Revitalization of the Japanese Economy And the Future of Asia

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Opening Remarks

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East Asian economies including Japan are now facing the most serious difficulties after the second World War.

While eight years have passed since the collapse of the bubbles, the Japanese economy is still suffering from deep recession due to delayed reformation of its financial systems and inappropriate economic policies.

The financial turmoil which attacked Thailand last July spread to most countries in East Asia. While the financial crises were triggered by abrupt in-and-out flows of short-term capitals between countries, we could explain that the crises were based on a failure in each country in adjusting its economic structure to drastically changed principles of markets and corporations caused by the thoroughly globalized capital flows and rapidly improved technologies of communications.

Thanks to closely interactive flows of capitals, goods and services, ties between Japan and East Asia are quite strong; one third of exports from East Asia goes to Japan, and one third of foreign debts in the region is owed to Japan. Economies of Japan and East Asia are so deeply related that a good performance of one economy will bring good fortune to the other economy, and vice versa. It is the reason why concerns over and expectations towards the Japanese economy are currently spoken so loudly that such close ties between the two regions have been recognized clearly through the recent serious crises in Asia.

Japan is now waiting for results of stimulus policies prepared and implemented recently to promote economic recovery, as well as several measures currently taken to strengthen its financial systems. As you may easily make out from present stock prices and foreign exchange rates at markets, the real economy of Japan seems to be reluctant to step out of its long-lasting sluggish situation in all aspects of consumption, productions and investments.

When can the Japanese economy start to pull itself out of the present miserable situation? Are those measures appropriate in contents and timeliness that were already implemented and/or are going to be taken for the purpose of economic recovery? Can the East Asian economies restore their vitalities again? What kind of efforts should be made for the purpose from now on? What kind of measures and policies should be taken for the purpose by developed countries such as Japan and the US as well as by international financial institutions?

This symposium is designed to encourage profound discussions on those issues.

Since its establishment in December 1995, Institute for International Monetary Affairs (IIMA), in addition to its activities in fields of economic research and publications, has kept holding a symposium twice a year with currently important financial topics, where IIMA, I believe, succeeded in showing its sound farsightedness.

At the first symposium in April 1996, various problems contained in financial markets in the East Asian countries, whose economies were still indicating steadily strong growth, were discussed by persons in charge of those markets.

The second symposium in October 1996 was held on a theme related to perspective of international currency regime. There, we tried to investigate how the euro, when starts, would influence the international currency regime, with a strong confidence that this unprecedented monetary project would be brought surely to full completion, while negative views towards feasibility of the euro prevailed over financial markets, especially in the UK and the US.

At the third symposium in April 1997 discussions were focused on how businesses would change in financial and other aspects after commencement of the euro, in order to enlighten Japanese business circles on the subject who looked behind in preparation for the euro to be introduced as planned.

The fourth symposium was held in December 1997 to discuss possible and desirable countermeasures against the financial crises which, as we guessed, unfortunately occurred in the East Asian countries in the same year.

And now in this fifth symposium, I am proudly pleased to introduce each of the panelists who, I believe, are the most suited resources for the theme of discussion here.

Dato'Seri Dr. Mahathir Mohamad, Prime Minister of Malaysia, needless to say, belongs to the most distinguished political leaders in Asia. Dr. Mahathir, who has unshakable convictions and superior leadership, is regarded with respects and hopes as one of the most prominent national leaders not only by the twenty-one million Malaysian people but also by the world.

Dr. Stanley Fischer, First Deputy Managing Director of IMF, is equipped with clearly lucid intelligence and excellent administrative ability, and is often described as the prop of the IMF which plays crucially important roles to the world economy. Great contributions by Dr. Fischer extended in IMF's activities in remedies for the recent economic crises in East Asia should be noted forever.

Dr. Edward J. Lincoln, Senior Fellow of The Brookings Institution, is a world-famous authority on Japanese and Asian economies, and is highly appreciated for his coherent and accurate analyses.

Dr. Eisuke Sakakibara, Vice Minister of Finance for International Affairs, Japanese Ministry of Finance, is one of the most prominent Japanese policy-makers known to the world, whose fame stems from his superlative administrative abilities supported with distinct theories.

This symposium will proceed in accordance with a program distributed to you all. This remarks of mine will be followed by Dr. Mahathir's speech with a question-and-answer session. After a fifteen minutes coffee-break, the remaining three panelists will provide us with their speeches, and discussions will be held between the panelists with another question-and-answer session to be followed. Dr. Fischer will be replaced by Mr. David C.L. Nellor, Deputy to the Director, Regional Office for Asia and the Pacific of IMF for the panel discussion and the question-and-answer session, as Dr. Fisher has to leave this venue after his speech due to an imminent business.

Revitalisation of Japanese and East Asian Economies

Dato' Seri Dr. Mahathir Bin Mohamad
Prime Minister of Malaysia

Let me begin by noting what a difference a year makes.

Last year, at this time, there was some concern about the Thai economy, which had successfully repulsed two attacks on its currency. But there was still much talk about "the East Asian Miracle", a characterisation invented, if I am not mistaken, in the impressionable West. All of us, we thought, were "not Thailand", a unique, special case.

Many foreigners - including the most tough, hard-nosed personalities and organisations told us the most flattering things, which strengthened us in our conviction that our "fundamentals" were very strong indeed.

The annual World Competitiveness Yearbook, issued by the prestigious International Institute for Management Development (IMD) told Malaysians, for example, that we had some problems here and there, some quite serious. But on the basis of what it called the "overall evaluation of the strength of the domestic economy at the macro level", Malaysia was the second most competitive economy in the world. We were in the best of company. At number one was the United States. At number three was Singapore. At number four was Luxembourg.

Most of the other economies which have been so severely hit since the IMD issued its 1997 report also scored highly according to the 244 criteria, or fundamental factors, that were used. I wait with great interest their annual report for 1998 which should be issued later this month.

I hope the IMD will stand by its analysis of the fundamentals and not change its analysis of the 200-plus fundamentals, which so convincingly argue that the turmoil of the last year are not the result of fundamentals but of forces that have very little to do with the economic fundamentals. I hope the IMD will not alter the facts so that they will fit into some sacred truth, some hallowed theology.

It is so easy for some analysts to slip into the view that currency movements are purely the function of fundamentals. The market fundamentalists tell us this is so with incredibly sincere conviction, however loudly the speculators chuckle all the way to the bank. Since, according to the theology, currencies cannot fall unless the fundamentals are weak, and since the Asian currencies have fallen so dramatically, then ipso facto the fundamentals must be weak even if you have said that they were strong immediately before. The truth is that the currencies plummeted even though our fundamentals were very strong. The truth is that, ipso facto, the fall of our currencies were not a function of our basic fundamentals.

The IMD was not the only one with such a good impression of my country one year ago. In mid June, 1997 - in fact, on June 17, 1997 - just two weeks before the July 2 collapse of the Thai Baht which resulted in a horrendous collapse of the regional currencies, Mr Michel Camdessus, Managing Director of the IMF was handing bouquets to Malaysia for our sound economic management, for our superb economic fundamentals. He told an international conference on Global Capital Flows in Los Angeles: and I quote " Malaysia is a good example of a country where the authorities are well aware of the challenges of managing the pressures that result from high growth and of maintaining a sound financial system amid substantial capital flows and a booming property market."

