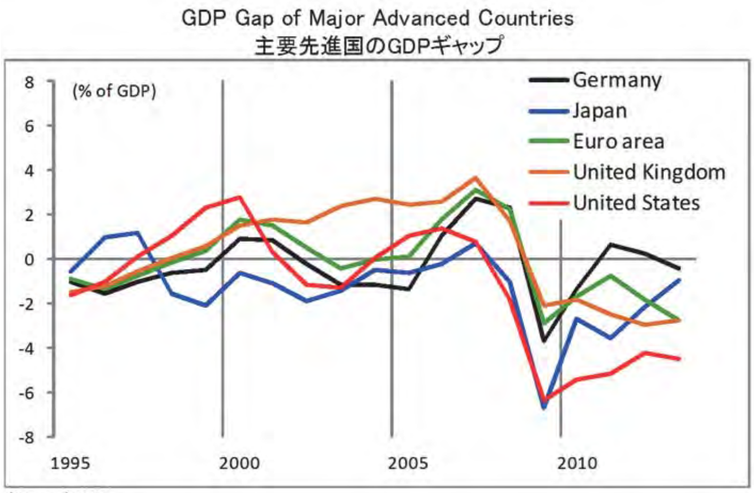
(Source) IMF

Those high inflation countries show a large current account deficit. And this is the point where the speculation on the downfall of foreign exchange rates came from.

Back to the start of my story, depreciation of foreign exchange rates in some countries was quite a logical outcome. It is a typical chain reaction of monetary expansion, strong domestic demand, inflation, current account deficit and then adjustments of foreign exchange rates as a final outcome.

4. What should be worried?

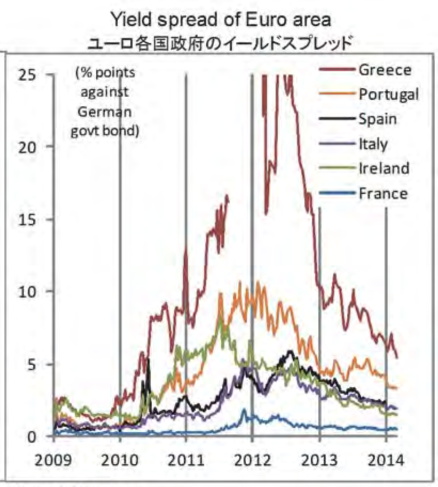
Although the current fragile market is regarded as a natural result of economic development, some uneasy feelings remain in the investors' mind. What is wrong? I would like to point out two things.



(Source) IMF

One is a concern that not a few investors are still unconvinced on the recovery of the US economy. Although the FRB believes the US economy is strong enough to start tapering, the GDP gap still remains deep in a negative position. So is the gap of UK and the Eurozone, too. Is the economy of the advanced countries really recovering well enough for ending the extraordinarily loose monetary policy? We do not know the answer yet.

(Source) Datastream



(Source) Datastream

The other is a concern over optimism in some markets. Although the tapering has made the sentiment of global investors more cautious, it is actually a mere slowing of the expansionary speed of monetary base. Global Money will be still increasing for the time being and we are still in the time of abundant supply of liquidity. In such a market circumstance, investors may start again investment like a herd. It might happen in the stock market of US or Japan. It might be in the government bond markets in the Eurozone. Or it might be somewhere else.

Besides, there are many country specific issues which may have a global impact, such as shale gas revolution in the US, shadow banking problem in China or newly emerging geopolitical uncertainty in Asia and Europe. In particular, geopolitical risks are becoming a bigger concern so that as any incident could affect seriously on the global economic sentiment.

In short, we are still in the middle of uncertainties mixed with optimism and pessimism. What will happen next and how should we prepare for it? Let's listen to the live voice of opinion leaders, policy maker of today's honorable panelists. I will stop here and please enjoy the symposium.

Thank you very much.

2. Opening of Symposium
Toyoo Gyoten, President, IIMA

Seven years have already gone by since the onset of the crisis. It was indeed a major financial crisis. Against the background of the globalized finance and trade, no country could escape from the Tsunami of contagion. Therefore it is encouraging to see that in many countries contraction of finance and demand has hit the bottom and the macro-economy began to show a sign of recovery.

We cannot, however, afford to be complacent. None of us has yet to clear ourselves out of the aftermath of the crisis. On top of the direct damage caused by the crisis all of us have had endemic problems we have to attack. In fact the situation varies from one country to another. In some countries the night is still very dark before the dawn.

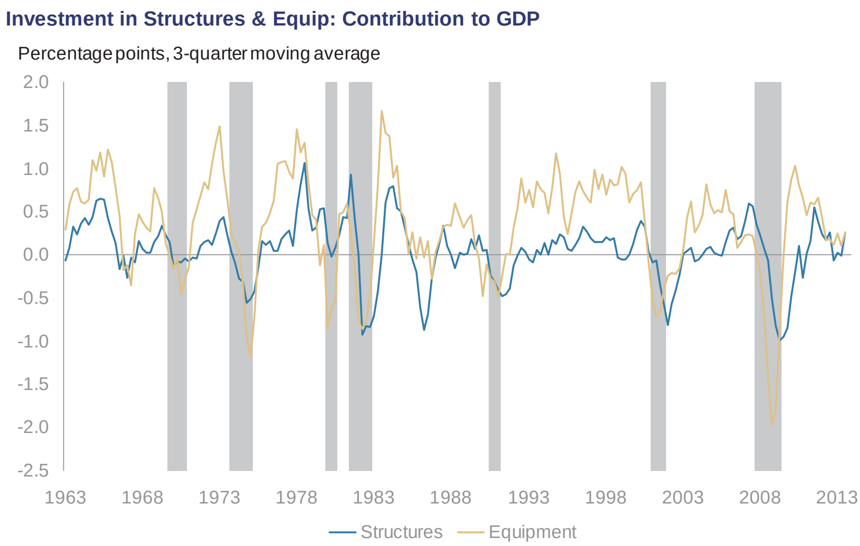
It is, I believe, quite opportune to organize this symposium with a view to collect insight on the situation and problems of major countries and explore the direction of desirable common endeavor. We are extremely fortunate to have been able to welcome an excellent group of panelists to this occasion. I am sure they will provide you very rich food for thought.

3. The US Outlook in Brief
Vincent R. Reinhart, Chief US Economist, Morgan Stanley

The changeable, often harsh weather in the US has been hard to bear and obscures near-term economic trends. At Morgan Stanley, though, we have the advantage of being data collectors as well as observers. Our AlphaWise Macro team regularly assembles a wide range of high-frequency data on spending, activity, and employment to assess aggregate economic momentum. Their source material shows the geographic footprint of weather effects. Domestic spending, it appears, retains vigor underneath the recent crust of ice.

In our forecast, real GDP is expected to move up to a growth channel centered around 2-3/4 percent for this year and next. True, weather disruptions weaken the first-quarter outcome. But the economy rebounds like an uncoiling spring on the expression of pent-up demand in the second quarter. On average, real GDP expands at 2.7 percent this year and only a touch slower in 2015.

Four forces support this 2-3/4 percentage point cyclical pickup. First, now that there is a budget deal, fiscal policy will not be the drag on growth it was in 2013. The contribution of government spending to GDP growth is not expected to be deeply negative. Second, the financial crisis of 2008-09 was a tectonic event reshaping the economic landscape, but we are leaving that territory behind us. Evidence of healing comes in the form of wealth creation: equity price gains, piled atop house-price appreciation, have added the equivalent of three-quarters of a year's income to household wealth over the past 1-1/2 years. Third, as a consequence of this wealth creation, personal consumption expenditure is supported and sentiment improves. Fourth, with firms racking up sales and expecting more, capital spending should amplify this impetus. Cash on their balance sheets is ample to fund a newfound enthusiasm for fixed investment. Meanwhile, US success in oil and gas extraction keeps investment in structures at a torrid pace.

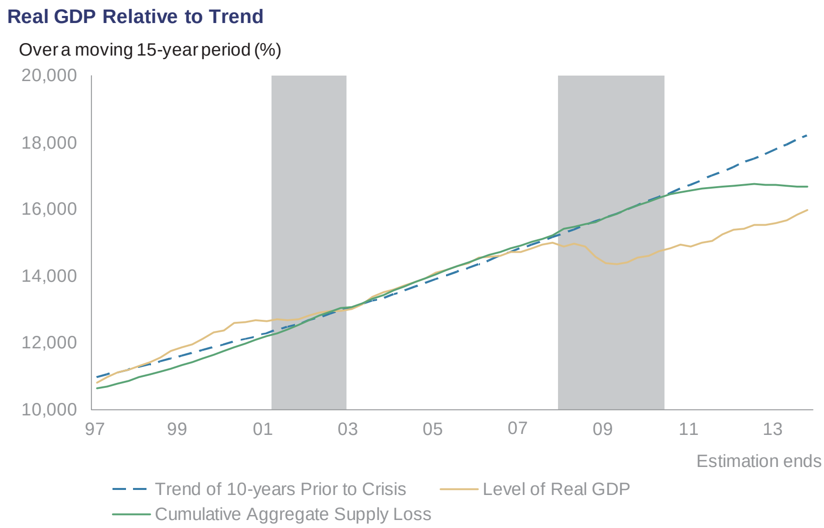


Source: Bureau of Economic Analysis, Morgan Stanley Research

Once past weather disruptions, we expect job gains to clock in at 200,000, on net, each month. A significant portion of the decline in labor force participation owes to secular forces, but there is also some cyclical element to unwind, slowing the descent of the unemployment rate. Still, with the unemployment rate forecast to be around 5-3/4 percent by year-end, the economy will have worked off resource slack.

Central to the conversation about the economy in 2014 will be an assessment of the level and growth rate of aggregate supply. The financial crisis and subsequent poor economic performance took a long-lasting toll on both.

Actual real GDP is 12 percent below the trend predicted by the experience in the ten years prior to the crisis. Our reading is that 8 percentage points of the difference owes to a reduction in potential real GDP, consistent with a rise in the natural rate of unemployment to 6 percent and a decline in the level of productivity. In addition, about 1/2 percentage point was shaved from longer-term growth, slowing the expansion of potential output to a 2 percent pace. The degree of slack drives the Fed's tactical decision on the path of the policy rate, while the rate of potential output growth sets where that path ultimately ends—the equilibrium real federal funds rate. In models of the sort that Fed officials rely upon, trimming ½ percentage point from longer-run growth lowers the equilibrium real federal funds rate at least as much.



Source: Bureau of Economic Analysis, Morgan Stanley Research

The Yellen-led Fed, however, will not be in any hurry to get there. In fact, we think 2014 will be the year that the Fed rediscovers that inflation is low. Core PCE inflation opened the year almost 1 percentage point below the Fed's long-run goal of 2 percent. While Fed officials almost surely think aggregate supply is more ample than we do, they are right that resource slack should prevail over most of 2014. In our forecast for 2015, real GDP surpasses potential output, but the force of excess demand exerts only weak impetus to inflation. With the Fed showing itself to be the first G-4 central bank heading for the exit and emerging market economies expected to stabilize at a lower growth rate, the dollar should strengthen and commodity prices stay subdued. In our forecast, inflation moves up slowly over the next seven quarters, tracking below the Fed's goal throughout.

