

Is the Recovery of East Asian Economies Sustainable?

Institute for International Monetary Affairs

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Occasional Paper **10**

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3-2, Nihombashi Hongoku-cho 1-chome, Chuo-ku,

Tokyo 103-0021, Japan

Telephone: 81-3-3245-6934 Facsimile: 81-3-3231-5422

e-mail: admin@iima.or.jp

URL: <http://www.iima.or.jp>

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**Is the Recovery of
East Asian Economies Sustainable?**

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Preface

This is a record of proceedings of the 9th symposium by IIMA, which periodically sponsors symposiums and seminars on international economic and monetary matters. The 9th symposium was held on November 15, 2000, at Hotel Okura in Tokyo. The names of the panelists and short profiles of them are available below. (Please note that all responsibility in compiling these speeches and discussions is solely IIMA's, as are any errors in their presentation here.) We hope the opinions and discussions presented here will be informative to those interested in Asian economies.

Panelists :

Mr. Chatsiri Sohnbanich

President, Bangkok Bank Public Company Ltd., Thailand

1980 Graduated from Worcester Polytechnic Institute

1982 M. D. in Chemical Engineering from Massachusetts Institute of Technology

1984 M. D. in Management from Sloan School of Management, MIT

1993 Senior Executive Vice President, Bangkok Bank

1994— President

Mr. Tasuku Takagaki

Senior Advisor, The Bank of Tokyo-Mitsubishi, Ltd.

1953 Graduated from the University of Tokyo, and joined The Bank of Tokyo, Ltd.

1979 Member of the Board of Directors

1990 President

1996 President, The Bank of Tokyo-Mitsubishi, Ltd. (upon merger with the Mitsubishi Bank)

1998 Chairman of the Board

2000— Senior Advisor

Mr. Hubert Neiss

Chairman, Asia, Deutsche Bank, Asia Pacific Head Office, Singapore

1959 M. A. in Economics from University of Kansas

1960 Doctor in Economics and Business from Hochschule für Welthandel,
Vienna

joined Austrian Institute of Economic Research, Vienna

1968 Part-time Lecturer in Economics, University of Maryland

1991 Director, Central Asia Department, International Monetary Fund

1997 Director, Asia and Pacific Department, IMF

2000— Chairman, Asia, Deutsche Bank, Asia Pacific Head Office

Mr. Zembei Mizoguchi

Director-General, International Bureau, Ministry of Finance, Japan

1968 Graduated from the University of Tokyo and joined the Ministry of
Finance

1985 Alternate Executive Director for Japan, World Bank

1993 Deputy Vice Minister of Finance for International Affairs, Ministry of
Finance

1994 Minister, Embassy of Japan to the United States

1996 Deputy Director-General, Budget Bureau, Ministry of Finance

1998 Deputy Vice Minister of Finance

1999— Director-General, International Bureau

Mr. Charles H. Dallara

Managing Director, Institute of International Finance, Washington, D. C.

1976 M. A. in Law and Diplomacy from Tufts University

1986 Doctor in Philosophy from Tufts University

1989 Assistant Secretary for International Affairs, U. S. Department of the
Treasury

1990 Honorary Doctor in Laws from University of South Carolina

1991 Managing Director, J. P. Morgan & Co.

1993— Managing Director, Institute of International Finance

Mr. Toyoo Gyohten (Moderator)

President, Institute for International Monetary Affairs

1955 Graduated from the University of Tokyo and joined the Ministry of Finance

1984 Director-General, International Finance Bureau

1986 Vice Minister of Finance for International Affairs

1990 Visiting Professor at Princeton University

1992 Chairman, The Bank of Tokyo, Ltd.

1995— President, Institute for International Monetary Affairs

1996— Senior Advisor, The Bank of Tokyo-Mitsubishi, Ltd. (upon merger with the Mitsubishi Bank)

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I. Opening Remarks

Toyoo Gyohten

I am pleased to welcome such a large audience today to the 9th symposium sponsored by the Institute for International Monetary Affairs. As you are all aware, assessment of the East Asian economy has swung drastically in the past few years from pessimism to optimism, then to cautious one. When the East Asian economic crisis erupted in 1997, the economies of the region were severely criticized for being under-developed. The so-called Asian values, which we believed to have been the backbone of the miraculous development of East Asia in the 1980s succumbed to near complete denial. However, East Asian economic management was not the only target of criticism. Increasingly vehement criticism was directed to such factors as the IMF's conduct of crisis management as well as speculative short-term capital flows.

Fortunately, however, from the latter half of 1998, East Asian economies began to recover rapidly. Why were they able to achieve such a rapid recovery? Of course, it was partly owing to the macro economic policies that were applied in each country to provide strong economic stimulus. But the key factors were the strong increase in export competitiveness due to the weakening of their currencies, rapid expansion of the American economy at the time, and the vast increase in exports led by the expansive international semiconductor market. At the same time, based on their experiences during the financial crisis, these countries were making serious efforts towards restructuring in such areas as financial sectors. As a result, highly optimistic views concerning the East Asian economies were gaining ground at a rapid pace.

However, as you well know, we have been hearing some cautious views expressed about this optimism in the last few months. There are various reasons

behind this attitude. First, there is a fear that the favorable conditions which sustained the rapid recovery in the region since 1998 could be weakening. Second, there is another fear that the economic and structural reforms that are underway in these countries, especially reforms related to the problem of non-performing assets owned by financial institutions, are not making adequate progress. Third is a fear that many of the East Asian countries are suffering from the lack of political leadership.

Are these fears justifiable? If so, how can they be overcome and how can the recovery of the economies be placed on a more secured footing? What can be done to avoid the resurgence of crisis in the future? What roles are the public sector and the private financial institutions resolved to play in order to achieve these objectives? We might keep these questions in mind as we listen to the panelists and exchange opinions during today's symposium.

I am pleased to welcome today our distinguished panelists, some of whom have come from afar including Washington, DC. They are all well known and need no introduction from me. They have all been deeply involved in the economies of East Asia in one way or another during the era of miraculous expansion, during the crisis that followed and now at the stage of recovery. I am pleased to have these five panelists who, I believe, because of their experiences and expertise, are most qualified to discuss the subject of today's symposium.

Let me now turn the microphone to our panelists, starting with Mr. Chartsiri Sophonpanish, President of Bangkok Bank.

2. Is the Recovery of Thailand Sustainable?

Chartsiri Sophonpanich

Good afternoon. It is a great pleasure to be here today. This is, after all, a subject, which is important to all of us — the continued economic recovery in East Asia. We have certainly been enjoying rapid economic growth during the first half of this year — the question however now is — is this recovery sustainable.

A ‘sustainable recovery’ is one in which economic growth is underpinned by continuous improvements in competitiveness and productivity. This can only be achieved through state-of-the-art technology, falling production costs and growing investment returns.

Historical overview

To see whether this is indeed the path, which Thailand is embarked upon, I would first like to give you an historical overview.

During the early years of the 1990s Thailand together with other East Asian economies enjoyed unprecedented rates of growth. This spectacular growth was due to the exploitation of cheap factors of production such as land, labor and natural resources. It was, therefore, growth without productivity increases. There was no evidence of a significant shift in methods of production and no widespread introduction of modern technology. This meant that the overall ‘capital/labor ratio’ in the production process remained stable or even decreased during the 80s and 90s.