He noted: " Over the last year, output growth has moderated to a more sustainable rate, and inflation has remained low. The current account deficit - which is primarily the result of strong investment spending - has narrowed substantially. The increase in the fiscal surplus targeted for this year is expected to make an important contribution towards consolidating these achievements".

There had been complaints that we were growing too fast. So we brought our growth rate down very substantially. There had been complaints that our current account deficit was too high. So we halved it, to the obvious delight of the IMF, which rightly noted that in any case our high current account deficit was not because of excessive consumption but was the result, in Mr. Camdessus' words, " of strong investment spending".

You may say there is no need for more testimonials. But how about the banking and financial sector? If you can believe Mr Camdessus, again I quote: " The Malaysian authorities have also emphasised maintaining high standards of bank soundness. Non-performing loan ratios of financial institutions have fallen markedly in recent years; risk-weighted capital ratios are above Basle recommendations".

You might just wish to note that in 1988, the non-performing loans in the Malaysian banking system had stood at 32.5 percent. In June 1997, just eight years later, as luck and a tremendous amount of sweat would have it, our non-performing loans stood at a historic low of 3.5 percent. This is as dramatic a performance as you can get. Perhaps this was why the IMF was so impressed and so complimentary.

Today, there are all sorts of talks about transparency. I agree that transparency is important. But I suspect that when so many complain about a lack of transparency, what they are complaining about is simply their own lack of knowledge, which is not so surprising because five years ago or even five months ago some of the younger money movers might have thought that Malaysia was somewhere in the Himalayas. As for the transparency of the Malaysian financial system, let Mr Camdessus speak for Malaysia. In the same Los Angeles speech, Mr Camdessus said: “In an effort to increase the flow of comprehensive up-to-date and reliable information to markets, Malaysia was also among the first to subscribe to the IMF's Special Data Dissemination Standard".

So, ladies and gentlemen, on June 17, 1997, just two weeks before the currency hurricane struck, the IMF gave Malaysia not just a clean bill of health but the IMF in fact praised Malaysia's economic fundamentals. The IMF had the best of things to say about our economic management. And the IMF commended Malaysia to investors as an economy that “justifies the confidence of the markets".

I cite all this in order to address all those extremist “market fundamentalists" who believe that the market is always right and that the reason why so many of us are in desperate straits today is because we mismanaged our economies and because all our “fundamentals" were rotten to the core.

If all our fundamentals were wrong, why were the foreign investors so eager and so foolish as to pour billions upon billions of investment dollars in our region? Of course all the international banks kept on lowering interest rates in order to persuade us to borrow even when we were without need for additional funds. Obviously they, as the definitive market, had a lot of confidence in Malaysia, its economic management and its future.

If our fundamentals were rotten to the core, why did all the clever analysts not say so? Why is it that not a single economist, financial analyst or economic soothsayer has dared to come out to say that he or she had predicted what has happened? Not a single one. And yet these same people continue to predict, to be believed in and to influence the market. If it is wrong for insiders to leak information which can affect share prices, why is it not wrong for forecasters to forecast something which influences the market to their advantage.

Professor Paul Krugman has for years been arguing that the East Asian miracle was not a miracle at all and was bound to hit a brick wall. Many Western journalists credit him with forecasting the Asian Crash of '97. He has in fact publicly stated that he did no such thing; that he could not in his wildest dreams have imagined anything like it. In Hong Kong on March 26 this year, Professor Krugman admitted: “I was 90 percent wrong about Asia's future. The only consolation is that everyone else was 150 percent wrong".

The analysts and all those who are obviously cleverer than us simple elected leaders must know that we have had not ten years but forty years of economic growth unparalleled in human history. Since some of them are young enough to be our grand children, perhaps we should remind them that many of the things that they complain about and which they say are the reasons why we are in such difficulties today were things that we ourselves started complaining about when we ourselves were their age. So many of the so-called fundamentals which are now listed as the main causes of the currency and financial turmoil of the last 12 months - corruption, monopoly, crony capitalism, inadequate human resources, very far from perfect banking systems and practices - have always been with us. Yet we were able to grow faster and longer than anyone before in human history.

All of Asia must obviously work on our numerous weaknesses, to get rid of the stones around our necks and the chains on our feet. We must do this not because they are the causes of our economic turmoil but because they are bad and they weaken our capacity to compete and to succeed. We must do this because we cannot allow corruptive influences to determine who supplies us with what. But the true causes of why our currency plummeted and why we are facing an economic crisis must be sought elsewhere.

Our meeting today is not focused on the causes. It is also not focused on the consequences, the terrible consequences. Our task is to focus on the remedies, the things which must be done if we are to re-vitalise ourselves, if we are to ensure the re-vitalisation of all of Asia. So let me concentrate on the things that must be done in order to ensure the quickest, most healthy and sustainable revitalisation.

Quite obviously, there is a need for short term imperatives as well as medium term measures and longer term strategies. At this stage, although we must not neglect the medium and longer term, we must remember the admonition of Keynes that in the long run we are all dead. Seldom has the short term been as important. This is why I speak of the “short run imperatives".

Quite obviously also, there are three principal theatres of operation:

＊ the things that we should aspire to achieve internationally;

＊ the things that we should try to achieve regionally; and

＊ the things that we must achieve at home, within the confines of our own borders.

Given the nature of this meeting, I will concentrate on only a few areas. I will focus on some issues that should be of primary interest to this Institute for International Monetary Affairs and its strategic intellectual constituency.

At the international level, I believe that the time has come to deal with the entire issue of reform of the international financial system to ensure currency stability and to contain the activities of those who buy and sell money for no other purpose than to make profits. Let me say once again that currencies need to be changed if there is going to be international trade. That is why the leaders of the Western nations met to draw up the Bretton Woods Agreement, the purpose of which was to agree on a mechanism for determining the value of one currency against another. The system worked very well and enabled the countries bankrupted by the war not only to recover but to prosper as well. Of course the Marshall Plan and the opening up of the American market to Japan played a role. But if there had been no system for stabilising currency values, all the plans in the world would not have succeeded.

But then some countries in the West decided to devalue their currencies in order to enhance competitiveness. Very quickly a currency market emerged which took advantage of the mildly unstable exchange rate. True speculation took place because the funds were relatively small and depended on intelligent guesswork as to the movements of the exchange rates.

But soon the funds grew huge and were in fact able to move the exchange rates through their interventions. The famous herd instincts replaced economic fundamentals. With the invention of arbitrage and futures trading, the need for exchange rate stability for the purpose of trading gave way to the desire of currency traders to make massive amounts of money in the shortest possible time. An artificial system of devaluation and revaluation of currencies was devised which enabled currencies to be appreciated or depreciated literally within seconds. Thus the Indonesian Rupiah was at one time devalued by more than 600 percent, then in the space of a few days recovered by 200 percent. It is still moving up and down by 100 percent to 200 percent in the space of one day or even half a day.