With the Fed short of its inflation goal and wrong in its assessment of maximum employment, the nominal fed funds rate should remain pinned to its zero lower bound through this year and next. Indeed, we have penciled in the first rate hike for early 2016.

Our economic forecast provides a smooth runway of declining asset purchases of $10 billion per FOMC meeting—the taper. The reality is that a majority of Fed officials already lost their faith in quantitative easing by early 2013. By October, net purchases end, with the Fed's balance sheet leveling out at around $4-1/2 trillion.

Two aspects of this US outlook worry me from the perspective of my temporary perch in Japan. As the Bank of Japan is well aware, a central bank does not create extra output. Monetary policy "borrows" it, either internationally from its trading partners by keeping the value of its exchange rate depreciated or intertemporally from the future by keeping real interest rates low.

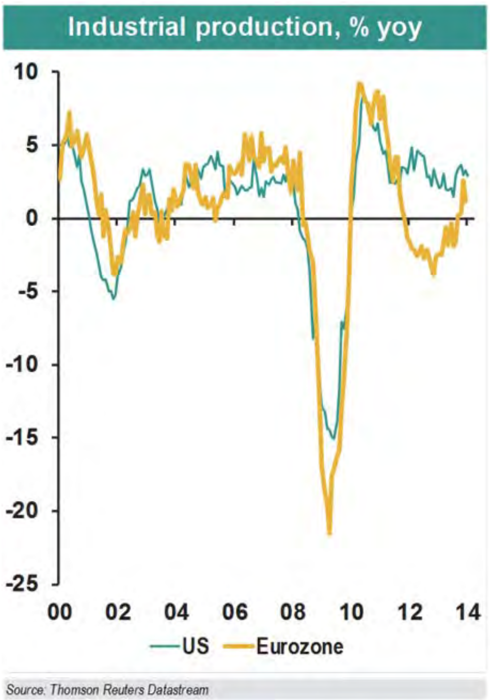
The US might prove an unhelpful policy partner if the best we get in an election year is a tepid cyclical expansion. As for the international mechanism, the US Treasury might push back against dollar appreciation, even if a partner's currency is depreciating because of the same monetary policies earlier employed by the Federal Reserve. As for the intertemporal mechanism, there will be no extra output to borrow from the future if structural reform stalls. Do not count too much on speedy and significant progress on trade reform, via the Trans Pacific Partnership, as a lever to open up domestic industries.

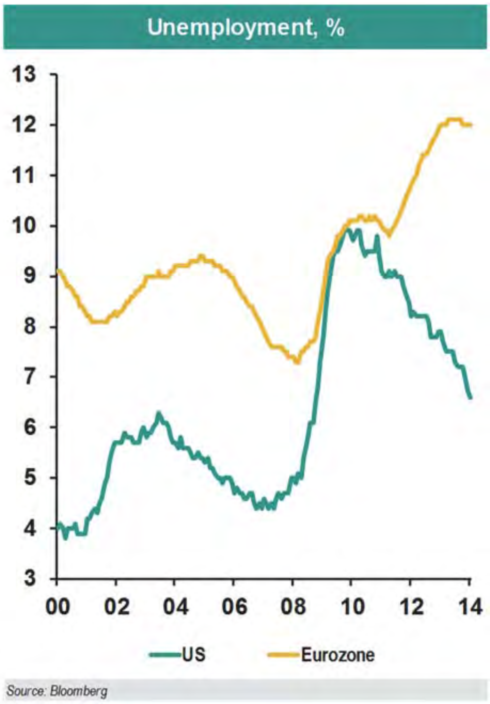
4. Europe after the crisis: the potential for positive surprises
Han de Jong, Chief Economist, ABN Amro Bank

Thank you, Mr. Gyohten, for your kind introduction and thanks to the organisers of this meeting to invite me to highlight what is going on and what is in store for Europe.

The European economy has been an underachiever for a considerable length of time. Its growth performance in recent years has been strikingly poor. Many countries around the world were drawn into a deep recession when the credit crisis erupted in 2007/2008. But few fell back into recession after the 2009/2010 recovery. Europe did.

The European business cycle typically follows the US cycle, with a lag. This pattern tends only to get interrupted when either the US or Europe is hit by a shock that the other economy somehow does not experience. While the US continued to grow after 2010, Europe experienced another painful downturn. The question is why?





Many economists think that European governments implemented far too much austerity. However, looking at the development of structural budget deficits, this view is hard to substantiate. In fact, the US government's structural deficit improved more during the 2011-2013 period than the same deficit for the eurozone countries combined, suggesting that the US economy actually experienced more restrictive budget policies than the eurozone.

A more likely explanation for the eurozone's cyclical trouble is the stress that developed in Europe's financial system in the course of 2011. The messy, 'voluntary' debt write-down on Greek government bonds and the fear that the euro might fall apart triggered bondholders to sell their bonds of other, perceived weaker countries. As a result, bond yields in, for example, Spain and Italy rose sharply. This pushed up borrowing costs throughout these economies and put further pressure on their banks. It was the nail in the coffin for the fragile recovery.

If Europe is to find the road again to proper economic growth, its strategy must consist of two elements. First, it must restore stability and strengthen confidence. This is a necessary but not sufficient condition for lasting growth. The second part of the strategy must be to improve economic efficiency and raise potential growth through structural reform.

If the euro crisis demonstrated one thing, it was that the monetary union itself had serious shortcomings. In essence, there was no adequate governance structure to make sure that economic policies in the member states gave sufficient consideration to the implications of membership of a monetary union. Several countries lived beyond their means after the introduction of the euro. They were enabled to do so by the capital inflows they enjoyed and there was no eurozone authority correcting these errors. Very large external deficits in a number of countries were a clear warning signal, but the signal was ignored. When these economies were hit by a sudden stop of capital flows, a painful adjustment became inevitable.

The eurozone needed three things at once: a significant reduction of imbalances, more economic growth and a new and improved governance structure. It is hard to see how policymakers could deliver all three at the same time. Commentators arguing that the US policymakers did a much better job than their eurozone peers are right, but they do not make allowances for the fact that the necessity to rebuild the governance of the monetary union made life for the eurozone policymakers considerably more challenging. In addition, the imbalances in some countries were also considerably larger than in the US. For example, Spain's external deficit amounted to over 10% GDP just before the crisis.

Initially, policy efforts were aimed at "fire fighting". This was a phase of trial and error, and new fires seemed to pop up constantly. The correction of imbalances demanded painful policy adjustments in troubled countries and financial support from the stronger ones. Public sentiment became very resentful in both sorts of countries.

Gradually, plans for a more adequate governance regime took shape. The initiatives can be grouped in four categories:

- Budget surveillance
- Macroeconomic policy coordination
- Financial support mechanisms
- Banking union

As far as budget controls are concerned, a comprehensive set of new arrangements was developed. Countries have now signed up to a much stronger commitment to keep budget deficits under control, and the cooperation between countries and the European Commission is much more 'intimate'. The question remains what can be done about countries failing to comply. While the new arrangements provide for the possibilities of fines for individual countries, it remains to be seen how effective these will be. Coercion, peer pressure and constant nagging by the European Commission would appear to be the real drivers of this process.

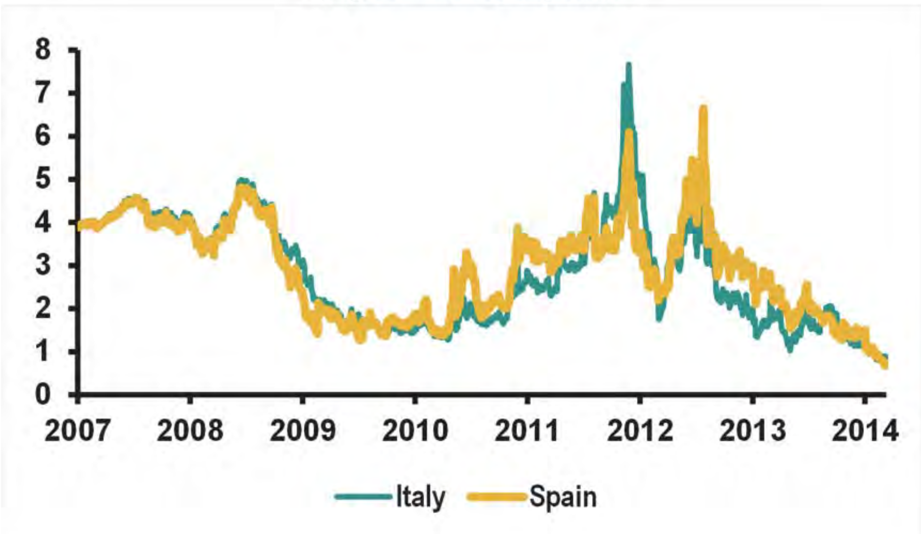
The so called Macroeconomic Imbalances Procedure (MIP) is one of the key elements of macro policy coordination. In this procedure, countries are assessed on 11 economic indicators. The idea is to identify imbalances before they go out of control. The European Commission can give policy recommendations to countries to address these imbalances. Interestingly, in the 2014 cycle of the MIP, the European Commission included Germany as a country with imbalances. In particular, its large and persistent external surplus was analysed. The Commission concluded that the surplus does not only reflect Germany's strong competitiveness, it also argued that domestic demand is too weak for Germany's own good. The Commission identified poor public investment in infrastructure and low private investment as threats to

Germany's longer-term economic outlook. The Commission also recommended measures to improve incentives for people to work and to make the services sector more efficient. The recommendations are, unfortunately, somewhat vague and are not expressed with much assertiveness or urgency.

Five countries (Greece, Ireland, Portugal, Spain and Cyprus,) have so far received financial assistance from the troika of IMF, ECB and the Commission. Initially, temporary arrangements were set up to provide this assistance. All these arrangements were merged into the European Stability Mechanism in 2012, the permanent rescue fund.

The European Central Bank also played its role, particularly after Mario Draghi took over the presidency. The ECB supplied massive liquidity to the financial system late in 2011 and early 2012 to try and ease the stress in the system. It worked to a degree. In July 2012, the ECB President stated that the ECB was committed to do, within its mandate, whatever necessary to preserve the euro. The ECB backed up those words by launching the Outright Monetary Transactions (OMT). This facility allows the ECB to buy government bonds of countries in distress, but only on the basis of strict conditionality. Together with improved economic policy this was enough to convince markets. And while not a penny has yet been spent under the OMT, stress started easing on a, so far, lasting basis.

2yr government bond yields, %



Source: Bloomberg

While the ECB has engaged in some quantitative easing, it has so far lagged other main central banks as regards size. This is partly the result of the reluctance in Germany to accept such policies, for fear that they are inflationary. By taking this position, the ECB is risking deflation. In my view, the risk of painful deflation is limited for the time being as the economy is now picking up and income growth is strengthening. But the surprising strength of the euro is most likely a by-product of the ECB's relatively hawkish stance.