However, easy money and rigorous government export drives gave Thailand and other Asian economies a temporary impetus to achieve unusually

high growth rates. This eventually led to the infamous bubble in the Thai economy. This was caused by a combination of financial imprudence due to easy domestic credit policy and a continuous inflow of foreign capital. Most businesses, regardless of their size, had easy access to foreign borrowing at a much lower cost. A large chunk of the borrowed money was badly misused for speculation in the stock market and the real estate investment.

The situation deteriorated quickly when the deficit in the current account grew as high as 8 to 9% of GDP. Capital outflow began and the stock market took a dive. The liquidity shortage led to a collapse of the real estate sector and brought down many good finance companies along with it. General public confidence of course fell and that led to a massive drop in consumer spending. After a series of speculative attacks, the fixed exchange rate collapsed, the bankruptcy rate exploded and massive NPLs (non-performing loans) swamped the banks.

A full blown economic depression had arrived and the IMF was called in for a 'quick fix'. The IMF saw all this as the byproduct of a lack of financial discipline and therefore enforced tight monetary and fiscal policies as one of the conditions for providing relief loans to Thailand. The result was disastrous. The liquidity shortage worsened and the bankruptcy rate skyrocketed. At that moment in time, no one seemed to really understand the true nature of the problem, nor did anyone know the correct remedy.

The growth rate, as measured by GDP, plunged from 7.2% in 1996 to a mere 1% in 1997, and then dove further to minus 10% in 1998. Only when the IMF reversed its tight policy mandate by allowing interest rates to fall and massive public expenditures to take place, did the economy pick up momentum. The growth rate rose to 4.2% in 1999, and is expected to average 5% for 2000.

A recovery

Does this mean Thailand is on the way to recovery? The overall macro picture seems to indicate that it is. Firstly, the exchange rate has improved greatly, from USD/Baht 57 in 1998, to 37-38 in 1999 and most of this year. Recently, it has depreciated to 43, due mainly to the oil price hike. Secondly, exports have made a great comeback, while imports have been contained at lower levels, giving us a surplus every year since the crisis. Thirdly, NPLs at banks began to drift slowly down, from a peak of more than 50% of all loans in 1998, to less than 30% at the moment. This has been achieved without a massive government NPL bail-out. Fourthly, the necessary laws required for basic financial reform have been passed. These include the new Banking and Finance Company Act, the Bankruptcy Act, the new accounting code, and regulations related to transparency and good governance practices.

The dark side of the coin

In spite of this optimism, the Thai economy is still hindered by a number of uncertainties and weaknesses. The most critical concern is that the recovery is not evenly distributed, but concentrated mainly in the export sector. The top five exports from Thailand are all ‘low value-added’ products, as most of the required inputs have to be imported from abroad. These are — electronics and computer parts, automotive and spare parts, electrical goods and garments.

The rest of the economy is still suffering from stagnation and cannot generate sufficient demand to accommodate new investment. The capacity utilization rate in the domestic manufacturing sector remains below 60%. New technology, which of course requires new investment, is not being introduced and this means general manufacturing in Thailand is becoming less competitive.

Thus, if you ask whether the recovery of the Thai economy, as it appears now, is sustainable in the long run, the answer is probably not a “yes”. We have to acknowledge that the return process still has a long way to go. Sustainable growth of an economy in the modern world must be incorporated with up-to-date technology where quality and prices are highly competitive. It requires a continuous rise in the value of capital/labor rate. More capital means new technology, while less labor means more sophisticated and highly trained workers to work with new machines under improved work systems. This will not be the environment in Thailand nor many other Asian economies in the near future.

Government action

In spite of the public complaint that the government has not done enough to solve the problem, in fairness I would say it has done quite a lot in its efforts to lift up the economy from the crisis. However, the problems we have been facing may be too many or too difficult to reverse our course in such a short period of time. In a country where our people have vastly different education and economic background, the problems are much complex. Each group needs a different set of solutions to its problems. No single medicine can cure all.

1. To start with, the government decided to go along with the strict IMF conditions for belt tightening in both a fiscal and monetary sense, i.e, high interest rates and a budget surplus. These policies, together with a more liberalized approach, were aimed at reestablishing foreign confidence and inducing a capital inflow. When these mandated measures proved to do more harm than good, the government reversed its stance. It lowered interest rates and it raised public expenditure in order to revive economic activity. Public projects in construction were maintained, using both the fiscal budget and borrowed funds from the ADB. Rural development programmes were launched continuously using funds from Japan’s 1st and 2nd Miyazawa loans.

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2. To strengthen the industrial sector, the government devised a 5-year Industrial Development Plan (1998-2002), to upgrade the technology and performance in certain strategic industries, namely food, animal feed, textile and garments, glassware, ceramics, jewelry and gems.
 3. In agriculture, a lot of money has been spent to improve the general livelihood of rural inhabitants and to facilitate their farm production. This is the area where most of the Miyazawa funds have been utilized.
 4. The focus of recovery has now shifted from big enterprises to the development of SMEs (Small and Medium Enterprises). A new Act has been promulgated to provide a number of privileges to this sector. The privileges range from financial aid to free advisory assistance. Banks are also strongly encouraged to provide generous loans to SMEs at especially low rates of interest.
 5. Finally, the last move of the government, before the conclusion of its term, was to announce another stimulus package on October 31st. This package involves an outlay of more than Baht 50 billion (US \$ 1.2 billion) for SMEs and several agricultural development programmes. It also includes additional tariff cuts on essential raw material imports.

But the results of these measures will take time to be felt. It takes much more than physical changes, funding, and new public policies to bring about true restructuring especially when widespread corruption and nepotism is still entrenched. However, the situation is slowly evolving in a positive direction.

The future

My conclusion for sustainable recovery in Thailand is 3-fold.

1. Unless we successfully put our house in order, the economic recovery of
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Thailand cannot be sustainable. The most crucial factor for effective recovery is ‘domestic political stability’ which Thailand must strive to attain quickly.

2. Thailand cannot expect to depend solely on export-led growth as we have in the past. More attention will have to be shifted to domestic-led growth by creating and enlarging the domestic market.
3. We need a strong financial sector to act as a catalyst for overall economic recovery. In Thailand, NPLs, which rose to over 50% of total bank assets in 1999, have been our chief concern ever since the crisis broke out. It was suggested early on that the government should set up an Asset Management Company to handle these troubled loans, as has been done in other countries. However there are difficulties with this approach — such as the fiscal cost. In the end the government decided to take a market based approach. Time will tell which is the most successful solution.

With regard to the financial sector, some of you may be wondering what the banks have been doing since the financial crisis. I can assure you that we have not remained idle! Apart from helping our customers restructure their debts and putting them back on their feet, we have also been going through total restructuring and reform ourselves.

Bangkok Bank has been very serious about quality improvement for a number of years now. We have been working with international renowned consultants in our core structural Systems. We are reorganizing our entire bank, retraining and redeploying our workforce to gain maximum efficiency and productivity. We have cut down our headcount by 25% over the past 3 years and the process is continuing. We have installed the best possible hardware and software computer systems that enable us to compete effectively with speed and accuracy. We have changed our credit systems from the traditional collateral-

based to the more internationally accepted cash flow based. We have hired a number of foreign experts to help us in various fields of operation and technology, especially in building sound risk evaluation systems and training our credit personnel.

I am sure that this sort of restructuring is also taking place in other banks in Thailand. I am confident that within two to three years from now Thailand will have a reasonably robust financial sector indeed.