Mr. Volcker in a speech in Hong Kong stated “An exchange rate system that produces a 60 percent swing in the yen/dollar rate over a period of 18 months cannot reflect the fundamentals in any sensible sense". Well the Indonesian Rupiah moved 600 percent in the space of five months. Can it be that all the assets of that huge country with 220 million hardworking people are suddenly worth only one-sixth of its previous value? What indeed is the worth of a nation if suddenly someone can devalue and even bankrupt it?

If currencies can be made useless so easily then, what is the point in a country issuing its own money? We should go back to barter trading.

It is said that the currency will strengthen if confidence is restored. But there is no certainty as to what will bring back confidence. Who is monitoring what and who determines whether confidence should return or not. There is a lot of talk about market forces. But who constitute market forces and how do market forces determine what value to give to each act of a Government or an economy under attack.

All in all, the present system, if there is a system at all, is messy, unreliable and destructive. Can world trade depend on these shadowy market forces whose methods are not known to anyone except themselves? True, through hedging the effect of the fluctuation in the exchange rates can be minimised. But again, this hedging profits only the hedge funds, adding to the cost of goods and services. If exchange rates are minimally volatile, hedging and the profits for the hedge funds, would not be necessary at all.

There is nothing to indicate the need for currency trading other than the vast profits that can be made by currency traders. On the other hand we now know the extent of the damage to the economies of whole countries and regions that currency trading can inflict.

The excuse that currency trading provides market forces with the means to discipline Governments is totally unacceptable.

Currency traders thrive on unstable currency. It is ridiculous to suggest that they would discipline Governments and reward them with exchange rate stability when such stability will deprive the traders of the opportunities to make money. Governments do need to be disciplined but the international financial regime must be bankrupt of ideas if it cannot find other ways which are less destructive to discipline Governments.

Everything points to the need for an international financial system which will bring about stability of exchange rates among other things. Admittedly we cannot bring back the Gold Standard or the Bretton Woods system. It would be a sad commentary on the ability of the world's financial and economic experts if they cannot come up with proposals on a new international financial system. Their habit of merely trying to explain the present turmoil as being due to bad practices by the Governments concerned sounds too much like an apology and a defence of currency traders. Money does not know whether a Government is good or bad and react by adjusting their rates of exchange. Somebody is doing that and is evidently making a lot of profit. Do we need to protect these people's interest at the expense of world trade?

Fixed exchange rate is no longer possible or realistic. Obviously the political, economic and social performance of a country will have an effect on the value of its currency. If a country is having a revolution it is likely that its currency would be less acceptable and therefore should be devalued. As for the economy there are various indices which can be given points indicating the strength of the economy and therefore the currency. It is not beyond the capacity of the world's great economists to devise a measurement of the economic performance of a country using the political, economic and social indicators and then determine the relative values of currencies. The currency traders can still speculate but whether they buy or sell should not affect the value of a currency.

This is of course only a suggestion. The financial experts and the economists may laugh but it will stop the currency traders from laughing all the way to their banks.

There is a belief that when currency depreciates the goods produced by the country concerned become cheaper and more competitive in the world market. It may do so but the reduction in cost is always far less than the percentage of depreciation. This is because all imported inputs will cost more in local currency and will negate the devaluation of the currency. Imported inflation will push wages and other domestic costs up reducing further the advantage of currency depreciation. In the end the lowered cost is hardly detectable. The products of countries with a depreciated currency are no more competitive than they were before. In at least one case the capacity to import foreign inputs is lost altogether because of the extreme depreciation of the currency.

Devaluation or revaluation are not the answers to the world's economic problem. Improvements in productivity are and such improvements can be achieved through greater skills, better management and continuous technological improvements.

Nations depend on different factors for competitive advantage. Low labour cost is one, but capital, management skills and technology are more important. While those with capital, technology and management skills are loath to share these advantages freely, they are demanding that low labour cost should be nullified by raising wages.

We are moving inexorably towards globalisation. Like the proposal to link human rights, the environment and labour practices to trade, globalisation, liberalisation and deregulation are ideas which originate in the rich countries ostensibly in order to enrich the world. But so far the advantages seem to accrue only to the rich. True the poor countries can gain access to the markets of the rich, but then they do not have many things to export to these markets. The raw materials which they produce are controlled by commodity markets in the rich countries. The terms of trade for these keep on deteriorating.

In preparation for globalisation the pace of mergers and acquisitions have been stepped up. Super large banks and corporations are being formed in the developed countries which will dominate the world. There will be no room for the small companies in the poor countries to exist, much less to expand and spread into the rich markets now opened to them.

Perhaps the peoples in the developing countries should be happy because they will be served by the most efficient and the biggest companies of the world. They will have the choice of three giant banks, four makes of cars, five hotel chains, ten fast food chains etc. But it is going to be a dull world and I suspect some people would be stupidly nationalistic and feel unhappy without their poor quality national brands.

In a globalised world should there be national Governments? We have seen that market forces can change Governments. What is the need for national elections if the results have to be approved by the market?

These are some of the international issues which have either to be attended to immediately or at least debated seriously. Far too often decisions on these issues are far from democratic, yet the same people insist on democracy for everyone. It is about time that international democracy be recognised as being as important as national democracy.

Whether we acknowledge it or not East Asia is a region, a closely linked region. It is not an accident that the fastest growing economies are found in this region. Nor is it an accident that the most serious economic crisis the world has seen since the Great Depression involves this region. The fact is that this region grew together because we worked together. It is reasonable to expect us to get out of our present economic morass by working together.

Japan is the richest depressed country in the world. The capacity to grow and to be the locomotive of growth for the region is still there in Japan. You need to clean up the bad practices of the past and largely you have done so. Your Government, your businessmen and your people should now rehabilitate your confidence and rebuild your economy quickly.

You have the capital, the technology, the skills and everything else needed to grow your economy. You should employ all these assets and provide the lead that the region needs. you should invest in the countries of East Asia as you did before. You should buy their products in order to enrich them. You should help in making East Asia a market for itself and the world.

In Malaysia we are still looking East. Many have asked us why, when it is so obvious that Japan has failed. We admit that in several areas Japan has failed. But even failures provide lessons for us. There are still many things we can learn from you. Your exceptional skills, your technology, your discipline and work ethics are still worth copying.

What Malaysia and the rest of the region needs is a revival of Japanese investments, to create jobs, to enrich the people, to stimulate economic growth and incidentally to create good markets for Japan. Some of the money the Japanese Government is pumping into your economy could very well be pumped into the troubled economies of East Asia. As before when Japanese investments created prosperity for East Asia and in turn provided good markets for Japan's products, Japanese money to revive East Asian economies would benefit these countries and Japan. Japan has the means to resuscitate East Asia, if only it thinks less about what others will say if Japan frustrates them.

As for Malaysia, the only way we can overcome the instability in the Exchange Rate and to rebuild our economy, is to do away with currency in trade as much as possible. We will revert to bartering. We would want to balance our trade with countries which have a trade surplus with us and Japan is the country with the biggest trade surplus. Where we have to pay we will pay in the currency of the trading partner concerned.

Regionally we have agreed with the ASEAN countries that trade between us should be enhanced as the devaluation of our currencies is approximately at the same rate. We will also use our own currencies and balance our trade. This arrangement will probably be permanent, unless of course a new international financial system is put in place which will reduce violent fluctuations of exchange rate.