The purpose of the banking union is to rebuild confidence in the banking sector, eliminate fragmentation, but in particular to break the vicious mutual relationship between financial problems of sovereigns and of banks. The banking union must therefore also limit the costs of bank failures for the taxpayers and place that cost with bank creditors. The banking union is a complex project consisting of a single bank supervisor, a single resolution mechanism and a deposit guarantee system. The ECB will be the bank supervisor, and will assume full responsibility in November. The regulatory framework for the resolution mechanism and resolution authority is being debated now. While considerable differences of opinion exist, these negotiations are nearing completion as all parties involved have the intention that the resolution arrangements will come into force next year and they still need to be written into national legislation in all member states.

The deposit guarantee system is at an earlier stage of discussion and it is still not clear what will happen in this area.

A couple of observations are in order here. First, the governance that has been and still will be built is undoubtedly imperfect. Some elements will be effective, others not. In years to come plenty of tweaking and fine-tuning may occur. Second, what has been achieved is impressive. It is remarkable how much progress has been made over a relatively short period of time under difficult circumstances. Huge market pressure and the threat of a collapse of the euro, have undoubtedly contributed greatly to a keen sense of urgency. Third, the strengthened governance represents a significant deepening of European integration. It is remarkable that this could happen against a background of increased hostility towards further integration among a large part of the public. Now that the economy is showing a cyclical improvement perhaps euro scepticism will ease.

Bringing stability and confidence in the eurozone and its institutional setup is important, but not sufficient for a return to lasting growth. The eurozone's fundamentals are actually not so bad. Budget deficits are much reduced and public debt is smaller than in the US, let alone Japan. The current account of the balance of payments is showing a modest surplus. The corporate sector is relatively healthy on an aggregated basis although there are large differences between countries and also between sectors. Europe's real problems are the low (potential) growth rate, its high unemployment and the lack of clarity over the strength of its banks. On that last point, more clarity should appear this year as the biggest banks are currently subject to an Asset Quality Review before the ECB takes over as supervisor. New capital will have to be found where shortfalls are identified.

The issue of growth and employment is a matter for reform. In league tables on competitiveness, such as the World Economic Forum's World Competitiveness Report, as well as entrepreneurial environment, the eurozone scores are mixed. Some countries tend to do well, but others hold only very modest positions in these tables. And despite reform efforts in recent years, eurozone countries have so far failed to rise in these tables. Nevertheless, considerable reform has been implemented in several countries. This is true particularly for countries that were forced to implement such reform as part of the conditionality attached to financial support packages. This applies especially to Spain and Portugal. Encouragingly, the economies in these countries are now turning. Growth is coming back and confidence is rising rapidly. It is a long way yet to bring unemployment to more bearable levels, but progress is undeniable. Italy and France are the two concern countries. They could not be forced to adopt reform measures. As their economic performance is now clearly falling behind, perhaps their policymakers will change course. The increased scrutiny and encouragement (nagging) by the European Commission will also help. The French President gave a dramatic press conference in January this year, in which he announced a 'radical policy shift'. A Responsibility Pact is currently being negotiated between the French government, employers and trade unions. Perhaps this could be a start to meaningful reform.

On balance, I feel that the eurozone economy has a very good chance to exceed expectations in the years to come. That is partly because expectations are very low, but also because of progress being made on the policy front. The governance structure of the euro has been decisively strengthened over a relatively short period of time, although this process has not yet been fully completed. The problem with structural reform is that the glass is always half full and half empty at the same time. In countries such as Spain and Portugal the glass is certainly filling up. That must be an encouragement for other countries to follow suit.

Thank you for your attention.

5. Overcoming Deflation with Quantitative and Qualitative Monetary Easing

Haruhiko Kuroda, Governor of the Bank of Japan

It is my honor to be an invited panelist at the International Financial Symposium hosted by the Institute for International Monetary Affairs.

The theme of the symposium is the important issue of challenges and policies for world economic growth. Looking at the current situation of the global economy, it has finally overcome the financial crisis following the Lehman shock and has recently been heading toward recovery on the whole. However, the pace of recovery remains moderate and a risk of the euro area and other advanced economies tumbling into deflation has been noted. I do not think that such risk is significant because medium- to long-term inflation expectations are anchored at the levels central banks are aiming at. *Inflation expectations* is the key term in Japan's experience of deflation and challenge toward overcoming deflation, which I am going to talk about now.

In retrospect, a series of events since the second half of the 1990s -- such as banks' nonperforming loan problems, the Asian currency crisis, the Lehman shock, and the Great East Japan Earthquake -- weighed strongly on Japan's economy. In addition, a variety of factors put direct downward pressure on prices, such as low-priced imports from emerging economies and firms' low-price strategies to counter intensifying competition stemming from deregulation. In response, the Bank of Japan implemented a series of unconventional monetary policies ahead of other central banks around the globe, such as the zero interest rate policy, the quantitative easing policy, and forward guidance. With these policies serving to stimulate economic activity, the economy headed toward recovery from time to time. However, these policies failed to put an end to the trend of a price decline. Rather, people's inflation expectations declined as deflation became protracted, and deflationary expectations -- a sense that prices would not increase -- became entrenched.

In a world in which deflationary expectations are entrenched, the holding of cash or deposits becomes a relatively better investment strategy, and firms' incentives to launch new initiatives through investing in business facilities and in research and development become reduced. Thus, Japan's economy was deprived of vitality and this generated a vicious cycle in which the low vitality made it more difficult to overcome deflation. Due to its long persistence, deflation has become a challenge that is more and more difficult to overcome.

In order to escape from such a situation, it has become necessary to pursue a policy that quickly and drastically changes people's sense that prices will not increase. To that end, what was introduced as a prescription last April was quantitative and qualitative monetary easing (QQE). This policy differs from the Bank's past monetary easing policies, as well as monetary easing policies implemented by major central banks overseas, in that its policy effects focus on dispelling deflationary expectations by directly working on people's expectations; in other words, on raising people's inflation expectations.

The QQE comprises two elements. First, to eliminate deflationary expectations that were entrenched among firms and households, the Bank showed its determination that it would definitively overcome deflation through a strong and clear commitment. The Bank clearly stated that it would "achieve the price stability target of 2 percent in terms of the year-on-year rate of change in the consumer price index (CPI) at the earliest possible time, with a time horizon of about two years," and thus clearly specified the period in which it would achieve the target. Second, given that deflation had continued for a long period, even with a strong commitment, it was difficult for the Bank's strong determination to be viewed as convincing without any underpinning measures in place. The Bank therefore decided to double the monetary base in two years, and to achieve this it decided to massively purchase Japanese government bonds (JGBs), including those with longer remaining maturities. So far, the Bank has been pursuing the decided provision of the monetary base, and the year-on-year rate of increase in the monetary base was about 55 percent in February. The monetary base is expected to reach about 56 percent of nominal GDP at the end of this year. This far exceeds the current ratio of 22 percent of the Federal Reserve in the United States and 22 percent of the Bank of England in the United Kingdom, and is an unprecedented monetary easing.

The key to the QQE's transmission mechanism is the lowering of real interest rates. By raising inflation expectations through a clear commitment and underpinning large-scale monetary easing on the one hand and containing nominal interest rates through massive purchases of JGBs on the other, real interest rates will be lowered, thereby generating the effect of powerfully stimulating economic activity. As the real economy improves due to such stimulus, the actual inflation rate will rise, which will lead to a further rise in inflation expectations: such a virtuous cycle can be expected to operate.

Is such a mechanism actually at work? So far, the QQE has been steadily exerting its intended effects. Surveys on various economic entities and break-even inflation rates have suggested a rise in inflation expectations on the whole. As for nominal interest rates, in contrast with other advanced economies in which long-term interest rates have been rising in tandem with economic recovery, Japan's long-term interest rates have been hovering in a stable manner at an extremely low level of around 0.6 percent.

Under such financial conditions, Japan's economy has continued to recover moderately in association with a virtuous cycle among production, income, and spending. On the price front, the year-on-year rate of change in the CPI excluding fresh food was negative when the QQE was introduced but has since improved, registering a positive figure of around 1¼ percent in the latest data. One year has passed since the introduction of the QQE, and we have reached the midpoint of "about two years" that we specified. So far, Japan's economy has been following the path toward achieving the 2 percent price stability target as expected, and we have become increasingly confident that the anticipated transmission mechanism of the QQE is actually working.

In Japan, two rounds of consumption tax hikes are scheduled. Based on the experience of the economy going into recession when consumption tax was raised last time, in 1997, there are some concerns that the same might happen again. However, looking at the economic conditions of that time, the economic growth rate plunged immediately after the tax hike but subsequently showed signs of recovery. The economy seemed to have instead been affected substantially by a series of failures of Japanese major financial institutions and by the Asian currency crisis that took place just when the economy showed nascent recovery. By contrast, at present, Japan's financial system has been maintaining stability and emerging economies have become more resilient against negative shocks. The current conditions are quite different from those in 1997. Taking these differences into account, the Bank believes that, even assuming two consumption tax hikes, the virtuous cycle in the economy will not be interrupted and Japan's economy will continue to grow above its potential growth rate as a trend.

To conclude, let me briefly touch on one of the challenges that lies ahead; namely, how prices and wages will be set when we achieve 2 percent inflation in a stable manner. The Bank is committed to continue with the QQE as long as it is necessary for maintaining the 2 percent price stability target in a stable manner. We are aiming at an economy and society in which actual inflation rates will be around 2 percent on average, and in which firms and households will behave on the assumption that prices will increase by about 2 percent. In the United States and Europe, people's medium- to long-term inflation expectations have been anchored at about 2 percent, and the setting of prices and wages based on these expectations has been firmly established. We would like to achieve this in Japan as well. On this point, there have been encouraging developments in annual wage revisions for next fiscal year. We are paying close attention to how the wage decision framework based on the assumption of price rises will be created.

The QQE, which I have talked about today, holds the huge challenge of raising inflation expectations through monetary policy. So far, with the policy exerting its intended effects, Japan's economy has been stepping toward achieving the 2 percent price stability target as expected. Of course, we are only halfway there. The Bank will steadily pursue the QQE to overcome as soon as possible the deflation that has continued for nearly 15 years. It will examine both upside and downside risks to economic activity and prices, and make adjustments if necessary to achieve the price stability target.

Thank you.

6. Indian Economy: Recent Financial Market Developments and medium to Long Term Prospects

Duvvuri Subbarao, Ex-Governor, Reserve Bank of India

Good afternoon. First of all I want to thank the IIMA, Gyohten-san in particular, for inviting me to this conference. Speaking at this conference is a privilege to which I attach a lot of value. What I propose to do is, first, to give an overview on the India's macroeconomic situation, then talk about the short term vulnerabilities and the medium term policy priorities, and conclude by talking about whether the India Growth Story is still credible.