Conclusion

Ladies and Gentlemen, it may be worthwhile to look ahead and ask, what then is the best path for Asian economies to follow? The great Asian financial crisis of 1997, which unfortunately started from Thailand, has provided us an invaluable lesson. It was a case of complacency with our own success and blissful ignorance of the outside world. It was also a case of “bubble growth” without a solid foundation and glory without substance.

So of course, there were problems with the old system. However, an unconditional move to a totally free market, as demanded by the IMF and World Bank, may not be the answer either. Asian countries are bounded by their individual cultural and social values. A practice that is successful in the West, may be quite futile in Asia. An Asian government that rushes to get onto the ‘unconditional-free-trade-band-wagon’ will likely see disruptions throughout the whole society, from financial meltdown to widespread bankruptcy, unending social protests, and political unrest.

Having said all this, I am not going to suggest an alternative economic philosophy such as a new form of sub-regional economic zone, or anything of that nature, to protect our countries from mightier foreign competitors, as do

some academics and policy makers. However, there is no harm to think hard about it, as it may turn out to be a better solution for all of us one day.

What I would like to do is to commend the initiative in regional cooperation put forward by Japan under the late Prime Minister Keizo Obuchi, known as the New Miyazawa Initiative to cope with possible future currency crises. Its essence lies not in the setting up of a Fund to invest extensively in Asia and making loans to troubled countries, but in the establishment of a mechanism for mobilizing private capital under guarantees from both private financial institutions and other Asian governments.

The Chiang Mai Initiative of May 2000, that brought together Finance Ministers of all 10 ASEAN members and 3 other countries, namely Japan, China and Korea, in short ASEAN+3, resolved to set up a “Financial Lookout System” which includes a US \$ 200 million swap arrangement. The parties to the initiative also agreed to work closely with each other by sharing information and monitoring the regional economic and financial situation to help avoid future crises.

Establishing this kind of teamwork is the first step forward. The idea behind this type of cooperation is to lessen the possibility of volatility in an age of globalization. What Asia needs most is a stable environment to maximize its economic recovery and thus sustainable growth in the long run. I sincerely believe that, with continued determination, we shall eventually achieve this. Thank you.

3. Japanese Banks and Asia

Tasuku Takagaki

Current Economic Situation in Asia

Recently it has sometimes been heard that a recurrence of financial distress similar to that of 1997's Asian currency crisis in 1997 is possible. The factors which could trigger such a crisis are cited as the slowing of US economy, especially a hard-landing of US stock markets; a relapse of the Japanese economy into deflation; a spread of economic chaos in Asia caused by political unrest in a country within the region; persistent or sudden rises in crude oil prices; or a combination of two or more of these.

It is difficult to conclude that another Asian crisis is impossible. It is also difficult to precisely forecast the extent of such a crisis should it occur, in terms of how severe it would be in the region and how it would affect the global economy, particularly when political factors come into play.

It is not in doubt that Asian countries have survived the 1997 crisis, strengthening their crisis-management abilities or ability to absorb shocks, as seen in the improvement of trade and current account balances; increased foreign exchange reserves; decreased short-term debt, especially in speculative capital flows; increased foreign direct investment; and the development of advanced, market economy-based financial and industrial systems.

During the past year we also often heard that the development of necessary structural reforms in Asian countries is incomplete, that the remedy is being postponed or slowed because a few countries have experienced rapid economic recoveries since the 1997 crisis. Because of this rapid recovery, it is argued, the

momentum of reform in important domestic restructuring, deregulation, and streamlining of legal systems has only been met halfway. This argument seems to start with an over-estimation by a handful overseas economists of the rapid recovery of countries like South Korea and Thailand. It is necessary to stress the importance of the structural reforms and economic recovery, but in my view it is extremely difficult, if not almost impossible, to expect that both financial and industrial restructuring, including disposition of the non-performing assets of banks and corporations, and economic recovery will proceed simultaneously and rapidly. More objective evaluations of the situation, country by country, are required.

Japanese Banks and Asia

I have been asked to comment on Asia's relationship with Japanese financial institutions. More specifically, I have been asked about the current investment and lending attitude of Japanese corporations in Asia, especially that of private Japanese banks, and whether they are aggressive. If we look at the history of Japanese banks in the region during the past decade, in terms of both loans and investments and the number of branches and representative offices, we notice their presence has declined. To determine whether this trend will continue, or whether Japanese banks will rebound in the region and increase their exposure, we must look at the changes in their Asian policies, which are based on the changes in business conditions surrounding them.

It may be unnecessary to go into detail on the current situation of the Japanese banking industry, which stems from the end of the bubble economy in the early 90s and subsequent slow-down and aggravation of profitability and management of Japanese banks. They have had to struggle to settle bad loans, and to improve overall loan and investment assets in Japan. Japanese banks also had to review their overseas operations, including those in Asia. As a

result, some overseas branches and subsidiaries had to scale down operations or, in some cases, were completely shut down if it was judged that their credit portfolios were problematic in terms of asset quality and profitability. This change in policy was in sharp contrast with Japanese banks' aggressive expansion into overseas markets, especially to Asia, during the 70s and 80s.

A new movement has been observed during the past year or two, however, as a result of the strenuous efforts toward financial restructuring and economic recovery in Japan. Some Japanese banks are now once again looking positively at their overseas markets, particularly those in Asia.

The Bank of Tokyo-Mitsubishi has always been consistent in its commitment to the overseas operations, and some other large Japanese city banks which had retreated from overseas markets are now redeclaring their importance, as a result of progress in mergers and consolidations into new banking groups. The number of Japanese banks operating overseas is nonetheless much lower than it was during the 1980s. The size of their operations and coverage of areas is also smaller, but they are also focusing on the reestablishment and enhancement of relationships with their neighbors in Asia.

Let me touch upon the future of relations between Asia and Japan. First of all, Japanese manufacturers, with their first-rate technological and engineering capabilities, will continue to maintain or even increase their production bases in nearby Asian countries, mainly due to cost considerations. The expansion of WTO membership to include China will have a positive effect in deepening economic ties of countries within the region. This will not be limited to only the export and import of goods and services, but will also include exchanges in human resources, culture, and the flow of various kinds of funds and capital. Although it may take years to complete, the formation of a new "regional economic area" will gradually develop in Asia, similar to that already seen in

Europe and the Americas. The concept of an Asian Monetary Fund is taking form, and there is also the possibility of bilateral free trade agreements similar to the one recently agreed between Japan and Singapore spreading to other countries in the region. Furthermore, creation of a multilateral economic organization as an expanded version of ASEAN may not be just a dream.

From this perspective the relationship between Japanese and Asian financial institutions will become closer, taking many forms. The roles to be played by Japanese financial institutions may gain in importance, considering the size of their operations and macroeconomic influence. The main players will be the Bank of Japan and Japan Bank for International Cooperation, from the public sector, and from private sector will be large city bank groups, securities houses, and insurance company groups, all of which will explore and expand their operations in various forms, based on the needs of their domestic and overseas customers.

Although the past bitter experiences of the bursting of the bubble economy and currency crises in Asia have inevitably made Japanese financial institutions cautious and selective, various business opportunities will be created through their relationships with customers, backed by the advancement of streamlined legal systems which cover capital markets and business transactions in Asia. It is only natural that cooperation and competition among Japanese financial institutions and their influential European and American counterparts operating in the region will develop.