Malaysia intends to revitalise its own economy through several local measures. It will take note of the various criticisms directed at it by market forces and will study their alleged effect on Malaysian economy including the recent devaluation of the Ringgit.

I have tried to itemise the factors which need to be corrected in order to revitalise the economies of Japan and East Asia. I am no expert in this area but I have had some success in my own country. I think I know what I am talking about more than the theorists who had never run any country, much less help it grow. Left to themselves the economies of East Asia will grow again. But the chances are they will never be left to themselves. And so the revitalisation will not be easy.

The Asian Crisis, the IMF and Japan

Stanley Fischer[1]
First Deputy Managing Director
International Monetary Fund

In October 1997, when the Hong Kong dollar was attacked, for a few days the contagion threatened a global economic conflagration, that could have spread from Asia through Wall Street, and on to Latin America, Eastern Europe, and Russia. In the last few days, we have seen another round of crisis, with pressures spreading from Russia and Asia and threatening to engulf other markets. This has provided a vivid reminder - not that we needed one - that the Asian crisis is still very much with us. It will take determined policies to remove the threat that it poses not only to Asian countries but also to the global economy.

Let me briefly talk about the role of the Fund at times of intense market turmoil, such as now. In Russia, we have been closely involved in the preparation of the latest measures and we remain in close contact with Russia and other countries in that region. In South-East Asia, we work intensively with our program countries, Indonesia, Korea, the Philippines and Thailand and with other member countries, discussing ongoing events and their policy responses. In the Middle East, we have programs with Egypt, Pakistan and Jordan, in Latin America with Argentina and other countries, and we have programs in Africa - and in all cases we work closely with these countries to strengthen their economies. We stand ready to do our duty, which is to help stabilize economies that may need financial assistance, provided they are willing to undertake appropriately ambitious economic reform and adjustment programs. As we have shown in the last 12 months, we are able to move rapidly and on a significant scale to provide assistance to countries willing to undertake the necessary policy measures. We stand willing to do that for others of our members that may need assistance.

Of course, the Fund's ability to continue to play this role requires that the envisaged rise in our capital base - the 45 percent quota increase - be implemented expeditiously. It is vitally important that the quota increase take place. This period of stubborn episodic fires that refuse to be extinguished and indeed threaten to spread is not the time to delay funding the fire department - even if as some think the

[1] The remarks draw extensively on an earlier presentation to the Asahi Shimbun symposium, held in Tokyo on April 8 1998. The views expressed are those of the author, and not necessarily of the IMF.

institution requires some reforms.

Let me now turn to the Asian crisis and leave further discussion of events elsewhere for another day. For now, Korea and Thailand are well on the way to stabilizing their currencies. The situation in Indonesia remains extremely difficult, but after the recent political transition, there is a prospect of strong and credible reform policies that could gradually - but only gradually - reverse the excessive devaluation of the rupiah and begin the arduous task of restoring the economic health of that once fast-growing economy. I am glad to report that Mr. Neiss was extremely impressed by the determination of the new economic team, and will recommend that a full mission be sent to Indonesia this week.

While Korea, Malaysia, the Philippines, and Thailand are all dealing well with the crisis, we cannot today tell how long it will continue. At best, the countries just emerging from the worst of the financial crisis face a difficult year of slow or negative growth as they restructure their financial and business sectors. But the crisis could go on much longer, if the wrong policy decisions are made-in the crisis countries themselves, and among their neighbors, most importantly China and Japan.

Today I would like to take advantage of the opportunity of speaking in this distinguished forum to cover three topics: first, the policy approach recommended by the IMF in the crisis countries in Asia; second, and very briefly, the prospects for the crisis countries, including Indonesia; and third, the critical economic policy choices that now confront Japan.

I. THE IMF AND THE ASIAN CRISIS

The Asian economic crisis has been all the more shocking for having struck countries with a sustained record of outstanding economic performance. Nonetheless, by the start of their IMF-supported programs, Thailand, Indonesia and Korea faced a number of similar problems, including the loss of market confidence, deep currency depreciation, weak financial systems, and excessive unhedged foreign borrowing by the domestic private sector. Moreover, all suffered from a lack of transparency about the ties between government, business, and banks, which has both contributed to the crisis and complicated efforts to defuse it. But the countries also differ in important ways, notably in the initial size of their current account deficits and the stages of their respective crises when they requested IMF support.

The designs of the programs that the IMF is supporting in Thailand, Indonesia and Korea reflect both these similarities and the differences.[2] These programs have sparked considerable controversy on a range of issues. Two main criticisms have been expressed in Asia. First some have argued that they are merely the same old IMF austerity medicine, inappropriately dispensed to countries suffering from a different disease, and that there is a kinder, gentler Asian way. Second is the criticism that by attempting to do more than restore macroeconomic balance - for instance in the measures to restructure the financial systems and improve corporate governance - the programs go beyond what is necessary, and thereby impair their effectiveness.

Are the programs too tough?

In weighing this question, it is important to recall that when their governments approached the IMF, the reserves of Thailand and Korea were perilously low, and the Indonesian rupiah was excessively depreciated. Thus, the first order of business was to restore confidence in the currency. To achieve this, countries had to make it more attractive to hold domestic currency, which, in turn, required increasing interest rates temporarily, even if higher interest costs complicate the situation of weak banks and corporations. This is a key lesson of the tequila crisis in Latin America 1994-95, as well as from the more recent experience of Brazil, the Czech Republic, Hong Kong and Russia, all of which have fended off attacks on their currencies in recent months with a timely and forceful tightening of interest rates along with other supporting policy measures. Once confidence is restored, interest rates can return to more normal levels - and they are, in both Korea and Thailand.

Why not operate with lower interest rates and a greater devaluation? This is a relevant tradeoff, but there can be no question that the degree of devaluation in the Asian crisis countries is excessive, both from the viewpoint of the individual countries, and from the viewpoint of the international system.

Looking first to the individual country, companies with substantial foreign currency debts, as so many companies in these countries have, stand to suffer far more from a steep slide in the value of their domestic currency than from a temporary rise in domestic interest rates. Moreover, when interest rate action is delayed, confidence continues to erode. Thus, the increase in interest rates needed to stabilize the situation is likely to be far larger than if decisive action had been taken at the outset. Indeed, the reluctance to tighten interest rates forcefully at the beginning has been an important factor in perpetuating the crisis.

From the viewpoint of the international system, the devaluations in Asia are

[2] The full texts of the most recent letters of intent outlining their program objectives and commitments are publicly available via the IMF's website.

leading to massive current account surpluses in those countries, damaging the competitive positions of other countries and requiring them to run current account deficits. Although not by the intention of the authorities in the crisis countries, these are excessive competitive devaluations, not good for the system, not good for other countries, indeed a way of spreading the crisis - precisely the type of devaluation the IMF has the obligation to seek to prevent.

On the question of the appropriate degree of fiscal tightening, the balance is a particularly fine one. At the outset of the crisis, countries needed to firm their fiscal positions, both to make room in their budgets for the future costs of financial restructuring, and - depending on the balance of payments situation - to reduce the current account deficit. Among the three Asian crisis programs, the balance of payments factor was important only in Thailand, which had been running a current account deficit of about 8 percent of GDP.