Overview of India's Macroeconomic Situation

On today's macroeconomic situation in India, the first point to note is that growth has significantly moderated. Growth last year was 4.5%. This fiscal year, 2013-14, growth is expected to be below 5% once again. This is the first time in the last twenty years that India will be posting growth of less than 5% in two consecutive years. Contrast that with India's growth acceleration in the three years before the crisis, 2005 to 2008 when India posted growth of 9.5% on the average. Even in the crisis year of 2008- 09, India clocked growth of 6.7%. So, today's growth of less than 5% is low even by our recent record.

What explains this steep moderation in growth? Abstracting from all the details, if you want to identify one factor that is responsible for India's growth moderation, it is that investment has significantly decelerated. Why has investment decelerated? Investment has decelerated because of a number of factors, including some want of confidence in the governance structures. Today, investment in India is slower than aggregate GDP growth, and that is a concern because today's investment is tomorrow's production capacity.

The third important factor to note about India's current macroeconomic situation is that inflation has come off from double digits, but it is still 8% which is quite high. You must understand that inflation hurts every economy, but hurts much more in poor economy like India. In fact, I used to joke when I was the governor of RBI that Europe and Japan could take up some of our inflation! They want badly and we can give away much of it. What is intriguing about India's inflation is that even though growth has fallen, inflation has not come off, which means that India's potential growth rate has probably slipped.

Finally, the balance of payments situation. The rupee has stabilized after substantial depreciation. We were affected by the announcement of the taper in May last year. But when the taper actually happened in December and January, India withstood that because a lot of depreciation had already taken place. There was a sharp correction to the current account deficit. The current account deficit last year was 4.8% of GDP. This year it is expected to decline to less than half of that, posting maybe to about 2% of GDP. That stabilization is comforting, but behind these numbers there is quite some discomfort about its sustainability, a point to which I will return later in my comments.

Given that snap shot of India's economy, what are India's short term vulnerabilities?

India's Short Term Vulnerabilities

The first short term vulnerability is the adjustment in the current account deficit. The current account deficit, as I said, has declined to less than half, but it still raises two questions. Is this adjustment sustainable, and what has been the quality of adjustment?

The current account deficit has come down because gold imports, which ballooned over the last three years, have declined. And they came down because of a steep increase in customs duty and some very stringent quantitative controls by the government. This provided short term relief. But, for the current account deficit reduction to be sustainable, India needs to reduce imports and increase exports on a long term basis. In particular, we should cut down imports of gold and unproductive assets and increase imports of productive assets. That is not yet happening.

The second dimension of our balance of payments adjustment is our dependence on costly and volatile capital flows. Even as India ran large current account deficits for the last four to five years, we were able to finance them because of the enormous amount of money in the global system as a result of quantitate easing by advanced economy central banks. But precisely because we financed our CAD by volatile finance that we are affected every time there is a hiccup in global economy, every time something happens in Europe or in America. India therefore is vulnerable to sudden stop and exit of capital. This is exactly what happened in last May last year when the US Fed announced that there might be 'tapering' of its quantitative easing (QE) down the road. That caused an enormous amount of destabilization in India's currency market. The rupee depreciated by over 25% and exchange rate had become volatile. When the tapering actually happened, as I said short while ago, the currency did not move very much, in part because much of depreciation had already happened, but also because in the meantime the Reserve Bank instituted measures to bring in capital inflows through non-resident deposits and through swaps with banks. Even as that money provided a short term buffer, the concern today is that that money has to be returned exit sometime, and when the payback time comes, India might become vulnerable once again. So, what the Reserve Bank now has to do is to increase the buffer of stable reserves.

The third facet of India's vulnerability is fiscal deficit which stands at 7.2% combined for the center and the states. A fiscal deficit that large is a big concern. All of us are aware of the maladies of large fiscal deficits. In particular, a large deficit militate against the Reserve Bank's fight against inflation. On one side, the Reserve Bank is tightening interest rates in order to control inflation, but on the other hand, the government is running an expansionary fiscal policy, thereby stimulating demand. So the government's fiscal policy is willy nilly eroding the Reserve Bank's anti-inflation policies.

The fourth vulnerability stems from stubborn inflation. Inflation has been high. It has and has of course come down from its peak, but is still high. There are three factors that are driving India's inflation. The first is food; there are both cyclical and structural dimensions to food inflation. One of the unrecognized and unacknowledged factors in the India growth story is the increase in rural incomes over the last seven to eight years. As a consequence, rural people's food consumption pattern has changed. They are eating more protein and less of cereal. This is a welcome development but it has also thrown up a problem as it is putting pressure on protein food prices and adding to inflation pressures. . The second driver of inflation is the global oil price, the price of crude. India is the fourth largest importer of oil in the world, and quite unsurprisingly, our inflation is sensitive to global oil prices. The third factor driving inflation is demand pressures. In an economy with a per capita income of $2,000, any increase in income is rapidly going to translate to consumption demand. That is what is happening in India.

The fifth dimension of India's short term vulnerability is deceleration in investment. As I said earlier, investment has slowed significantly; investment growth today is slower than GDP growth. Also, corporate investment as a proportion of GDP has declined to nearly half its pre-crisis level. So the big concern is how do we revive investors' confidence?

The sixth vulnerability stems from supply constraints, especially in food and infrastructure sectors. These supply constraints have accentuated in recent years because of inefficiencies, sectoral imbalances, flawed raw material linkages, transport bottlenecks and administered pricing etc.

Given those vulnerabilities, I now want to talk about five medium term policy priorities.

India's Medium term Policy Priorities

First, India needs to remove policy and implementation bottlenecks, and do so urgently. In the World Bank's ranking of Doing Business, India ranks at 134th. Disturbingly, India has actually slipped three places since the last rating. What should be done about it? First, India's bureaucracy has to become more responsive. The bureaucratic interface with both domestic and foreign investors has to improve. There are a mind-boggling number of approvals, permits, licenses, and clearances that investors are required to get. The other concern in connection with speeding up investment is governance, in particular corruption. It is not clear that corruption has only actually gone up in recent years, but what is certainly clear is that the perception of corruption has certainly gone up. In the latest Economist which some of you may have seen, there is a four page briefing on corruption in India. What is really happening is that in response to increasing corruption, the bureaucracy has become very scared. They are concerned that any action might invite charges of corruption or nepotism and their defensive mechanism is simply not to do anything. This apathy is really hurting the tempo of investment in India.

The second priority is to ease the supply constraints, particularly in the agriculture supply chain and in infrastructure.

The third policy priority is to raise productivity, raise efficiency. I think there are three powerful forces in India that have a bearing on efficiency and productivity. The first is the demographic profile. India has a large and burgeoning labor force. Second, there is scope to move hundreds and millions of people from the low productivity agriculture sector to the high productivity industry and trade sectors. The third force is the economies of scale that we can exploit as people move from agriculture to manufacturing.

The fourth policy priority is to improve the quantum and quality of fiscal adjustment. Fiscal adjustment is more than a question of reducing the headline fiscal deficit number to a pre-agreed number; we have to pay attention to the quality of fiscal adjustment. How do you reduce fiscal deficit? What expenditure do you cut? Do you cut productive expenditure? Or do you cut unproductive expenditure? How do you increase your taxes? Just as consumption tax has been at the center of policy debate in Japan, India has been talking about a nationwide goods and services tax (GST); that can be an enormous game changer. But that is not materializing because of a number of political deadlocks. But once the GST materializes, it is going to be very transformative. Also, the subsidy burden in India is very high. subsidies take up about 3.0 to 3.5% of GDP. The concern is that the subsidies are not targeted. For credible fiscal consolidation, India needs to cap the subsidies and target them. That will yield fiscal space for raising the much needed capital expenditure.

The fifth policy priority is to accelerate financial sector reform. We need to invest an enormous amount in infrastructure which requires long term financing. Banks, by their very nature, are not structured to finance infrastructure. Infrastructure needs long term finance which means that India needs to improve, and deepen its insurance and our pension markets. One of the important things in this regard is to increase both foreign and domestic investment in insurance and expand the pension market. We also need to recapitalize our banks. And most importantly, we need to deepen financial inclusion.

Is the India Growth Story Still Credible?

One final comment before I finish. That comment has to do with asking an important question. "Is the India Growth Story still credible?" I believe it is. The medium term growth drivers of India are all intact. What are those growth drivers?

These growth drivers are the enormous entrepreneurial talent, immense capacity levels in the country, the demographic dividend which will both generate savings and provide a huge market. And then there are our democratic structure and a credible legal system. These are the drivers of the India growth story.

I also want to add that the India growth story is not inevitable. It will not happen unless we in India do the right things, and importantly do the right things in the right time. So, the final thing I want to say is that the India Growth Story is still intact.

To put that India Growth Story back on track, we need investment both from within India and from outside, particularly from Japan.

Thank you very much.

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7. The third plenum and its implication for the Chinese economy

Gao Haihong, Professor and Director, Institute for World Economics and Politics, Chinese Academy of Social Sciences

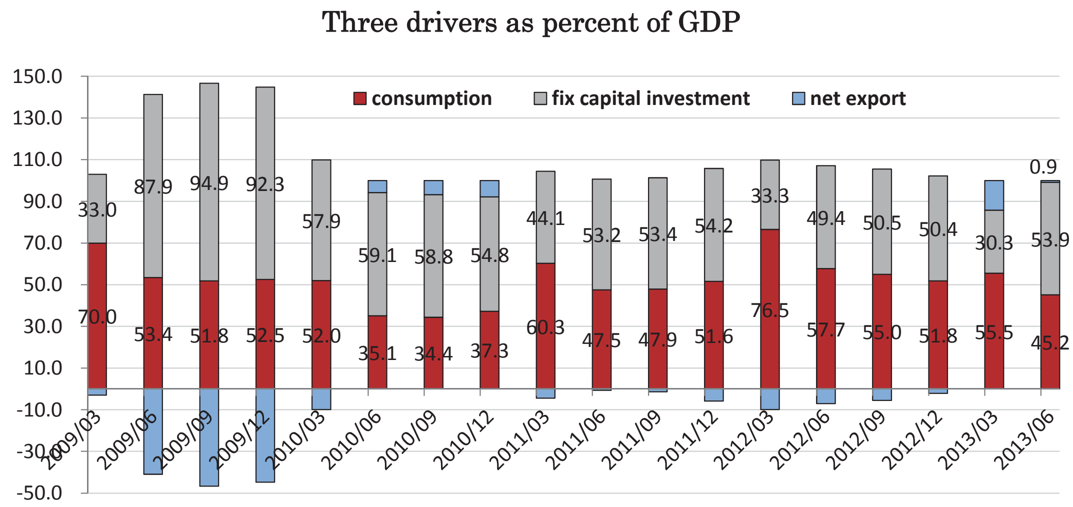
Thank you, Mr. Gyohten. I am truly honored to be invited to IIMA's symposium again.

My topic today is about the third plenum and its implications for the Chinese economy. First of all let me present you the current situation of the Chinese economy as a background. You probably know that over the past 30 years China's average GDP growth has been on 9.8%, but China is now on a slower growth path.