I would like to conclude by saying that there are many good reasons and solid bases for believing that Japanese financial institutions are positive toward Asia, and that their operations within the region will expand in line with that belief. Thank you.

4. Economic Outlook and Reforms in East Asian Economies

Hubert Neiss

I will briefly comment on the following issues which the organizers asked me to address in my presentation :

- the economic outlook for East Asia
- Financial reform and corporate restructuring, and how to accelerate them
- Remaining structural deficiencies and what to do about them
- Regional financial cooperation in East Asia.

In terms of specific countries, I will concentrate on the former “crisis countries”, i.e. Thailand, Malaysia, Indonesia, the Philippines, and Korea.

Economic Outlook

- All countries affected by the Asian crisis have stabilized their financial systems and staged an impressive recovery. At the same time, they are undergoing wide-ranging reform and restructuring to build a solid base for sustained expansion. Several developments in recent months, however, have clouded the prospect for continued recovery :

- a slowdown of the boom in the US
 - less buoyant and less liquid financial markets
 - a weakening of demand for electronics
 - a higher oil price
 - political uncertainties in several countries
-

These are important concerns. However, they should be balanced by a number of positive points :

- the global economic environment remains favorable. The probabilities of a soft landing for the US economy have increased, and Europe and Japan continue their recovery.
 - the oil price is likely to weaken somewhat during the course of next year.
 - The Asian “crisis countries” have restored a strong external position. They have rebuilt their foreign exchange reserves, reduced short-term external borrowing, and are running current account surpluses; and, very importantly
 - every country has remained on the reform course, although the pace has been uneven, and there have been occasional setbacks.
- Against this background, the present market pessimism seems exaggerated. There is a high probability that the recovery will continue, despite the difficulties mentioned. Its speed, however, will significantly slow down, with GDP growth rates falling from around 8% this year to around 5% next year. The main risk to this recovery scenario is a relapse into unsound macroeconomic policies and a reversal of the reform course. But there are no signs that this would happen.

Financial reform and corporate restructuring

- A large part of financial sector reform has been completed and the threat of a systemic collapse has disappeared. Unviable institutions have been closed, weak but viable institutions have been recapitalized, NPAs (non-performing assets) have been taken over by AMC (Asset Management Corporations), and short-term foreign liabilities have been re-scheduled. At the same time, banking regulations have been updated and supervision has been strengthened. The process of working off NPLs and dispose NPAs, and of bank consolidation
-

and reprivatization is ongoing and will take another couple of years.

- While far from perfect, the record of bank restructuring has been more impressive than that of corporate restructuring which started late and has been slow. It has followed the “London approach” i.e. voluntary agreements between private debtors and creditors on debt re-scheduling, debt reduction, and debt-equity swaps as well as on operational restructuring to restore the corporations’ capacity to generate cash flows.

- This is inherently time consuming. Corporate restructuring is technically complex and politically sensitive, and, unlike in bank restructuring, the government’s role is more limited. The government, nevertheless, can do a lot to accelerate the process :
 - To the extent that the government owns creditor banks, and its ownership has increased through bank recapitalization, it can take a direct influence in the negotiations.
 - It can also set deadlines for agreement between the parties, after which the case would be taken over by the bankruptcy court. This would be less favorable for debtors and creditors.
 - It can stand ready to provide funds for additional bank recapitalization if this should become necessary in the process of corporate restructuring.
 - It can also provide incentives to an agreement by giving favored tax treatment to restructured companies.
 - Finally, in most countries, the government must update bankruptcy and foreclosure laws and strengthen the technical capacity and political independence of bankruptcy courts. Only with a credible threat of effective bankruptcy procedures, is there pressure on debtors to come to the negotiating table.

Remaining structural deficiencies

- Beyond the uncompleted tasks of reform and restructuring, the major remaining deficiencies are, in my view, in the governance practices which have prevailed in the past and which have played an important role in the run-up to the Asian crisis.
 - Governments have recognized that the previous model of economic management, which was based on government directives, personal relationships, and non-transparency, and which could be abused and misallocate resources, is no longer suitable in an era of global competition. They have set up a new regulatory environment to change this model. In banking, for instance, many areas have been brought closer to best international practices, including risk assessment, prudential norms, accounting standards, and disclosure. However, this is a necessary but not a sufficient condition. The real challenge is to change the behavior of owners, managers, government officials, and politicians.
 - Such changes will take time, but will gradually be forced from three directions :
 - first, more effective and more independent government regulation and supervision, especially in the financial and competition areas, will hold firms to higher standards. This is partly done through newly created institutions which also have the power of sanctions.
 - second, more intense competition through deregulation and liberalization, including greater scope for foreign ownership. Firms which fall behind in improving governance practices will find it difficult to attract the needed capital and personnel.
 - third, greater transparency of information, a free press, and a more critical public will make it more difficult for vested interest groups and politicians to inappropriately interfere in commercial decisions.
-

Regional financial cooperation

- Steps towards regional cooperation, like high level discussions at regional fora, or the recent swap agreement between central banks, are positive signs. They indicate a trend towards greater economic integration and economic policy coordination, which is a challenge for the region over the longer term. Its success will importantly define Asia's future role in the world economy. This is a comprehensive undertaking that goes way beyond the modest financial arrangements currently in place. Eventually it would include free movement of goods, capital and labor within the region as well as common policy rules for governments. Europe has shown that this is not impossible, but also that it will take time.

- In the foreseeable future, concrete actions are more important than rhetoric. There are several things governments could do to strengthen the trend towards regional integration :
 - creating the basis for closer economic policy coordination through an inter-governmental arrangement of monitoring and consultation,
 - taking steps in line with a clearly defined roadmap towards a free-trade area,
 - facilitating closer economic integration through step by step harmonization of the legal and regulatory framework, like financial regulation, competition policy, and the tax system.
 - making financial assistance in case of a crisis credible through increasing the amounts available and streamlining the modalities of support.

Will existing arrangements for regional financial cooperation prevent future financial crisis? They will help. But for the foreseeable future, Asian countries must rely on their own efforts. Their best insurance against another crisis comes from a steady implementation of policies to complete the reform

and restructuring process and to keep the macroeconomic situation on an even keel.

5. Asian Economic Recovery and Enhanced Regional Cooperation

Zembei Mizoguchi

Asian Economic Recovery

Since the panelists before me have commented on this subject, I will not repeat the details, but I, too, believe that the Asian economy is showing remarkable recovery.

Some of the factors behind the rapid recovery we are witnessing in Asia are increases in exports, appropriate fiscal and monetary policies, and progress in structural reforms.

However, there is also a view that not enough has been achieved in structural reforms, so let me give a perspective, though a very broad view, on the changes in the financial sector in the five countries that are at the heart of today's theme.

First is the issue of non-performing loans. The ratio of non-performing loans to the outstanding loans before the 1997 financial crisis was about 5%. At the worst period, the figure reached over 20%, but after efforts were made to dispose of non-performing loans, it is now down to about 15%. Purchases of non-performing assets by public institutions amount to over 10% of GDP (nominal figure for 1999).

Second, in order to strengthen the capital base of financial institutions, public money amounting to a total of nearly 10% of GDP (about \$70 billion) has been invested.

Third, as for the consolidation of financial institutions, the number of commercial banks has decreased from about 300 before the crisis to about 200.