The amount of fiscal adjustment in the initial program for Indonesia was one percent of GDP; in Korea it was 1.5 percent of GDP; and in Thailand - reflecting its large current account deficit - the initial adjustment was 3 percent of GDP. After these initial adjustments, if the economic situation in the country weakened more than expected, as it has in the three Asian crisis countries, the IMF has generally agreed with the country to let the deficit widen, to let automatic stabilizers operate. Asian countries are not generally in favor of large deficits, and their willingness to let the automatic stabilizers operate in full has varied. Indeed, in two cases IMF staff suggested a higher fiscal deficit than country authorities were willing to accept. Today we believe that larger deficits could be warranted in some Asian countries - and that will certainly be the case in Indonesia.

Thus on macroeconomics, the answer to the critics is that monetary policy has to be kept tight to restore confidence in the currency, and that fiscal policy was tightened appropriately but not excessively at the start of each program, with automatic stabilizers subsequently being allowed to do their work. That is as it should be. Moreover, these policies are showing increasing signs of success in Thailand and Korea, and interest rates in those countries have come down rapidly.

Structural policies

Macroeconomic adjustment is not the main element in the programs of Thailand, Indonesia, and Korea. Rather financial sector restructuring and other structural reforms are central to each program - because the problems they deal with, weak financial institutions, inadequate bank regulation and supervision, and the complicated and non-transparent relations among governments, banks, and corporations, lie at the heart of the economic crisis in each country.

It would not serve any lasting purpose for the IMF to lend to these countries unless these problems were addressed. Nor would it be in the countries' interest to leave the structural and governance issues aside: markets have remained skeptical where reform efforts are perceived to be incomplete or half-hearted, and market confidence has not returned. Similarly, the Fund has been accused of encouraging countries to move too quickly on banking sector restructuring: we have been urged to support regulatory forbearance, leaving the solution of the banking sector problems for later. This would only have perpetuated these countries' economic problems, as experience in Japan has shown. The best course is to recapitalize or close insolvent banks, protect small depositors, require shareholders to take their losses, and take steps to improve banking regulation and supervision. Of course, the programs take individual country circumstances into account in determining how quickly all of this - including the recapitalization of banks - can be accomplished.

In a recent article in Foreign Affairs, Martin Feldstein proposes three questions the IMF should apply in deciding whether to ask for the inclusion of any particular measure in a program. First, is it really necessary to restore the country's access to the international capital markets? The answer in the case of the Asian programs is yes. Second, is this a technical matter that does not interfere unnecessarily with the proper jurisdiction of a sovereign government? The answer here is complicated, because we have no accepted definitions of what is technical, or what is improper interference. Banking sector reform is a highly technical issue, far more than the size of the budget deficit - a policy criterion Feldstein is apparently willing to accept as fit for inclusion in a Fund program. Nor is it clear why trade liberalization - which has long been part of IMF and World Bank programs - is any less an intrusion on a sovereign government than banking sector reform. Nor does Feldstein explain why the programs supported by the Fund in the transition economies, including Russia - which are far more detailed, far more structural, and in many countries as controversial as in Asia - are acceptable, but those in Asia are not. Third, if these policies were practiced in the major industrial economies of Europe, would the IMF think it appropriate to ask for similar changes in those countries if they had a Fund program? The answer here is a straightforward yes.

Interesting as they are, Feldstein's three criteria omit the most important question that should be asked. Does this program address the underlying causes of the crisis? There is neither point nor excuse for the international community to provide financial assistance to a country unless that country takes measures to prevent future such crises. That is the fundamental reason for the inclusion of structural measures in Fund-supported programs. Of course, many of these measures take a long time to implement, and many of them are in the purview of the World Bank, which is why the overall framework for longer-term programs, such as those in Asia, typically include a series of World Bank loans to deal with structural issues.

The structural elements in the Indonesian reform program - in particular those relating to the ending of monopolies - have been especially controversial. Those elements were included for two reasons: first, because everyone in Indonesia understood that confidence in the country's economy could not be restored unless there was a change in the way of doing business in that country; and second, because in several cases, especially the clove monopoly, the changes benefitted small-scale individual producers who had been penalized by the monopolies granted to purchasers of their output. It is noteworthy that in all the recent troubles in Indonesia, the IMF was not blamed within the country for the civil unrest, which Indonesians well knew had deeper roots - and that today the IMF program still draws widespread support from all groups within Indonesia.

Thus on the inclusion of structural measures in IMF-supported programs, the answer to the critics is that such measures should be included in a program if they are essential to restoring the health of the economy - and that frequently these measures, while included in the overall framework provided by a longer-term IMF program, will be implemented with the technical and financial support of the World Bank and the Asian Development Bank (ADB). That is not to claim that all structural measures are fair game for inclusion in an IMF-supported program, nor to deny the legitimacy of questions about the inclusion of particular measures. It is to claim that the emphasis on financial and corporate sector restructuring and governance in the current IMF-supported programs in Asia is entirely appropriate.

II. PROSPECTS FOR THE CRISIS COUNTRIES

The financial turnaround in most of the Asian crisis countries began early this year. Since the start of the year, the baht and the won have each strengthened by about 20 percent; they are now worth about 36 percent less in terms of dollars than they were in June 1997. Their devaluations remain excessive, but they are not now outrageously so. While the currencies have rebounded, the Korean and Thai stock markets have fallen a further 10-15 percent since the end of 1997 and are down by very large magnitudes since mid-1997 - Thailand by 37 percent and Korea by 57 percent. The currencies of Malaysia and the Philippines have been basically flat since the start of 1998 and are down by about 36 percent since the middle of last year.

The prominent exception is Indonesia, whose currency has lost almost 80 percent of its value since the middle of last year, and about 60 percent of its value since the beginning of this year. Recent events teach lessons about the interactions of politics and economics at times of crisis, that we will no doubt analyze for years. But I will not attempt to go into those lessons here. After the recent political transition, events are inevitably difficult to predict but the initial steps taken by the new economic team are promising. If political stability and the reform momentum are maintained, the

Indonesian government program supported by the IMF - no doubt with adjustments and changes, but not on the structural side - should provide a basis for a gradual restoration of the health of the economy and investor confidence.

The restoration of confidence is never immediate: as we have seen in the Korean and Thai cases, credibility has to be earned - gradually, through actions, not promises. That will be doubly true in the Indonesian case.

While financial stability is slowly returning to those economies that are implementing stabilization and reform programs, it bears repeating that they all still face politically and economically difficult periods of adjustment. No financial recovery is ever completely smooth sailing. There will be days and weeks in which the East Asian currencies and financial markets will weaken, and the authorities are tested. Those are the periods in which the credibility of the program and the authorities can be strengthened - or lost.

Countries face both internal and external risks. Internally, governments could fail to follow through on politically difficult reforms - because early successes lead to unwarranted complacency, or because, although willing, they cannot muster the political strength to overcome vested interests, or because they lose heart as the going gets tough. The determination of the new Korean and Thai governments to follow through on their programs has been impressive, and should be maintained.