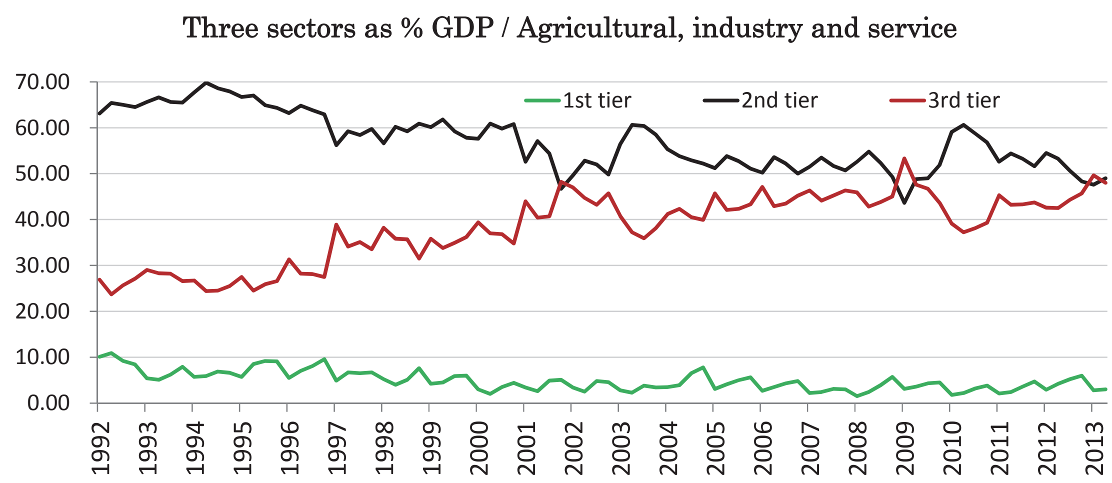
Premier Li Ke Qiang just set the target of the 7.5% economic growth for this year at National Peoples' Congress two weeks ago. I think this number is probably the upper limit for China's economic growth, because China now is attempting to deleverage shadow banking, local government debts, and real estate bubbles.

China is also very worried about employment issue. This year China expects 7.3million newly graduate students from colleges and 6 million migrant workers. So it is really a tough task to ensure employment for that people and is very challenging to maintain the decent growth, while deleveraging and conducting structural reform.

Looking at the drivers of China's economic growth, the export contribution has been negative in the most of time since 2009. Now we expect that is going to pick up this year, but it will remain marginal. As for the fix investment, I am afraid that it is going to be the key driver again if the 7.5% target has to be reached. And consumption is still frustrating and I am not going to see that there is a dramatic increase there in the near future.



Structural change also moves China into a slower growth path. The service sector has grown steadily over the past years and it overtook the industrial sector for the contribution of GDP finally. Also the potential growth rate in the next 10 years is about 6% to 8% and the total factor productivity is projected to be 2%. Considering that China had 4% of that on average in the past 30 years, China is going to have a slower capital and labor input in the future.



Let's move on to the new round of reform. What is new for this social and economic reform? It seems to me that the previous reform by Deng Xiaoping started in 1978 aimed at making the cake bigger but this time it aims at distributing it fairly. How can China achieve this?

There are two keywords, one is marketization and the other is liberalization. I would like to briefly go through this agenda.

The Third Plenum policies in brief

Reform areas		Policies	Objectives
1. Economic and financial reforms	Role of the government	– Reduce government intervention in the economy; – Let market determine the prices of water, oil, natural gas, electricity, transportation and telecommunication. – Delink officials' performance from GDP growth-based, link it to an index including resource consumption, overcapacity and incremental local government debt.	Let the market play a decisive role and establish a modern market system in terms of market rules and pricing.
	Financial sector	– Set up privately-funded small and medium sized banks; – Establish a registration-based stock issue system from current approval-based one; – Form a deposit insurance system; – Interest rate liberalization; – Exchange rate formation; – Speed up RMB capital account convertibility toward full convertibility by 2020.	
	Fiscal reform	– Improve the budget system and tax system include the property tax and VAT; – Revenue sharing between local and central government will be gradually adjusted by a local tax system, but the central government will take more responsibilities and have more power accordingly. – Consumption tax instead of business tax	
	State owned enterprise	– Set up state-owned asset management companies; – Increased state capital gains transferred to social security fund from the current level of 0-20%to 30% by 2020; – Allow non-public owned enterprises to take part in state investment projects.	
	Economic Openness and fairness	– liberalize investment access and more free trade zones following Shanghai; – Explore a model of national treatment (being treated the same as domestic investors) combined with a "negative list" – Explore the set up of intellectual-property courts	

Reform areas	Policies	Objectives
2. Social reforms	– More property rights for farmers include limiting the scope of rural land acquisition by local governments and establish a rural property rights trading market – Hukou (residency permit) system reform: fully opening for towns and small cities; gradual loosening limitations to settle in middle-sized cities; reasonable requirements for large cities but strict control of population size in large cities. – Loosen the one-child policy; Improve the education system and help college graduates for employment; Income distribution adjustment, establish a more reliable and sustainable social security system and continue healthcare reforms – Strengthen management of the internet; increase the supervision of food and drugs, and complete the social security risk evaluation system.	Enhance equality and social safety
3. Political reforms	– Abolish the system of re-education through labor camps; further judicial reform including centralized management of courts. – Complete anti-corruption system and explore an official residence system. – Continue to promote "deliberative democracy"	Enhance social justice
4. Cultural reforms	– Consolidate media resources to push the merging of traditional and new media; Complete online propaganda system	Enhance the soft power
5. Ecological reforms	– Protect the environment including making local officials permanently liable for any environmental damage.	Sustainable growth
6. National security	– Establish a National Security Committee to co-ordinate and centralize national security	

Basically the agenda covers 6 areas. The first area is about the economic and financial reforms. The first policy of the economic and financial reform is to change the role of the government such as to reduce government intervention in the economy, to let the market determine the prices of water, oil, natural gas, electricity, transportation and telecommunication. What is most important is the delinking of the official's performance from GDP growth. This is going to change the behavior in many levels of the officials in the government.

The second policy is related to the financial sector. It is going to set up privately-funded small and medium sized banks. There are five small private banks which are on the way to be set, and also it is going to establish a registration-based stock issue system which is different from the current approval-based one. It is debatable one but I am sure that it is going to be achieved very soon. Forming deposit insurance system is probably the long term objective. Interest rate liberalization is proceeding now. The lending rates have already been liberalized. Now the PBOC promised to liberalize the deposit rates in two years time. As for exchange rate formation, you have seen the PBOC had already broadened the trading band from 1% to 2% recently, and of course, speeded up RMB capital convertibility. This is very ambitious policy goal.

Third policy is the fiscal reform. It is very difficult reform compared to others. The long term objective is to improve the budget system and tax system including property tax and value-added tax. Perhaps China has a lot to learn from Japan on this matter. And I think everything is on the table but we still need to see details to implement.

Fourth policy is related to state-owned enterprises. It is going to set up state-owned asset management companies to increase state capital gains transferred to social security fund from the current level of 0 - 20% to 30% by 2020. There is also a new movement to allow non-public owned enterprises to take part in the state investment project.

The final policy of the first area is related to the economic openness and fairness. Most important one is the Shanghai Free Trade Zone which is going to explore a model of national treatment combined with a "negative list" for foreign capital companies. I think this is also a part of the government reform of less intervention. Exploring the way of setting up intellectual property courts is also the part of the final policy.

The second area of the agenda is about social reforms. The first policy is related to more property rights for farmers. This is very important because it is going to prevent consistent migrants from farmland to cities. The second one is the Hukou system relaxation. I think this reform will be achieved in a sequenced manner. It is going to be fully opened for towns and small cities at first, and gradually loosened for middle size cities and large cities which have reasonable requirement for it. I think this could be a long term objective as well. Third, loosening the one-child policy is very important and welcomed by the society. Strengthening the management of the internet and completing the social security risk evaluation system, which is the fourth policy, should be done. Those are just few examples of the social reforms. The purpose of this reform is clearly stated: to enhance the equality and social safety.

The third area of the agenda is about political reforms. As you may know, the anti-corruption is a really eye-catching action nowadays in China. I think the government is decisive, and the campaign could last for quite a long time.

There are also three other areas; cultural reforms, ecological reforms and national securities reforms. Those are very important for China to establish the sustainable growth model and also to enhance soft power and social justice.

To summarize this very complex agenda, you see the following four points. First, the government should have less intervention and more transparency. And its function should be based on the rule of law. Second, the factor prices including prices of land, labor and capital should be market-determined. Third, the factor for financial sectors should be going to be liberalized and decontrolled. Fourth, there should be more innovation and fair competitions for firms. And finally, household should have more equalized rights and social, health safety. China is now on the road toward marketization. Chinese media nowadays describes this agenda as “unprecedented, far reaching and deep and strong reform.”

What are the risks for China? I am going to have a very briefly outline of this.

One is the shadow banking. I am sure you have read about this and have known its development recently in China. The shadow banking is actually rooted in a long-lasting financial depression in China. For many years the negative real interest rates in China discouraged household consumption and, to some extent, subsidized state-owned enterprises. The major incentive for expanding shadow banking is regulatory arbitrage. As a result there are two parallel interest rates nowadays; one is the market rate and the other one is the official, fixed rate. The major form of shadow banking in China, wealth management products, grows very fast.

The problem is that it is very difficult to define the scope of the new products due to lack of accurate data. The different statistics actually have different figures- from narrowly definition such as wealth management products to a broader coverage of trust, securities and other financial entities. In terms of scale, it is not large and its feature is different from that in the developed countries: banks are deeply involved, and it is not a typical securitization.

So what is concerned about shadow banking in China?

First of all, it is hidden and off-balance sheet, and carries potential non-performing loans for banks. Second, it is leveraged and increasing the cost for real sector financing. Third, it has the liquidity and credit risks. Most importantly, there is an illusion of implicit guarantee. Although the banks, especially big four banks, never issue the explicit guarantees for their wealth management products, it is presumed that the banks and their products are guaranteed by the government. The possible default of ICBC's wealth management product in the end of January this year was a wake-up call. I would expect that there is going to be more defaults on the way, especially for the small and private-owned companies, which would put banks in danger. I think the policy makers have to watch shadow banking issue on a round-the-clock basis to prevent spillover to the entire financial system.

Another risk is associated to the local government debt as it increased so rapidly in the past year. The government debt ratio to GDP for 16 local governments is over 100%, which put the Chinese government in a very challenging situation. Why it is so dangerous? Apart from the overcapacity, environmental bottlenecks and financial risks, I think China is afraid to become a debt-dependent nation.

The worst is not over. By saying that, I am not sending a pessimistic signal. As long as China realizes the worst scenario, it is going to be prepared to react and to prevent it from happening.

That's my presentation. Thank you.

8. Panel Discussion

Gyohten: Thank you very much. Now I'd like to open the question and answer session. As I told you, I have received many questions from the audience beforehand and had a hard time choosing among them. Anyway, I will ask each panelist individual questions and listen to their responses.