Besides these developments, measures have been taken to tighten supervision over financial institutions, such as gradually applying a higher standard of financial prudential provisions.

Needless to say, each country has its individual, complicated hurdles in pushing forward structural reforms. Structural reform in the financial sector continues to be a major challenge, while there is also a continued need for restructuring in the manufacturing sector.

There are other worrisome factors which must continue to be closely monitored, such as the fall of currency and stock values and political instability, as well as the possible risks such external factors as the American economy and crude oil price could have on the economies of this region.

Future Policies for Asia in view of the Financial Crisis

Based on the experience of the Asian currency and financial crises, the following policies have been recommended.

First, since the weaknesses of the financial and corporate sectors were the major contributors to the crisis, individual Asian countries need to take positive measures to restructure these sectors. Also, they should adopt a more flexible exchange rate system since pegging their currencies to the dollar was a major cause of the crisis.

Second, the international community as a whole should take measures to strengthen the international financial system, through an enhanced surveillance

by the IMF for instance, in order to prevent the resurgence of a crisis.

Third, financial cooperation in Asia should be strengthened so that the region can quickly and adequately deal with the situation in case of another currency or financial crisis.

Since the first topic of measures taken by individual Asian countries has already been touched upon, I would like to concentrate on the second and third points, the strengthening of the international financial system and cooperation within Asia.

Reform of the International Financial System

Now I would like to comment on the reform of the international financial system.

Based on the lessons learned from the recent currency crises, there has been an international debate concerning international financial system reforms, such as the reform of the IMF, in order to prevent the resurgence of a crisis as well as to stop the spread of a crisis and to rapidly resolve a crisis when one occurs. Efforts have been made on this front.

First of all, in order to prevent a crisis, it is necessary to strengthen the surveillance of the economic situation and policies of member countries by the IMF. Until now, Japan has argued that the IMF should concentrate its surveillance on core areas of its responsibilities, in other words, on macro-economic policies and the foreign exchange system together with the structural problems of such sectors as the financial sector which importantly affect the macro-economic stability, and capital flow. It is especially important that the developing countries spontaneously implement sound financial supervising policies such as

supervision and nurturing of the financial sector, and good macro-economic policies. Surveillance by the IMF should carefully examine if these measures are adequately applied.

Second, as part of the measures to be taken at a time of crisis, the IMF's function to support the international balance of payments at the time of a temporary liquidity crisis of a member country has been strengthened. Various means to rationalize and simplify the loan system have been considered, such as easing the conditions under which CCL (Contingent Credit Line) — the credit line to prevent the spread of a monetary crisis — could be used.

Third, in view of the large impact the flow of private funds can have on an economic system, there is now an international consensus that when a crisis occurs, private creditors should share due burden. On the other hand, because capital flows into emerging economies have shifted from bank loans to portfolio investment, the unit of credit is becoming smaller and creditors are becoming more diverse, which means that it is more difficult to secure the cooperation of creditors at a time of crisis. Debate is still continuing on how the private sector should get involved in a crisis. I feel that it is crucial to enhance the transparency of the procedures so that the market participants can better foresee the outcome, while sustaining flexibility to be able to cope with a crisis properly. It is also important that there should be a continuous dialogue between the private sector and the public sector that includes the IMF, and I am pleased that such a dialogue is beginning to develop.

Enhancement of Regional cooperation within Asia

Next, I would like to say a few words on increasing regional cooperation in Asia.

We are witnessing an increased inter-dependence in Asia. When we look at trade relations of the 10 Asian countries (4 ASEAN countries, NIEs, China and Japan), 32% of both exports and imports were transacted within the region in 1980. The figures jumped to 46% of exports and 50% of imports in 1997. (In 1998, the figures shifted to 41% of exports and 52% of imports due to the Asian monetary crisis.) Looking at foreign direct investment, 67% of investment into China came from other Asian countries in 1998.

Parallel to the interlinked industrialization among the Asia nations, multiple layers of close trade-and-investment relationships are developing within the region, and a structure is developing where both trade and investment are circulating in the region.

It is predicted that Asia will continue to enjoy a higher rate of economic development than other regions in the coming years, and with it, a further expansion of markets in the region. Also, with the development of free trade agreements such as AFTA (ASEAN Free Trade Area), interdependence of Asian trade will increase further in the years ahead.

I believe that Asia will develop a very robust inter-dependency that has never been seen before. It is, therefore, quite natural that these countries would want to enhance regional cooperation within Asia for the benefit of a more stable development of their economies. In fact, political leaders in Asia are already seriously discussing what is the best way to cooperate within the region to prevent the resurgence of a crisis similar to the last Asian ones.

It was under such circumstances that the understanding to strengthen “self-reliance and support mechanisms” within the region was accepted at the summit meeting of ASEAN plus Japan, China, and South Korea held in Manila in November last year. Based on this agreement, the “Chiang Mai Initiative”

was agreed at the meeting of the Finance Ministers of the above countries at Chiang Mai in Thailand last May to create a network to accommodate short-term funds within the region.

Under the Chiang Mai Initiative, Asian countries will accommodate funds in the form of bilateral swaps arrangements to countries in need of short-term liquidity support to meet the international balance of payments obligations. We are currently discussing concrete measures for the framework.

What role can such a regional support framework play in preventing the resurgence of an international monetary crisis? I do not believe that a regional cooperation framework such as the Chiang Mai Initiative by itself is adequate to deal with a currency crisis. In order to settle a currency crisis like the one that occurred in Asia, where the capital accounts worsened rapidly and drastically because of the sudden loss of credibility by the markets, an extensive international support with substantial amounts of funds would become necessary. In such a case, the whole international community needs to join forces around international financial institutions such as the IMF and extend its support.

Accordingly, I believe a regional cooperative framework, such as the Chiang Mai Initiative, should be regarded as a supplementary system to the existing international financial support mechanism. Since such a regional framework will be able to react to an emergency more quickly and more flexibly, it will reinforce international financial input or can play a role to provide bridging capital until international support can be organized.

I believe that a financial support system like the Chiang Mai Initiative can enhance communications on the economic situation in Asia and deepen the understanding between these countries, which I hope will give a momentum to strengthen further regional cooperation.

Conclusion

As we have seen, Asia still has various hurdles to overcome such as the structural problems like the restructuring in the financial sector. However, generally speaking, I believe the region will continue its economic recovery provided the governments pursue adequate economic policies and continue to push reform measures while receiving international and regional supports I have mentioned before.

Finally, let me make a short comment on progress in regional cooperation. The Asian currency and financial crisis brought immeasurable suffering to many people in Asia. However, because the countries in the region suffered from the same problem and struggled together to find ways to cope with that problem, a certain sense of shared destiny developed within the region. I think this was a huge factor behind the agreement of the Chiang Mai Initiative.

We need to nurture this new trend. By doing so, I am sure the last Asian crisis can serve to strengthen the cooperation within the region and be a stepping stone to a more stable and prosperous Asia.

6. Asian Economic Recovery and its preconditions

Charles H. Dallara

Thank you very much, Toyoo. Let me first say you how delighted I am to join such distinguished panelists, and to be a part of the program sponsored by the Institute for International Monetary Affairs. Indeed, the President of the Institute, or Chairman today, Mr. Gyoten, is a long time friend, and I think, one of the true leaders in global finance for the last quarter of the century. So my only, perhaps, complaint about the program is that you, yourself, are not speaking to these issues, and I hope that you will indulge us, after my comments, for just a few minutes to share some of your own perspectives because they are likely to be of extraordinary value. Indeed, I should say also, that just in the few years that the IIMA has been of existence, I think it has already contributed substantially to the global debate on monetary issues, and to specially bringing new perspectives to regional monetary and financial issues, and I am delighted to be playing a small part of that effort here today.