But there is also the risk that the external environment will turn adverse. We are fortunate that this crisis comes at a time when North America and Europe are growing strongly. That seems likely to continue. But there are often-expressed concerns about the Chinese and Japanese economies, about the possibilities of a Chinese devaluation, and the danger of continued slow growth and a deteriorating banking sector in Japan.

The Chinese authorities have left no doubts that they understand the importance of not devaluing, and their determination not to do so. They understand that a devaluation could set off another round of devaluations in the region, thus frustrating its purpose. They understand also that it would most likely spark further financial instability, that would deepen the crisis from which the region is now painfully digging its way out. They show no signs of wavering in their intent, nor is there reason to think they will waver. For this they have earned the commendation of the international community.

III. THE JAPANESE ECONOMY

No-one in this audience needs to be reminded that Japan today faces momentous economic decisions. After forty years of outstanding performance, the economy has virtually stagnated in this decade. At the heart of the protracted slowdown appear to be structural problems associated with the financial system and corporate governance that were revealed by the bursting of the asset price bubble. More recently, the slowdown over the last year has interacted with weaknesses elsewhere in Asia, reinforcing the urgency of dealing with these long-standing problems.

Japan's economic performance is of course a matter of domestic concern. But given the prominent role of Japan in the world economy, and especially in Asia, it is also a legitimate matter for concern by Japan's neighbors and by the international community. There is substantial agreement about what needs to be done, and the Government has begun action on some of the critical steps.

Deep-rooted structural problems, particularly in the financial sector, need to be addressed in a comprehensive manner. At the same time, macroeconomic policies should provide adequate short-term support to the economy. So the IMF welcomes the recently approved fiscal stimulus package of over 16 trillion yen, including about 12 trillion yen (or 2.5 percent of GDP) of “ real water", measures that will have a direct effect on aggregate demand.

It is true that Japan faces a long-term demographic problem that has major fiscal implications. But in this crisis, fiscal policy must first help get the economy moving again. There will be time to deal with the longer-term fiscal problem later.

It is also important that the stimulus not be withdrawn too abruptly in FY1999. One useful way of ensuring this, consistent with longer-term fiscal consolidation, would be to introduce further tax measures by combining up-front cuts in tax rates with a phased broadening of the tax base over the medium term.

But fiscal action is not enough. The bad loan problem inherited from the bubble years has continued to fester, contributing to unprecedented financial sector failures in late 1997, a sharp loss in confidence, and a tightening in credit availability despite record low interest rates. The long, slow, decline in property prices since 1990 has reflected banks' unwillingness - implicitly supported by a policy of regulatory forbearance and compounded by impediments to debt workouts - to recognize the full extent of problem assets. Market participants are clearly still not convinced about the longer-term viability of some Japanese banks. If a credible solution to the problem is not achieved, any other action to stimulate the economy will provide only temporary relief, and the risk of a further prolonged slowdown will be greatly increased. Markets will react more favorably to a clear, decisive strategy, even if it involves, as it regrettably must, difficult initial adjustments.

Fortunately there appears to be a growing recognition that the time has now come for a decisive break with the past, and important steps have been taken in recent months. A framework for self-assessment of asset quality and prompt corrective action (PCA) is being put in place and preparations are under way for setting up the independent financial supervisory agency. These are fundamental for the creation of a modern, sound, banking system. Public money has also been made available to strengthen the finances of the deposit insurance system and to help restructure under-capitalized banks. Plans to establish a new mechanism to accelerate debt workouts are also under discussion.

What is needed now is to build upon these recent initiatives to establish a comprehensive and transparent approach that would ensure that the bad debt problem is finally dealt with, and the banking system restored to profitability and a sound capital position. Essential ingredients of this approach, some of which are already under way, include:

- vigorous efforts to recognize the full extent of bad loans; the self-assessment framework is the right approach, but will need to be rigorously enforced by supervisors;

- a strengthened framework for prompt resolution of insolvent institutions, but with appropriate safeguards - which are already in place - to protect depositors and creditors;

- linking future injections of public funds to strong restructuring plans;

- aggressive efforts to dispose of problem loans and to improve the institutional mechanisms for debt workouts;

- increased independence, authority and staff resources for the new financial supervision authority, to allow it to fulfill its mandate.

There is a lot to be done. It is not easy. But such measures have been taken in other countries, some of them in crisis, in this region and elsewhere, to deal with banking sector problems. There is no advantage to further delay. Those delays have contributed to the sustained period of slow growth in Japan, and it is urgent to overcome them.

One more word - on the need for transparency. In both the banking and fiscal areas, problems have persisted in part because of a lack of transparency. It is always difficult to work out the precise content and timing of a fiscal package in Japan, and this contributes to uncertainties in estimating their impact. Introduction of a consolidated, multi-year, budgetary framework is long overdue. And the lack of transparency in the financial sector has also allowed problems to linger for far too long. The need for transparency is one of the key lessons we have drawn from earlier financial crisis, including those in Asia.

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The strategy followed in the IMF-supported programs in Korea and Thailand is beginning to work, and we are confident that it can work too in Indonesia, with the help of the international community. It is reasonable to believe that, deep and unfortunate as the crises in individual countries have been, growth in this region can resume within a reasonable period.

But that will require courageous policy decisions in all the countries in this region, not least Japan.

An American View of the Japanese Economy

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The first country in Asia to experience economic difficulties in the 1990s was Japan, and those problems have been far more severe than anticipated. Because of the lengthy Japanese stagnation, American views of Japan have become more pessimistic. I would like to sketch out some of the reasons Americans have become more pessimistic about Japan and its role in Asia.

The collapse of the bubble at the beginning of the 1990s brought severe asset deflation, and the resulting bad debts in the financial system and overall economic stagnation was no surprise. Given the severity of the drop in asset prices, Japan did well to escape with stagnation rather than a contracting economy. The macroeconomic packages of 1994 and 1995 did have a positive impact-cutting taxes and raising expenditures helped to push the economy back toward recovery. By the time I left the American Embassy in the summer of 1996, the economy appeared to be entering a phase of self-sustaining growth. But several things have happened since then to produce a much more pessimistic view:

First, the decision to raise taxes and medical fees in the spring of 1997 was a major mistake. Many of us sympathize with the long-term need of Japan to control its fiscal deficit, but the moves in 1997 were too much too soon. The tax increases had negative real impact on the economy as well as a negative psychological impact. Having created a pessimistic public psychology, the government then faced a difficult task of reversing those attitudes.

Second, the government was slow to recognize the real and psychological damage done to economic recovery. While American analysts were becoming concerned by the summer of 1997 that the damage would last longer than just one or two quarters, the government did not respond until December.

Third, even when the government began to respond, the decisions were small and taken one at a time. The initial tax cut was in place for only two months, and accompanied by public statements about no consideration of any further tax cut. The stimulus package then took over four months to develop, with new rumors every week or two, while all economic indicators implied the situation was worsening rapidly. Even now, the government is sending signals that additional measures on the tax side might be considered after the summer. This drawn-out process did not inspire any confidence among Japanese or foreign observers, especially since each step was accompanied by optimistic government statements widely believed by outside observers to be unrealistic. Speeches by government visitors to Washington over the past six months have been greeted by skepticism by their audiences.