So without much ado, my first target is Mr. Reinhart. My first question is about the American growth model. Historically, US growth has been mainly supported by household consumption, which I think in turn created the so-called twin deficits, budget and external. At present, as you forcefully described, the US economy is certainly being a front runner of the recovery among the developed countries, and we are all very happy about that. My question is, if the US economy is going to lead the world economic recovery, what will be its growth pattern in the medium term? Will it stay as a consumption-led economy or will there be some shift to an export-oriented or investment-oriented economy? I'd like to get your views on that.

Reinhart: I think the main point is that as a nation we have historically tended to be under-saving and therefore require foreign capital to invest. That gives us a couple of challenges, but we are also given an opportunity.

In some sense the biggest challenge comes from the following question: What is the most overvalued asset in the US today? I would say it's the net present value of entitlements that our citizens think they will receive from the government. Actually, we don't have a fiscal delivery system that can make good on those promises. When you think about it as an asset overvaluation, you get the obvious consequence. As a nation we under-save because we already think we have the wealth. As a nation we over-leverage because we think we are matching it with those assets. And politicians are not likely to start their conversation about that problem because this involves telling their voters that they are not as wealthy as they think they are. So the medium-term challenge is to deal with that entitlement problem. The good news is that because we are so bad in delivering fiscal policy, there are many opportunities for tax reform, dealing with tax expenditures, and making actuarially and generationally fair improvements in entitlements. So the best medium-term prospect for the US is comprehensive fiscal reform.

The second advantage we have is that the middle part of the North American continent is extracting a form of energy we don't like to ship: shale oil and natural gas. That gives manufacturing a local comparative advantage, but you have to be located there to benefit. Therefore, the direct contribution of capital invested in oil and gas extraction and the re-siting of manufacturing give us a chance to grow faster. I would, however, point out that there are some consequences for emerging markets from all this. The US has been the engine of growth to global exports because we have liked a lot of those consumer goods that emerging countries are good at producing. The more we re-site manufacturing domestically and the more we redirect our spending toward capital goods, the more we are competitors rather than purchasers.

Gyohten: Thank you. Regarding your emphasis on fiscal consolidation, may I take it that it implies your view on the so-called Obamacare issue or do you argue that this is not a relevant question?

Reinhart: I think it is entirely relevant because the impetus behind the Affordable Care Act is to recognize our problem in delivering entitlements. As a nation we cannot have a budget system that relies on a 1% increase per year in the relative price of health care versus everything else. The Affordable Care Act was an attempt to address that, so the spirit of the act is entirely appropriate. You might think there are some execution problems though.

Gyohten: Provided that those necessary measures will be taken, do you predict in the medium term that the American household saving rate, for instance, will return to more or less its historical level of 6-7%?

Reinhart: My earlier answer was about what should happen. We should deal with our fiscal problems. In doing so we will redirect activities toward saving and therefore to the benefit of investment. That would help bring consumption back toward more historical norms. But I cannot look at Washington DC and promise you that what should happen, will happen. Indeed, I can almost guarantee that it won't. But if something is unsustainable, it will stop. We will, as a nation, need to increase our savings and also address the problem of entitlements. Therefore, as a medium-term forecast you are right. The real question is, "Is the process done in a way conducive to growth or in ways less conducive to growth?" – and I cannot predict that part.

Gyohten: Thank you very much. Well next, Mr. de Jong. As you alluded in your remarks the Eurozone crisis which erupted in 2011 has exposed very serious disparity within the region between the so called center group and the periphery group. My feeling is that this disparity may not disappear very easily. It seems to me that in the coming years Eurozone must have a stable and prominent mechanism to equalize this disparity between the haves and the have-nots, rich and poor. Such mechanism must be installed with another obligation on the part of the center countries, particularly Germany. Germany's position in the zone has been elevated substantially since the onset of the crisis, and I know there is a very active debate about the future distribution of burden for this equalization process. But at the same time we hear a lot from Germany too, arguing that the greater efforts should be made by the periphery countries. So my question is, "Do you agree that there is a need of some kind of sustainable, stable mechanism of equalization and also a need for Germany to bear significant cost of burden of that?" If that is the case, do you think it's a feasible proposition or do you see serious difficulty in that? I think having some stable mechanism of equalization is really a sine qua non for the avoidance of future recurrence of crisis in Europe. That's why I am asking this.

De Jong: I was hoping for a simple question. Before I answer the question, let me clarify my own background a little bit. I am Dutch, and my country is supposed to be one of the strongest countries. My mother is half German, and my wife is Irish. Although I work and am based in Amsterdam in the Netherlands my family and I actually live in Ireland and I commute between Ireland and Netherlands. Therefore I have experienced the crisis from a country that perceived itself as a strong country and have also seen the pain of the austerity and internal devaluation. In fact my younger son, still a student, worked for a Microsoft subsidiary in Dublin for a summer job a couple of years ago. The job was great. The next year I told him again that I would stop his allowance during the summer, so he had to find a summer job and went to the company for his interview again. When he came back home, he looked rather gloomy, so I assumed he didn't get the job. I said, "Gosh Thomas, this is very frustrating. Obviously you did very well last year and they are not giving you the job back. What happened?" "No, no, no, they gave me my job back." "So why are you so depressed?" "They are paying me 10% less than they did last year." So I said to him, "That's fantastic because you are making a significant contribution to the recovery of the Irish economy."

He is a student of chemistry so he had no appreciation of those economics insights.

To come back to your question, I think there are disparities at different levels. When you say rich and poor, there is a disparity that we have to live with. Some economies are more productive than others. What you hope is that by further integrating these economies we will all basically adopt the highest level. But you have to start somewhere. I don't think the difference between rich and poor is sort of a breaking point for integration. What is more important is the ability of an economy to grow. When you look at potential growth rate, and when you look at, for example, measures of international competitiveness which is called ease of doing business, and also the OECD Indicators in terms of how far countries are in structural reforms, you'll find that there is a great disparity between the economies. Finland, Germany, Austria and to some extent Netherlands also has been scoring quite well on those measures. Economies like Spain, Portugal, and France are scoring embarrassingly low. I think you cannot have a successful union if they stay like that. The countries that scored low on these measures should all act and must improve. I think such process has started. We aren't wasting a crisis here. We are using this crisis to get the process on the road. The so-called program countries, which have been given financial support, have been put under pressure to implement reform. They are doing so and their economies are benefiting from it. As I said earlier, I would hope that other countries will follow.

As regards whether Germany understands the obligations it has toward this stress, I think they do understand that. I think they have shown great financial commitment over the last couple of years making significant funds available for bailout operations etc.

Gyohten: Thank you. I had a hard time choosing a proper question to Governor Kuroda because I did not want to put him in a very difficult situation given the fact that this session is recorded, but I decided to be courageous. You advocated three transmission channels of quantitative and qualitative monetary easing effects in order to revitalize the real economy. The first is the reduction of real interest rate, the second is portfolio rebalancing of the banking institutions, and the third is the enhancement of expectation. I think your proposals are right. I certainly think all of these are important. As for the third one, I do think that at the end of the day we will find that this sea change in people's and corporations' mentality is really crucial for the recovery of the Japanese economy. But this is very vague, I have to say. It sounds almost like a matter of mass psychology. So my question is, from your advantage point of view. What does Japan need in order to sustain this robust mentality which would trigger a sort of national momentum toward the revitalized economy?

Kuroda: It is a difficult question, but let me try to answer. First of all, expectations are always very important with respect to whatever kind of economic policy the government pursues. However, it is particularly important for monetary policy. That is the case for all countries, but at this juncture expectation is extremely important for Japan's monetary policy. This is because the interest rates have been relatively low in Japan. Short-term interest rates are practically zero and even long term interest rates are at low levels. This means that scope for reducing real interest rates through the reduction in nominal interest rates is limited. In order to reduce real interest rates significantly, we have to raise inflation expectations significantly as well. Whether this concept is vague or not is a matter of judgment. However, even from the theoretical point of view, expectation formation is somewhat uncertain as it still remains to be a very challenging analysis subject.

For many years, the so-called rational expectation was utilized for macroeconomic modeling and macroeconomic policy making, because it is easy to deal with as long as you assume rational expectation. But during the last five-six years the possibility that rational expectations may not be so omnipotent, has been raised. This is because expectation formations differ from one economic entity to another. You cannot ramp up all expectation formations by just one assumption. Therefore some sort of adaptive expectation is inevitable. Such combination of rational and adaptive expectation is very difficult to analyze from the theoretical point of view or even from the statistical point of view.

I agree that expectation is somewhat elusive, somewhat vague. But expectation formation's effect on the economy and implication to the economic policy, particularly to the monetary policy is very critical. Therefore you have to somehow analyze and assume some kind of expectation formation.

As I said in my initial remarks, we thought that by making our commitment clear and strong, inflationary expectations could be raised. But we were not so optimistic as to believe that by announcing 2% price stability target to be achieved in two years or so, inflation expectation would immediately rise toward the target rate.

We have already seen some increase of inflation expectations but simultaneously inflation expectations would also be made through some adaptive process. That means that by seeing the actual inflation rate rise, inflation expectations will also rise. Through these two mechanisms inflation expectations will rise. This will lead to the upward shift of the augmented Philips curve and the gradual rise of the inflation rate in Japan.

Expectations are a very crucial element of economic activity, and they remain to be a very difficult theoretical analysis target. But it is necessary to analyze and assume some types of expectation formation mechanism, and we have assumed two process. So far, as intended, inflation rate has been rising, and inflation expectations are rising as well.

Apart from that, if Mr. Gyohten is questioning about the medium term sustainable growth path, or growth potential, I should say that it is basically determined by supply-side factors. So, it is the so-called growth strategy which would raise the medium to long term growth potential and the government aims at raising growth potential from below 1% toward 2% in coming years.

The government has already implemented a number of structural reforms including deregulation of the power sector, abolishment of rice quota, establishment of the framework of special deregulatory zones and so forth. I understand the government intends to submit something like 30 bills to the current Diet session to further reform, to further deregulate the various sectors in the economy. I am quite sure that if those deregulatory measures and structural reforms are implemented, which is the key to growth, the growth potential of the Japanese economy in the medium term would increase.

Gyohten: Thank you very much, Governor Kuroda for answering my question very straightforward. Now Governor Subbarao, I am sure everybody was very much impressed by your remarks which taught us that the Indian economy is surely facing a mountain of challenges now. There should be many questions but in my view one of the most important issue is how to encourage FDI (Foreign Direct Investment). Because I believe that for a country like India the activation of FDI is one of the best means to stimulate domestic market by introducing not only capital but also technology and other soft parts with it. I also think new competition with foreign capital in the domestic market is something which will help trigger what you call Schumpeterian process. I know I do not have to tell you that deregulation of the FDI in India is one of the issue which attracts greatest interest and some concern among the Japanese investors as well. I know this issue is very much riddled with political and social considerations. It is not a simple economic issue. But yet I have to ask what your assessment on the status of deregulation of some major areas of FDI is. I would appreciate very much if you can give us your very frank overview of the current situation and prospect of that.

Subbarao: India has been struggling with its FDI policy for several years. I too was involved in formulating and implementing India's FDI policy both as Finance secretary in the government of India and then as Governor of RBI.