I guess my first point is, in an overly simplistic effort to answer the question, “Is the recovery of East Asian economy sustainable?”, is to say, yes, but with two strong caveats. First, yes, only if there is a re-invigoration of reform efforts in East Asia. And secondly, only if the global economic and financial environment remains supportive. And both of these if’s are big if’s.

First, let’s acknowledge, and I think that many of the speakers before me have made the precise comments and I only have to associate myself with those who have noted the very powerful, progressive, and important reforms that many governments and private financial and corporate institutions have made

over the last three and a half years since the onset of the crisis.

Indeed, if you look at the pace of change against historical standards, you would say that it has been dramatic and impressive. If you look at how quickly banks in Korea, Thailand and Malaysia have worked to get on top of their capital problems, their credit risk management problems, their bad loan problems, and you compare that, for example, to the decade of efforts in Latin America in the 1980s, you would say, "East Asia has made impressive strides." But if you compare the progress against current challenges, current circumstances, and the pace of change in the global community today, the progress does not look as impressive.

Part of the challenge for East Asia moving ahead is to recognize that the standards have risen considerably. The water level in order to swim ahead is much higher than it was only a few years ago. This is one of the dimensions of globalization. Technical, professional leaders, I think, are aware of this, but I wonder sometimes if political leaders are adequately aware that they are not marching on a flat plain any more today. It is a very steep hill. And if you fall, it's not just a minor stumble today. We learned in 1997 that if you fall, you can fall way back down the hill.

Against that backdrop, let me just provide a slightly different perspective, because I really don't have much to add to the very impressive facts and presentations and opinions. I agree with virtually everything that has been said, but a slightly different perspective is to put what is happening in East Asia today in the global environment. Yes, as Mr. Neiss pointed out, the U.S. continues to grow; it is moderating, it is perhaps finding a soft-landing.

But this soft-landing may not be an easy one for East Asia. Financial markets have been volatile and uncertain throughout the year in the United

States, and a problem most likely looms ahead in terms of the U.S. current account deficit, and perhaps a problem looms ahead for the major currency alignments. A weak Dollar would mean a strong Yen, perhaps. Would this be good for Japanese and for Asian recovery?

We can take some comfort, that Europe continues to expand, but they are being hit by the oil prices. They have a weak currency which actually hasn't been anywhere near the economic problem, as it has been a psychological problem. But their growth is moderating. And Japan, after a strong first half, is demonstrating that turning the corner. To find sustainable strong growth is still a big, big challenge here. A lot is taking place in Japan, and I don't want to diminish the pace of structural change here in the financial sector or the corporate sector. But you know, I find myself in Tokyo today, looking at the political uncertainty in my own country and the political uncertainty in your country, and wondering if we don't have more on that front than we would like to have. So maybe the global environment is not so positive after all for East Asia and the capital flows into Asia themselves have, at a superficial level, a positive dimension, but underneath the surface, perhaps there are some areas for concern as well.

You know, I was in the Navy for a few years before I became an economist and a banker, and I learned that it is the problem beneath the water line that has to concern you. If you have a hole in your ship in the super-structure, it doesn't look very nice, it may damage some gear, but it's not a threat to your safety. But if you have a hole below the water line, you have to be concerned.

Above the water line, capital flows are growing to Asia. Bank lending is no longer so negative, equity flows are being sustained, and capital market activity into the region has picked up. Below the water line, I wonder if Asian authorities appreciate the structural changes that have been made in the banking community. Yes, I listened carefully, and I agree fully with Mr. Takagaki that

Asian banks will and are renewing their activity throughout the region. At the same time, many banks around the world are finding that on balance sheet lending to emerging markets does not pay the way it used to. They would rather use their balance sheet for capital market activity, or maybe to acquire a bank and generate local lending activity. The fact is that cross border bank lending into East Asia is probably not going to rebound. And maybe that's partly good, because clearly there was excess lending, there was weak risk management.

The problems of East Asia may have originated in East Asia, but they were fostered, they were facilitated, unfortunately encouraged by excess lending. But now the consequence of that is in the environment where bringing in debt capital is going to be difficult. And bringing in equity capital involves more political choices, facing tough political decisions than perhaps leaders are quite prepared to make. Recently in the last few weeks, the aversion to risk in global capital markets has increased. Spreads on emerging market debt, Asian debt, Latin American debt, even central European and Turkish debt have increased significantly. Availability of finance for emerging market borrowers has declined somewhat.

Of course this is related more to global developments than to problems in East Asia, but the combination of perceived problems growing once again in the reform effort, along with the more difficult global financial conditions, is indeed posing a new round of challenges to East Asian leaders. And I think that it's important to recognize that those challenges are going to be quite serious. One can look at the lack of appetite for lending to East Asia and say, "This is just a reflection of the lack of appetite for high risk lending." And that is partly true. But it is a reality.

I also think that, unfortunately some of the lack of appetite for lending to emerging markets around the world, including East Asia, reflects the very

strange signals coming out of some finance and central bank officials around the world, and let me hasten to add that I don't mean from my friend to the left in the Japanese Finance Ministry, but primarily out of Europe, you hear a drum beat, "We want to see private sector involvement in crisis management." It's not clear what they mean, but I have just been in Europe before arriving in Japan, and I can tell you that many institutional investors, pension funds, asset management firms, and other institutional investors are not anxious to put their money into East Asia or Latin America. If one day the IMF stands up and says, "Gentlemen, this is what we should all do tomorrow. You should lend this much, and you should do this," Capital markets do not work that way. And I think that policy makers need to appreciate this.

Against this challenging context, and within this challenging context, I would have to say that in many ways, East Asia earns high marks for what has been accomplished. Certainly after the initial crisis period, and after a period in countries like Thailand and to a lesser extent in Korea, after the policy makers move beyond being stunned and dazed, they implemented on the whole strong macro policies. They have begun structural reforms which moved, unfortunately in my view, into a period of some complacency. They need very much to move beyond that period of complacency, and face the difficult choices. Banking reform has made a lot of progress, and yet developing a fundamentally new culture for credit risk management, ensuring that your capital is there and is soundly managed, improving transparency, these are all on-going medium-term tasks, and as Hubert Neiss pointed out, they cannot be done without adequate corporate restructuring. It does no good to restructure a bank, if it continues to lend to the same corporate clients who continue to make the same mistakes, year in year out, and I am disappointed and concerned that management of banks has changed more than management of the borrowers. What does that say about the long-term help of the banking system? It raises real concerns to me.

I would also argue that transparency, which has been gradually embraced,

needs to take another step up : Accounting standards, auditing standards, bankruptcy, and as has already been mentioned, corporate governance. If you are going to attract equity into East Asia, as well as debt, corporate governance has to be more reliable, minority shareholder rights have to be protected, and there has to be an open and fair sense of competition. Investor relations programs need to be developed by emerging market authorities in Asia. They cannot take for granted that because the money is coming in one day, it will always be coming in. You know, markets are so volatile. And they have mood swings. And we should not forget those mood swings. Just because it has been a year and a half since we have had the crisis in emerging markets does not mean that the markets will not go through another period of a mood swing. And when they do, those authorities who have worked to get to know their investors and their lenders, who have really developed strong, trusting relationships, will be better positioned to withstand the period of volatility.