Fourth, Americans have been listening to Japanese complaints concerning the inefficiency and corruption associated with public works spending for two to three years. This leaves people puzzled as to why the new stimulus package would rely mainly on public works. Even the notion of a different approach emphasizing new technology rather than traditional public works is not convincing because the largest new item is acceleration of construction of a fiber optic network - which is essentially a construction project (and one that should not be subsidized by government spending in the view of most Americans).

Finally, Americans have been hearing for five years statements from Japan concerning the need to accompany macroeconomic stimulus with extensive deregulation of the economy to enable a more robust, self-sustaining recovery. But the view of most observers is that general deregulation and administrative reform has been slow and weak. This leaves people worried that the current macroeconomic stimulus package will only have a temporary effect on the economy.

Besides these concerns about the macroeconomic situation, American observers are worried about the continuing problems in the financial sector, and worried that Japan is repeating mistakes we made in the 1980s. On the positive side, restoring confidence through refinancing the Deposit Insurance Corporation to protect depositors was a good decision. Depositors need to be reassured that their money is safe even if the bank into which they have put deposits were to fail. This should be sufficient to restore depositor confidence.

But restoration of a healthy financial system also requires weeding out weak institutions that are a drag on the economy. In both the 1930s and late 1980s, many American banks or savings and loan institutions went bankrupt as part of the solution to solving bad debt problems. Rather than weeding out weak institutions, though, the collapse of Yamaichi Securities and Hokkaido Takushoku Bank appears to have driven policy back to protection of all (or virtually all) financial institutions. This could prolong the recovery of the financial sector and damage public confidence in the system.

To prop up financial institutions, the government has implemented a series of accounting measures and other government actions that permit weak or insolvent banks to appear stronger than they really are. These additional moves do not restore public confidence. In fact, some foreign observers in the financial community believe that the government will eventually fail in this attempt to support very weak institutions, and having implicitly promised that additional bankruptcies would not occur, these additional bankruptcies would further undermine public confidence in both the financial system and the government.

What should be done about the macroeconomic and financial situation? The current ¥16 trillion stimulus package will certainly have a positive effect on the economy over the next year, sufficient to keep the economy expanding slowly. Government policies toward the financial sector will prevent any disastrous collapse of financial flows. Nevertheless, I believe that a somewhat different set of policies could help Japan recover from its problems faster. If I were dictator of Japan, I would adopt the following policies:

1. Announce an economic emergency to the public to convince them that the government understands the severity of the economic situation.

2. Proclaim a substantial, permanent income tax cut. This might include both the increased personal exemption method of the current tax cut, but also a sharp drop in the top marginal tax rates. And this would be accompanied by a promise that any future need to dampen fiscal deficits would take the form of decreased government spending rather than a reversal of the tax cuts.

3. Mobilize all Ministry of Finance and Bank of Japan officials with expertise in accounting to begin a systematic inspection of all banks, securities firms, and insurance companies. These inspectors would be empowered to shut all institutions considered too weak to save.

4. Move forward dramatically with deregulation, including action on the many zoning and tax problems concerning real estate so that it would be easier to actually sell the real estate collateral behind bad debts. Other actions should include accelerating and strengthening the “big bang" reforms, as well as substantial deregulation of telecommunications, construction, domestic transportation, agriculture, and other areas.

In the short run, my policy might cause considerable pain, and is obviously easier for a dictator than a democracy. But I have confidence in the entrepreneurial spirit of Japan. While the weak and inefficient enterprises in finance and construction suffer, others freed from regulatory restraints will grow and bring Japan into a new era of expansion.

This set of proposals leads to a final question - the role of Japan in restoring Asian economic growth. The trigger for problems elsewhere in Asia was a currency crisis as foreign investors withdrew funds from Asian currencies. But this broader Asian problem is only partly a currency crisis. The currency crisis was caused by internal economic problems in several countries, and foreign investors were reacting to the lack of effort by governments to deal with these problems. Although the nature of those problems varied - corruption in an aging political regime in Indonesia, a real estate bubble in Thailand, and imprudent investment decisions in manufacturing in South Korea - they do have a common theme: weak financial systems. Many Asian countries have relied heavily on banking to mediate the flow of funds from savers to real investments. Within banking these countries have relied heavily on either personal relationships with borrowers or informal signaling from government to allocate loans. As was the case in Japan from 1950 to the early 1980s, such a system can work. But there are dangers, which have now disrupted Asian economic growth.

Obviously economic systems must be compatible with underlying cultural characteristics of a society. The reliance on personal relationships in business has been one feature of Asian economies that may have some cultural basis. But even with this social background, careful financial analysis remains important. Therefore, a critical component of Asian recovery lies in reform of financial systems to inject greater emphasis on financial analysis, accompanied by stronger rules on disclosure to convince outsiders that such analysis and prudent lending decisions are occurring.

Japan could set a good example by bringing about reform of its own financial sector, thereby encouraging others to do the same. Unfortunately, this is not the signal that Japan has sent to the rest of Asia so far. Japan's emphasis has been more on the supply of financial credits to debtor countries to help bail out their bad debt problems. Because the bad debt problems in Asia are primarily in the private sector, this response is controversial in the United States. Some financial support (by the IMF or individual creditor countries) may be necessary to prevent severe economic and political problems in Asia, but experts in the United States generally believe that both debtors and the foreign financial institutions lending to them should bear much of the loss because this is the essence of private markets. This view also emphasizes the need for reform, because reform would create financial sectors in these countries less prone to the kind of imprudent lending that created the current problems.

In conclusion, economic problems in Japan and elsewhere in the Asian region are serious. But many of the economic fundamentals - high levels of education, strong work ethic, entrepreneurial spirit - remain. If Japan and other countries successfully address their current problems, they should be able to return to a path of healthy economic growth.

Observations on Current Japanese and Asian Economies

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Let me start by saying that both the Japanese themselves and observers from abroad look at the Japanese economy with a very short-term perspective. As Dr. Mahathir mentioned, the assessment and understanding of a country change very rapidly. Even so, the speed with which appraisals of Asia altered was quite unprecedented.

I tend to think of the present Asian financial crisis as not merely an Asian problem, but a crisis of global capitalism. I do not agree with the analysis that there is something wrong only with the governance of Asia. Looking over the past 20 years, there have been about 100 such financial crises, and among those cases, we must remember that there were those that occurred in such developed countries as the United States and Scandinavian in the past 10 years. So shouldn't we regard such financial crises as a periodic illness that afflict markets from time to time? I think that such crises will continue to occur in the future in the industrialized countries. When we look at the G7 countries, all except Japan have the potential ingredients for a bubble economy, and there is no assurance that such crises will not spread to those industrialized countries.

The current economic globalization is an outcome of revolutionary progress in information and communications technology, and the existing markets under such globalized conditions have come to bear a characteristic of, so to say, virtual markets. This means that the present situation is completely different form the 1950s and 60s when transactions centered on trade transactions and associated financing was the core of international financing. Now, most of the transactions are carried out across national borders instantaneously.