Even though India has an express preference for FDI, and more generally for non-debt creating capital, much of the foreign flows we have been getting are portfolio flows which are not as stable and as value adding to the economy as FDI.

India's FDI policy has been clouded by several misperceptions. The first misperception is to believe that foreign investors are eagerly waiting outside India's gates and they will flood the country as soon as we open the doors. The reality is far from this. There are hundreds of countries in the world which are competing for FDI. India has to compete with them in order to attract FDI. The second misperception is to believe that FDI will displace Indian investors, will bring in capital intensive technologies unsuitable for India and will take away profits. Admittedly, FDI comes in to make profits, not with altruistic motives. At the same time, it's win-win proposition. Both the foreign investor and India will stand to benefit.

The short point is that India needs FDI, not only to finance its current account deficit, but in its own right, in other words for its accelerated growth and development. In order to attract FDI, India needs to become much more investor friendly. This means not only more investor friendly policies, but more importantly reducing the implementation hurdles on the ground so that transaction costs for FDI, which are reportedly very high, are brought down.

Finally, since I am speaking here in Japan, I want to say that there is enormous scope for Japanese investment in India. Since the 80s, the Japanese have invested in east Asia but have not moved sufficiently westward to reach India. The Delhi Mumbai Industrial Corridors project is now underway. If some big Japanese corporates invest here and generate high profile success stories, there should be a positive multiplier effect and more and more Japanese investors will come to India. Thank you.

Gyohten: Thank you very much. We agree that there is certainly a need to increase the number of success stories before we can see anything really happens. I really agree with you.

Prof. Gao, it is quite obvious that China is really launching a deep, bold reform agenda now. I take it that China is trying to rebalance its economy, rectify the variety of disparities emerging in the economy and society by straightening financial, industrial, investment policies which inevitably require a great amount of deleveraging, curtailing or improvement of environment consideration. By carrying out all these policies, China will end up with slower growth rate as you mentioned in your presentation.

I recall you mentioning that China's potential growth rate for the next ten years is projected as 6% to 8%. If for any reason average growth rate settles down at around 6% which is the bottom line of the anticipation, how will it affect the Chinese labor market? Also, how would it affect the viability of numerous projects that are financed through the shadow banking system?

So my question is; how does China strike the balance between its desirable, sustainable moderate growth and its rebalancing which will put the economy through difficulties for the near-term? I certainly hope China can strike better balance and sustain its growth rate somewhere between 6% and 8%. But my question which may sound rather cynical is, if China's growth rate has to settle down at the lower level of its projected potential growth rate, what will happen?

Gao: This is a really difficult question. I don't think I have the ability to give you a perfect answer so I would like to try to give my thoughts on it. You are right. I think the 7.5% growth target is probably the upper limit, which is lower than many projections'. The Chinese government is trying to balance between the short-term growth and the long-term structural reform, meaning that China has to tolerate the slower growth. China hopes the global economy to recover steadily, especially in the leading countries like the US, Europe and Japan, so that the export sector would be benefit from it. But as I said the Chinese economy is heading toward a much less export-oriented economy, and is looking inward, to focus on domestic consumption. Domestic consumption is still very weak at present, but I think many factors suggest that improvement is underway. All projects need time to be accomplished. In the medium and long term, I don't think China's growth is going hit the bottom of the potential growth rate. 6% is quite a conservative estimation.

As for the labor market, China is trying to mobilize domestic labor force between farmland and cities under the Hukou reform. Service sector will provide more job opportunities as well. The plans on urbanization of the next decade will facilitate the domestic labor market development However, it remains a challenge for China to overcome the bottleneck caused by population aging problems.

In the long term I am quite optimistic for Chinese future, although in the short term I am a bit pessimistic.

Kuroda: I am not in a position to speak about the Chinese economy, but I was really impressed by her presentation about the Chinese economy. China's economy is rebalancing dynamically from external demand to domestic demand. As Ms. Gao already explained us, services sector is increasing its share. Usually services sector is more labor-intensive than the manufacturing sector. Therefore, even if growth rate is slightly lower than before, employment situation could continue to be very favorable and even improve.

Japanese economy is in a similar situation with China now. Japan's economic recovery is basically lead by strong domestic demand, including consumption, housing investment and public investment. It is unlike the typical recovery phases we experienced in the past, that were export driven, and began from the manufacturing sector. This time it is experiencing a domestic demand-led, non-manufacturing sector-led recovery. This means that our employment situation has significantly improved in spite of the fact that the growth rates are not so high. Actually the labor market is quite tight. Unemployment rate is already as low as 3.7%. We estimate that the structural unemployment rate is about 3.5%. It means the labor market is very close to full employment. The current unemployment rate is almost comparable to the level that had prevailed before the Lehman shock. Wages have already started to rise.

I think that Japanese economy will become more service-oriented in the medium to long term. As Ms. Gao mentioned, if services such as health care, child care, elderly care increase, other kind of services would be more demanded, too. As such the economy would become more service-oriented, like the US.

Gyohten: Thank you for your very useful input. Now, in the second round of questions I might shift a bit towards medium- and long-term risks. My next question to Mr. Reinhart is about the US economy's potential strength. I believe the US economy has many strengths, such as robust corporate dynamism and shale energy, but what are its medium- and long-term risks? You have already mentioned the welfare issue. I know some people argue that there is a possibility even in the US that demographic developments may hurt the housing market and fiscal condition. Also, some people are wary of the waning American leadership in global affairs. What is your view on the risk side of the US economy in the medium and long term?

Reinhart: Taking the issues in turn, we are getting old as a nation, and I think a place to ask for advice on how to deal with a graying population is Japan. There are three obvious consequences of the baby boomers moving into retirement. First, we are already seeing a decline in labor force participation. We think that about 0.3% a year of the declining labor force participation is secular, just the result of workers getting older. Those who have skills and who generated wealth look for retirement, and those who don't have skills and wealth look to government entitlements. Second, the increasing burden of entitlements is reflected in an adverse downward drift in just about every budget projection. Just look at what our Congressional Budget Office does in their long-term budget projections. Five to seven years from now the path takes a serious downward drift. Third, there is an asset rotation involved, because all those assets held by the elder cohorts are going to be sold to smaller, younger cohorts. How are we going to deal with those relative price adjustments? There is good news and bad news. Market mechanisms should buffer some of that in the sense that capital can substitute labor. We can shift even more from a manufacturing-oriented economy into services. Real wage increases can also keep workers in the labor force longer. So I think we can deal with it. The bad news is the promise of entitlements that we've already talked about.

The next set of issues can be lumped together into the issue of unfairness. Over the last 30 years in the United States the labor share of income has declined. Income inequality has increased, and even more striking is the extent to which wealth inequality has increased. The bottom line seems to be that some combination of globalization and technological progress has stretched even further apart the returns to high skills versus low skills. High-skilled workers accumulate wealth faster and look forward to retirement sooner. Low-skilled workers either look more toward the government or the informal sector. Democracy can't work over the medium to long term with such inequalities. A consequence of this problem is government dysfunction as parties tend to represent the winners or losers in that contest. It also makes the US look more inward and therefore perhaps have a diminishing influence on the global scale. It also means we have to redirect more resources inward, reducing the opportunity to help on a global scale. The problem is that we can't wave a magic wand and say "Solve the skills mismatch". It is about our education system, our openness to trade, technological progress shifting toward those who are complements of computers rather than substitutes for computers. These are really hard problems. But there is some good news, and I can end on that. The US is a volatile system with an education system that ranks disturbingly low in the league tables for advanced economies. But it is also a very diverse education system with some of the best institutions anywhere. Also there is technological progress and the advance of aggregate supply over time. Wealth creation is about picking the upper tail of those outcomes. And thus far we've been able to do so.

Gyohten: Thank you. Certainly everybody would agree that as far as higher education is concerned, the United States is the best performer so far. But at the same time, don't you think the American ability to increase the so-called elite population is actually accelerating the diversity in the society?

Reinhart: The skills mismatch is exasperating because those people who can use computing power to complement what they produce get higher and higher rewards. We also have to face the globalization of our elite universities. Since we don't have a sensible immigration policy, we give excellent training to young people from abroad and then force many of them to leave the country. The good news about our being so inside the efficient frontier of sensible immigration policy is that there are many things we can do to improve, such as just stapling an H-1B visa to diplomas. We can get better.

Gyohten: Certainly we need a couple of more hours to finish this discussion. Well, Mr. de Jong. This is about the long term future of Europe which is another issue that requires us a couple of hours of discussion. If you look at the history of European integration, it is quite impressive that for many generations European leaders were very much inspired by a common conviction about the European destiny. Maybe that was acquired from the experience of the history of the last century which was wars, wars, wars. Anyway I think Europe has so far been led by very enlightened, determined aspiration of your leaders.

Sixty to seventy years after the war, Europe, like anywhere else have new generations who do not know anything about the past. You have already mentioned in your remarks that as intensified the European governance or new regional arrangement including banking union etc. become, there are dangerous divergences between public view and politicians' intentions. My question is, in your view, do you think younger generation in Europe are willing to carry on this historic conviction about the European destiny or do you see any dangerous sign of deterioration in this respect?

De Jong: You didn't say with so many words, but maybe we have to say that Europe has a richer history than future. I am from a small country that used to be a world leader in the 17th century; we definitely have a richer history than a future. But I think that does not stop us necessarily from being happy. You don't have to be a world leader to be happy. I think you are right. The history of the last 100 years or so has led to this enlightened leaders who had gone for integration and peace. You have to say that for most of Europe, certainly for Western Europe, the last sixty or seventy years have been remarkable, because we have simply stopped killing each other. Now, will the younger generation carry on in that spirit? To be honest with you I'm an optimist by nature. So I want to believe they will do that. But to give you an intelligent and not an emotional answer to the question, I have to provide some sort of mechanism why they would do that. In my view they will do that, because they experience a much bigger Europe. They experience the integration as we currently have it. When I was a student I travelled to a few countries behind the iron curtain. Most of my friends, certainly my parents thought I was crazy, and it was very dangerous. Travelling to other countries was like, for instance, if you were a Dutch you would go to Germany and maybe to Italy but you wouldn't go much further. But as for the younger generations they don't stay within Europe, they travel the world. I think at the end of the day they will appreciate the richness of their lives if they were able to continue to do that. As a result I am hopeful that common sense will prevail and this process of integration will continue.

Now, you also mentioned there are dangerous signs. We do have extremists. One would hope that these extremists don't get the upper hand, and if they do, I sincerely hope that people learn very quickly that their policies are very damaging, and that these extremists will be voted out of power again. It will be a volatile path but I'm very hopeful and confident that this process of integration will continue.

Gyohten: Well, thank you for your encouraging remarks. Governor Kuroda, I'm afraid I have to ask your short-term views instead of long-term views. Last year, we had a very good combination of unprecedented easing in Japan and the tapering of QE starting in America. I think the combination of these two policies, as far as Japan is concerned, has produced a very favorable result overall. I would like to ask you whether or not you think this combination of dynamics, particularly between Japan and the United States, will continue this year?

Kuroda: Thank you. I think you have carefully avoided mentioning exchange rate.