Let me close by making two final comments, first on regional cooperation. I must say I was impressed by the comments that were made by all the other speakers in this arena, especially Mr. Mizoguchi, because I do think the Japanese leadership, and more broadly, efforts to regional cooperation are a critical compliment to global cooperation. Too often, some in Washington see regional cooperation as a threat or competition with global cooperation. But I, for one, do not see it that way at all. I think that only through looking at a problem through two different prisms, a global one and a regional one, and yes, a national one, you will find really the long-term solutions. I would encourage Japan, private and public sectors to continue to exercise leadership and the authorities of all countries, as well as the banking community, to work with them.

In closing, I am reminded of a statement made by President Vaclav Havel, President of the Czech Republic, during a recent annual meeting that my

Institute had in Prague, just over a month ago. He only spoke for five minutes, and yet perhaps, with all respect to me and my distinguished colleagues, he said more than hours of conversation, because he said he hears a lot of talk about globalization, but he doesn't hear enough talk about a global sense of responsibility. And I think it is what we need to bring, a global sense of responsibility and a regional sense of responsibility, both from the private sector and the public sector. If we bring that to the future of East Asia, we will find that the inherent strength of East Asia will lead to a much more prosperous future. Thank you very much.

7. Panel Discussion

Gyohten : Thank you, Charles, for your excellent presentation as a leader of global private financial circle. I think it is very well taken.

We have just listened to the presentations by five panelists. Frankly speaking, I do not intend to praise myself by saying some self asserting remarks, but in the type of international symposium as the one we are having today, it is quite rare to have such an informative and substantive discussion as the one we've just had, a kind of presentations and discussions that can truly stimulate the thought process of all of the audience. I would like to express my sincere gratitude to all of the five panelists.

Now, it seems to me that there was a very broad consensus or agreement among five panelists about the sustainability of East Asian recovery. I think all of them agreed that it may be sustainable, but at the same time, all of them stressed there must be important conditions to be met before the sustainability becomes real. I was interested to hear Mr. Chartsiri, who himself is in the midst of this very difficult process in his country, well, in my view, sounded probably more sober, less robust in the assessment of the situation, and also, Mr. Dallara, from his vintage point, made a very sharp analysis of the caveats he mentioned in his presentation. I, myself, certainly do belong to that broad consensus that recovery will be sustainable only if certain important conditions are met.

From that basis, I might try to be a little bit provocative, trying to challenge the validity of that consensus, and asking the views of five panelists to my provocation. Well, I think there is a broad consensus that although Asian recovery has been very phenomenal during last year and this year, but at the same time, they are all anticipating considerable slowdown of the recovery in coming years. I think Mr. Neiss said that average growth rate will be around 4 or 5%.

Now, my question is, if that is the case, this much speed of growth, say 4 or 5% for East Asian countries, will be fast enough, so that those countries can continue and complete their job of restructuring this debt problem for corporations and for banks in their non-performing loan portfolio? I think that can be a rather serious problem. And also, from the same point of view, some of the panelists mentioned about the political instability which has emerged in some of the East Asian countries, and although there was nuance among panelists, I think it is a broad consensus today that certainly at least some of those East Asian countries are indicating the lack of political leadership, particularly in recent times.

At the same time, all panelists stressed with extreme emphasis the importance of reform in various sectors. I think it is quite obvious that these reforms will require tremendous amount of political leadership. Now, if you anticipate that the political instability, or lack of political leadership in some of those countries, may persist, do you still believe that this task of reform could ever be possible to be done? I think this is also a very pertinent question to be asked. Now, my provocation is that, from your own respective viewpoint, what would be the most concrete problems each country does face in this recovery process, and particularly, I would like to get your view on the desirable speed of the economic growth and also practical ways to try to remove the current political uncertainty or instability in some countries. For unless we discuss squarely those two problems, we may not be able to get the real answer to the question we posed for this symposium. So, speed of growth will be enough? Will political stability could be regained? Charles.

Dallara : I don't know if it's fair to ask me first, Toyoo, but I'll try. But I suspect my colleagues to my left have better answers. You know, one of the ironies of political stability, of course, is that it can be very seductive in the short run. And it can be, in the short run also, at times, consistent with continued

economic reform. But as we learned in Indonesia and other places over the world, the long term political stability without political credibility can lead to remarkable periods of instability. And it is in that light that perhaps I see some silver lining in the political instability, for example, that we see in the Philippines today. Certainly it is not welcome. But will it lead us perhaps to a stronger reform-oriented government? Perhaps that is the case.

In other circumstances, what we see as political instability, I think, is the political process working to find solutions. I am not as concerned about political instability as I am about the lack of willingness of the political leadership to make the hard choices and to push through the deep seeded reforms. I think it was Chatsiri who mentioned earlier that forces of nepotism and other non-competitive forces are still alive and well in many countries around the region, and these things are not unique to Asia, but I do think that it will be critical that the political leadership has the courage to push ahead to create more competitive and more open and more transparent environments, because without this, East Asia may find that it does begin to lose the competition for global capital, and I am concerned about that. I see the competition being a very strong one. And of course the problems of banking side of reforms and others are not unique. I just was in Turkey two weeks ago, and I am struck how many countries in Latin America and in Europe are struggling with creating viable banking sector. It's not a problem unique to East Asia, for sure. But East Asia will have to advance the reforms more quickly if the growth is to move back on a sustained basis to 5 to 7%, instead of, in my view, slip down to 2 to 4%.

Gyohten : Mr. Mizoguchi, any comment?

Mizoguchi : I cannot assess or forecast on how political stability can be sustained, but as a personal reflection, I think the political leaders of Asia only came to realize how grave the situation was when the people began to suffer

seriously from the crisis. Although no one can accurately predict when such a crisis may occur, I think the fact that some global tide could affect every corner of the world did sink in their skin and deep into their memory. Political instability can occur under various circumstances, but I believe the basic factors are the same. The important point is for the political process to work effectively, and I think that is now happening in Asia.

Gyohten : Thank you. Hubert, can you comment on your prospect of East Asian growth rate and its compatibility with the solution of financial problems?

Neiss : Yes. On the question “will slower growth prevent reforms?” I am reminded that a year ago exactly the opposite question was asked. Will not the high growth in Asia lure everybody into complacency and prevent reforms? Now, reforms did take place during the high growth area, and I think they will continue when growth slows down, because the main driving force behind the reforms is (a) market pressure, competition, and (b) government leadership, because major reforms need a degree of national consensus, and therefore, political leadership.

Now, a higher growth rate, of course, makes the reform process easier. But remember, in Asia, most of the major reforms were made during periods of slow growth, like the far-reaching Indian reforms. They were not made when things were going well, but when India was in a serious balance of payments crisis. And even if you look at Japan, the reforms were made at a period, not when things were growing fast, but when things had slowed down. So while in theory it would be good to reform when growth is high and things are good, in practice it sometimes takes the pressure of economic difficulties to forge the will and the consensus to reform.

Now, on the second question, “will political difficulties prevent further

progress in several Asian countries?” Of course, nobody can forecast politics, but as far as I can see, the problems we see in these countries are serious, but they do not constitute a breakdown of the system. The system is still intact, and therefore the problems are amenable to solutions according to constitutional and democratic processes. So we only can hope that this process is as speedy as possible, so that the political difficulties are temporary, and not permanent, and that effective policy making will be possible in all the countries.