So you can see that we are probing for a new international financial architecture in a completely different situation from the days when the Bretton Woods system was created. The International Monetary Fund, too, is a huge bureaucratic organization, and I feel that even Dr. Fischer, who is very percipient, would not prefer to change the organization.

Japan definitely needs to adjust herself to this trend of globalization. That, I believe, is the only way Japan can grow and survive in this environment.

In other words, it is necessary for the responsible agencies in each country to study how they can decrease the instability which accompanies globalization. I suggested at the G7 meeting that it is necessary to monitor capital movements. There is no organization at present that has a full grasp of capital movements. There is no organization that has the complete picture of what is happening, including derivatives. The International Monetary Fund should at least endeavor to grasp what is happening in the markets. Without such knowledge, I do not believe that any effective measures can be taken to stabilize globalized markets.

There are voices that express doubts as to whether the risk management standards set by the Bank for International Settlements are adequate. There is also the question of how the private sector should participate in burden sharing at times of crisis. It must be remembered that both borrowers and lenders have responsibilities. I am glad to say that there have been some extensive discussions on this point at G7 and other occasions. Of course no drastic idea will emerge in the short run but it is definitely progress that such discussions have begun. We in Japan would like to play our part in contributing to the development of some concrete measures.

As a final point, I feel far more relaxed about Japan than I was five or six months ago. This is because the government has done, or at least has clearly drawn a picture of what needs to be done, and I believe that the perception of Japan will begin to change. Concerning the current fiscal package, I know that there have been various criticisms of it, but I think there is now a wider acceptance, even in the international community, of public works as a more effective means than tax cuts. In addition, under current circumstances, a strong multiplier effect can be expected, so I would think that the current policy will raise the GDP by about 2%.

As for tax reform, the government has made a clear statement that they will carry it out. Whether or not to cut taxes on a net basis is a different question. I personally do not think it necessary to do so, but putting that argument aside, tax reform will be carried out.

Some basic restructuring plan has been drawn up for the financial system. As you can see, we now have the necessary tools to revitalize the Japanese economy, and I believe further concrete measures will be announced after the Upper House elections.

I am extremely happy to learn of the capital tie-up between Travelers and Nikko Securities. This is a symbol that the Japanese “ big-bang" has really got off the ground. I am sure more will follow in the coming days. What is being witnessed in New York and London is finally occuring in Tokyo, and it will be beneficial to the Japanese economy if such a tendency is taken further.

As for the internationalization of the yen, Japan has traditionally been reluctant about it and has taken the attitude that it is for the markets to decide. However, we made it clear at the recent APEC meeting that we will take positive measures to internationalize the yen. It is now necessary to speed up the process as well as to vigorously pursue deregulation. In other words, we must tackle tax issues in domestic yen markets, as well as the yen-denominated bankers' acceptance market which seems not to have made much progress. Many of the Asian countries have large debts in yen, whereas most of their credits are in dollars. The imbalance is true even in the case of Japan. Forty percent of her exports are yen-denominated, while the figure for imports is less than 20%. It is necessary to solve these two imbalances in stock and flow.

Lawrence Summers, Deputy Secretary of the US Treasury has said that as regards foreign exchange rates, stability of the yen and of the renminbi is the firebreak of Asia, and without the stabilization of these two currencies, there will be competitive devaluation, which certainly must be avoided. His comments also point to the significance of stabilizing the yen and of avoiding excessive weakening of the yen.

Panel Discussion

1. Difference in understanding of current status of Japanese economy between Japan and other countries

Dr. Lincoln said that the Japanese economy has not collapsed yet, and its situation is not so badly damaged that the people have to worry about it seriously while there still remains vague uncertainty regarding stable employment in the future.

Dr. Sakakibara mentioned that the Japanese often tend to become, sometimes masochistically, too pessimistic about anything, and such a tendency seems to apply to domestic views on the current economic situation, which has been transmitted to viewers in other countries. Dr. Sakakibara believed that fundamentals of the Japanese economy stay healthy and strong.

2. Perspective of Asian economies that suffered from crises lately

Dr. Sakakibara agreed with Mr. Nellor on his comments that those Asian countries have to thoroughly implement drastic reforms of domestic institutions, especially financial systems, in order to restore lost confidence on their economies from overseas markets while it would take a considerable time.

Dr. Lincoln thought that it may differ from one country to another how long it will take to recover economic healthiness and vitality; Malaysia is expected to achieve its economic recovery rather swiftly, and Indonesia, on the other hand, is seen to need most among others to ensure political stability for economic recovery.

3. Role of Japan for smooth economic recovery in the Asian countries

(The four panelists shared the same view that economic recovery of Japan will further promote economic recovery of the Asian countries)

Dr. Sakakibara stressed that Japanese corporations should now endeavor to further direct investments into Asia. Dr. Sakakibara also insisted that Japan should promote yen-denomination of import trades, especially of international commodities, and that a secondary market should be prepared and developed for smoother negotiation of yen-denominated trade bills.

Supporting Dr. Sakakibara's opinion on direct investments, Dr. Lincoln suggested that Japan should hasten restructuring of its financial systems and show it to the Asian countries as a model case.

Mr. Gyohten raised an opinion that it is worthwhile to check carefully how increase of foreign shareholdings of domestic corporations in those countries will benefit the country, and to check if it will cause any disadvantages to the economies.

4. International capital flows: Should it be liberalized or controlled?

Dr. Sakakibara opposed a laissez - faire policy with regard to cross - border capital flows while admitting that perfect liberalization of capital flows would be desirable at the last stage. Dr. Sakakibara suggested that international capital flows should be liberalized moderately in a carefully planned order.

Mr. Nellor agreed that there are some cases where thoughtless rapid liberalization of capital flows is not desirable to economies, and, at the same time, proposed that as the liberalization would generally provide ample benefits to economies, it should be promoted in good order with close supervision.

Dr. Lincoln said that the current trend of liberalization of international financial markets cannot be reversed, judged from a longer-term perspective and necessity of capital flows into developing countries, and insisted that what should be done is not to strengthen control over capital flows with regulations revived, such as prohibition of activities by hedge funds, but to prepare rules for orderly capital flows.

5. Summary by the moderator

Any large difference of opinions was found among the panelists with regard to what to be done for revitalization of the Japanese economy.

As Dr. Sakakibara mentioned, arguments on the current recession sometimes look mixed up with the structural problem of Japan. Admitting that those two issues should be argued separately, we have to recognize that Japan has those difficult problems that should be solved promptly. I may say that the Japanese economy is now in a transitional stage, which tends to provide various pains to most sectors of the society, and people who experience such pains, including statesmen, bureaucrats, businessmen and consumers are expected to understand the issues accurately and to make best efforts to settle them swiftly.

The issues in the Asian countries reflect problems contained in the “global capitalism" that has been spreading over the world recently. From now on the Asian countries including Japan and the world will have to spend a considerable time to cope with these problems contained in the “global capitalism".

Conflicts have some implications. Recently we have witnessed two contradictory trends; maximization of corporate profits in business circle theoretically backed by capitalism, and development of a national economy and maximization of national benefits. It must have the uppermost importance to management of the Asian economies to seek for an appropriate political framework where these two trends can go with each other compatibly.

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