Gyohten: Yes, I did.

Kuroda: I would basically follow you. Favorable conditions prevailed last year. Stock market was quite buoyant, excessive appreciation of the yen in the past several years was corrected, if not completely. Due to the aggressive monetary easing and flexible fiscal policy, the economy started to recover. In annualized term, economic growth was 4% in the first half - year and 1% in the second half-year. While domestic demand contributed around 3% for every quarter, net export's contribution to growth dropped from positive 1% in the first half-year to negative 2% in the second half-year. Why did net export, that is, export minus import, become a large negative in the second half-year? There were two factors. One is that, though export showed a sign of strong recovery in the first half-year, it became somewhat stagnant in the second half-year, reflecting slow recovery and even some deceleration in economic growth in Southeast Asia. The other factor was the continued acceleration of import. In the 4th quarter the negative contribution of import was larger than 2%. This resulted to the net export's negative contribution by about 2%. This shows that domestic demand has become quite strong. It continues to be strong in the first quarter of this year. Certainly exchange rate affects export, but I must say that export is also affected by world trade. We are expecting Southeast Asian economies to recover reflecting strong economic recovery in the US and stable growth in China. Therefore we are reasonably confident that Japanese export in the coming months will contribute positively to the GDP growth.

Japanese monetary policy will continue to be very relaxed, loose and expansionary while the Federal Reserve continues tapering its bond purchases. We think the tapering by the US is basically good for both world economy and Japanese economy, because the smooth implementation of the tapering means that US economy is recovering steadily, which is great for the world economy. I truly believe expansionary monetary policy in Japan and steady tapering or steady decrease of monthly asset purchase program in the US, would be basically good for the Japanese economy and the US economy.

Gyohten: Now Governor Subbarao. We talked briefly about the American education a minute ago. I am curious to know what kind of practical progresses are being made in the area of education and training in India, for the purpose of raising productivity. I think that is really crucial for India's recovery.

Subbarao: I am not very well informed on the nitty-gritty of education reforms in India because I have not worked in that area. Nevertheless, let me offer some comments from the limited knowledge that I have.

There can be no denying that India needs to improve the quality of its education. Admittedly, there are some very high profile world class institutions in India, such as the Indian Institutes of Technology, the Indian Institutes of Management, and the All India Institutes of Medical Sciences. But these are the exceptions, at one end of the quality spectrum. They are not the rule. The large majority of higher education institutions in India are mediocre and below standard. The graduates they turn out are of poor standard

Let me give an example. India produces about 300,000 engineers every year, but not more than a quarter of them are employable when they come out of college. Many of our IT companies which recruit these engineers actually spend a lot of time, effort and money putting these graduates through a full college curriculum once again so as to improve their capacity levels.

Simultaneously, India needs to improve the skill endowment of its labor force. The scarcity of skills in India is reaching alarming proportions. Our polytechnics and

Industrial Training Institutes (ITIs) are supposed to give vocational training but their curricula are outdated, their facilities are poor and their teachers themselves are poorly trained. Consequently, the graduates of these polytechnics and ITIs are not good enough to be employed.

One problem with skill training is that it is a merit good. That means that the private sector will not invest in skill training if only because they have no way of appropriating the benefits of their investment. The trainee can simply walk away after training. That is the reason, skill training has to be done by the public sector. i.e. the government. But, the government is poorly structured to run training institutions as the experience of polytechnics and ITIs illustrates. That is why, India has fallen back on a PPP (public private partnership) model by establishing a national skill development mission involving just such a partnership. It's too early yet to assess the results of this initiative.

The short point is that India needs to improve the quality of its higher education and also its skill endowment if it has to accelerate its growth rate and sustain it.

Gyohten: Thank you very much. Professor Gao, I am afraid that I have to ask you the last question which everybody in this room is anxious to ask. That is about the RMB. Last decade since 2005, RMB's exchange rate has appreciated gradually but steadily. However, this trend seems to have reversed recently. My question is: how should we interpret it? If you can shed any light on that, I am sure that we will be very appreciative.

Gao: I think this is a million dollar question if I can successfully interpret the exchange rate fluctuation. Yes, you are correct. Since 2005 RMB exchange rate has experienced steady appreciation. I think the reason for the recent reverse is partly due to the market force.

RMB has basically three exchange rates nowadays; one is the CNY which is traded onshore and the other two are the CNH and the NDF (non-deliverable forward) that are both traded offshore. The NDF used to be a good indication of RMB exchange rate expectation before the CNH was born, but now we have to look at both: CNH and NDF, as the proxy of the market rates.

If you look at the trend of onshore and offshore exchange rates, you can see that they are coming closer and closer. Therefore the current reverse of official RMB rate is converging to the market rate. The fundamental change such as the shrinking of the current account surplus is also an important determinant factor.

There is also an estimation of equilibrium exchange rate. Since many people believe that current rate does not diverge greatly from the equilibrium rate, this causes rate correction.

It is also believed that the central bank is standing back. I am sure there is no central bank doing nothing regarding the exchange rates market in the world. PBOC has broadened the trading band. I think this is a very healthy movement.

As such, there are two ways of the movements regarding exchange rate; one is the movement by the market, and the other one is by the government. The Chinese policy makers would like to see the two factors affect each other and develop the exchange rate of the RMB in the same direction after all.

Gyohten: Thank you very much. I think that is very informative. I'm afraid we have to wind up our session now. However, I would like you to give us your final comments. You may say anything. It can be irrelevant to the topics we have discussed today. We would like to get your wisdom using this time.

Reinhart: The range of possibilities is boundless. I think I'll be earnest and provincial and limit myself to economics. Here's the key regularity mentioned in the book by my wife and Kenneth S. Rogoff, "This Time Is Different". If you go back to the Napoleonic Wars, some countries frequently have currency, inflation, and sovereign crises, while some countries never do. But whether you have repeated currency, inflation, and sovereign crises or none, everybody has banking crises. That suggests to me that you can legislate policies or create national attitudes that result in fewer currency, sovereign and inflation crises, but a banking crisis is about human nature and you cannot legislate against human nature. It's about hope and greed, fear and exuberance. But at each financial crisis we improvise and sometimes we set bad precedents. So my wish is for one of two choices: One is to get back into the DeLorean and travel back in time to fix the mistakes we made in prior crises. If we can't do that, then we should build up the infrastructure of crisis management. That requires us to understand what we want, what we don't want, what we can and cannot do.

Gyohten: Thank you very much. Mr. de Jong?

De Jong: I have two wishes. I don't know about Asia, or US, but in Europe there is an increasing conviction that people of my generation are going to be the last generation who can say I had a better material life than my parents. I would wish that is actually untrue. I'm not complaining about my material life, it's been fantastic. But I would wish my children and grandchildren to have an even better one. This is my first wish. Now I will mention my second wish, if I may. In this crisis the degree of pessimism is just enormous. When I look around I see all sorts of developments that give me an encouragement. However it seems to me that I am the one of the few people that sees those things. Maybe I am weird or crazy but I would wish for that pessimism to die down and optimism to take over.

Gyohten: Very good. Thank you very much. Kuroda-san?

Kuroda: Yes, thank you. I think by now people attending this symposium must have understood how those economies of US, Europe, India, China and Japan are different from one another, but I must emphasize that despite such huge differences, there are two common challenges faced by these economies. One of the challenges is to maintain macroeconomic balance. The other is of course, the structural reform. Though details are quite different between the economies, they are all facing the challenge of implementing necessary structural reforms.

Gyohten: Governor Subbarao?

Subbarao: What I would like to say by way of a final comment is that globalization has been a defining feature of our generation. It has been a very powerful force. We all experience it every day. Just before coming into this session, for example, we were talking about how developments in Ukraine have affected every economy in the world. That a developments in a small country like Ukraine in eastern Europe would have global implications would have been unthinkable 15-20 years ago. The same was the case with the sovereign debt crisis in Europe. When sovereign debt strains in Greece first came to light, I was very nonchalant. When my staff came told me that Greece was throwing up a problem, I was very dismissive. I recall having said, said, "Oh, Greece? How does it matter to us when we have very small trade and no financial relations with that country? How can the current event in Greece affect us?" But I realized very soon thereafter how wrong and stupid I was, because what had happened in Greece and across Europe started to affect us in a significant way.

We must realize that globalization is a double-edged sword. It brings enormous benefits but it also poses ruthless challenges. When we were all affected by the global financial crisis, we attributed that to globalization and believed that globalization was all bad. We became victims of what happened in America, though we had nothing to do with it. What we did not realize though was that we had also benefited enormously from globalization during the period of the Great Moderation when the world economy was stable and inflation was low. Virtually every country in the world benefitted from the Great Moderation just as every country suffered from the global financial crisis. Just goes to show that globalization cuts both ways. Every country needs to manage globalization so as to minimize its costs and maximize its benefits.

Globalization also throws up global issues. Purely national solutions are inadequate to resolve these issues which have cross border implications. We need global solutions and global coordination. This is where the G 20 comes in. There is a view that the G20, which performed a near miracle during the crisis by achieving global coordination to evolve global responses to the crisis, has now become ineffective, driven by dissension, disagreements, etc. The stereotype view is that it has degenerated into another international talk shop! But it is not realistic to expect the G20 to perform in a non-crisis period as it did during the crisis. We need to recognize that in an era of globalization we have global issues. Global solutions to resolve such issues require global coordination. The G 20 will succeed only if it realizes this. The members of the G 20 and every other nation, even if it is not directly on the G 20, should realize that we will have a better world if we put global priorities ahead of narrow national interests.

Gyohten: Thank you Dr. Subbarao. Now Prof. Gao, please let us have your final comment.

Gao: My final comments are similar to Dr. Subbarao. The crisis in 2008 changed the landscape of the world economy. When we talk about global imbalance, we are actually seeking for coexistence. While the world economy is so globalized, our policies are still directed at individual countries. So let's have more cooperation and less selfishness.

Lastly, as an only female panelist, I would like to difference myself by quoting the word 'World peace' from the movie "Miss Congeniality". We are all living in the same, global, and civilized society, but still we see blood and conflict. I truly wish for us to have world peace forever.

Gyohten: Thank you very much.

I am 100% sure you would agree that we have learned a lot today. We heard optimism, hopes, cautions, and warnings from our panelists. One thing in common is that every country is trying hard to correct the mistake they made and restore a better balance in their respective economy. I think that's all right. But we are in a sort of tricky situation that urges us to follow two conflicting dictums. One is to keep our own house in order and the other is to avoid the so-called fallacy of composition for the world. In that sense, as Dr. Subbarao mentioned, the role and responsibility of multinational fora such as the IMF, G-20 and also their member governments are all the more important in order to achieve the crucial coordination under such circumstance.

I was supposed to sum up the discussion, but it is impossible to summarize such a rich but very diverse discussion we had. Anyway, let us hope for the year 2014 to bring a better world for all of us. I would like to declare that we had a fruitful day. I wish you all the best. The meeting is adjourned. Please join me in giving a big applause to the excellent panelists. Thank you for attending the symposium today. Have a good day!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