Gyohten : Thank you, Hubert. Do you have a comment, Mr. Takagaki?

Takagaki : You are posing a very difficult question, Mr. Gyohten, but let me give a try at answering. My point might be slightly different from the question per se, but I feel that the average citizen’s understanding of politics or the economy is becoming quite sophisticated. This, I feel, is especially true in Japan. So when a crisis occurs and even when the newspapers offer various comments and analysis, and politicians say this and that, people maintain their own understanding of the situation to a considerable extent and act accordingly. The understanding of the people is quite sophisticated and they have a firm belief in some fundamentals such as that inflation should be avoided, or foreign reserves should not be wasted, or the fiscal deficit should not be increased excessively. They have forged commonsense. That is why, even when the scene seems to be set for a huge swing, it actually does not happen. This conversely is the cause of political instability. In other words, if a majority of people suddenly shift in a certain direction, that constitutes a political swing. Now, I am not sure if that would be good or bad. But because individuals have their own thinking, it becomes difficult to create a consensus. From this point of view, I think the East Asian countries are quite sophisticated.

I am quite a Philippino-phile, so whatever I say about the Philippines must be listened to with that proviso, but I feel that in the Philippines individuals

have their own mind and act accordingly so that it becomes difficult to predict whether President Estrada will be impeached or not. I think the people are exercising self-control, thinking that if they allow a real crisis to occur that could badly damage the country and the economy. The Asian countries with people of this nature will, I am sure, act prudently and the region will move forward.

Gyohten : Thank you. Mr. Chatsiri?

Chatsiri : I'm from a small country, a relatively small country like Thailand with emerging economy. Certainly political leadership is very important in help providing direction to solve problems and lead in reforms. Another point that has been mentioned by Mr. Neiss and also by Charles is that the right choice of the policy to be taken will be important because if the policy is not well taken, then it will take a few years later on to make that correction. What is also emerging in Thailand is that the new constitution that we have over the last few years also has allowed establishment of other type of agencies and other infrastructure that hopefully would also help insulate or protect the country from certain type of mismanagement by the political process. But it will probably take a few years to have all those infrastructure built, and it will take some time, to mature.

Gyohten : Thank you. Another point of interest which emerged in the discussions made by our panelists was, in my view, the practical steps to be taken in proceeding this reform process in the recovery. Although there was a broad consensus of the need of fundamental reform in various aspects, but at the same time, for instance, Mr. Chatsiri and Mr. Takagaki mentioned, Asian element to be taken into this process. For instance, how should this proper sequencing of de-regulation process should be introduced, or other so-called Asian approach needs to be implemented. But at the same time, Mr. Dallara emphasized the

importance of decisiveness, and also certain speed in this reform. So, it seems to me that there are subtle nuances between these two approaches. So I would be interested to listen to views from two gentlemen who are not mentioned there; that is, Mr. Neiss and Mr. Mizoguchi. How do you view the seeming difference in this so-called Asian approach and more global standard approach in this restructuring, particularly in the de-regulation? Do you think this differentiation is really substantive, or it is rather semantic, kind of thing it shouldn't be overplayed too much? Well, may I ask Burt?

Neiss : Thank you. I would agree with your last comment. It shouldn't be overplayed too much. I think the basic broad outlines of reform strategies are fairly universal. However, reform in practice has to take place within specific countries with specific traditions, with specific legal frameworks, and therefore the countries' specific aspects have to be respected and have to be given due consideration. Otherwise reform would not be effective. But I myself have never discovered basic and fundamental difference between reform strategies, say in an Asian country or in a European country. The basic outlines are the same.

Gyohten : Mr. Mizoguchi, do you have any comment?

Mizoguchi : I agree with Mr. Neiss that differences are just a matter of degree. Having two different approaches or rather evaluations is nothing new. I tend to think that it is healthier to have different views. Pragmatic judgements are made in such an environment. For example, in the case of Indonesia, of course differences of opinion emerge from time to time, but since there is fundamental support for the reform measures that Indonesia is pursuing, I do not think the differences are having any damaging effect on the reform programs.

Gyohten : Yes, Mr. Takagaki?

Takagaki : Although this may be going a bit astray from the topic of reform, let me quickly comment on private sector involvement (PSI). I am aware that the debate on PSI became heated during the peak of the Asian crisis, so I am not unsympathetic to the fact that there were debates on the issue. But I am weary of the possibility that the debate will lead to creating a rule or sort of a general principle which could lead to a rigid belief that whenever there is a crisis the private sector must get involved. I am afraid this line of thinking will lead to something on the other extreme of a moral hazard. There should be a country-by-country approach. The paper by Mr. Charles Dallara points out eight very specific criteria that should be met when there is a crisis. When a crisis erupts, we should have the patience to carefully apply a country-by-country approach to examine why the crisis occurred in that country, to examine how the public sector and the private sector are involved in the crisis, and what is the most effective thing the private sector can do to solve the crisis.

Gyohten : Before opening the floor for questions and comments, if any of the panelists has any urge to add or to supplement whatever you have said after listening to other panelists' presentation, are there any volunteer to do that? Charles?

Dallara : Just a brief word. I'm sure it would probably be an inadequate attempt to simplify a very complex issue, but on this issue of global standards versus regional approaches, it seems to me that because we are in a global economy with a global financial system, that the goal for most authorities and indeed most financial and corporate institutions must be to move toward and to realize, achieve global standards in many dimensions. But the way to get there, the modalities, the direction, the pace, should in fact be infused with regional and national consideration. So that is how I merge the two concepts in my own mind. Thank you.

Gyohten : If there is no additional comments from the panelists, I would like to open the floor to questions and comments.

8. Questions and Answers

Questioner : *I would like to direct my question to Mr. Neiss and Mr. Mizoguchi. It is generally said that the Japanese industrial structure consists of two layers : non-manufacturing and traditional industry, and the manufacturing industry which can be competitive at 80 yen to a dollar. This leads to a feeling that the so called strong yen syndrome will continue for the foreseeable future. On the other hand, there is also a feeling that, although the Japanese economy can survive until about the year 2010 according to the long-term econometric model which emphasizes the supply-side, the GDP will fall from about that time and with it the weaker yen syndrome will prevail. This must be the general feeling. When we take into account the fact that the East Asian economy is highly dependent on the Japanese economy, can the East Asian economy really sustain around a 7% growth in the next ten years?*

Mizoguchi : I understand the question is whether the East Asian economy can sustain a high growth rate of 7% from a longer-term perspective. I am afraid I am not capable of making such a prediction, but I believe the objective conditions for stable growth should be that the country in question or Asia as a region is stable within a general political framework, and that there are no restrictions in the movement of goods and capital. Judging from these standards, I personally feel that the kind of mechanism that worked in Japan during the period of high growth is more likely to work in Asia. I also feel that Asia is the region that can attract technology and capital needed for growth.

Neiss : Very briefly on the weaker yen syndrome. Of course, forecasting the yen rate is doomed to failure, but for the time being, for the immediate future, a weaker yen would indeed be desirable for cyclical reasons, just to underpin the recovery which is still not in full swing. But given the current account imbalances between major regions in the world, the medium-term outlook for the yen

would be a stronger yen, rather than a weaker yen to get to a more balanced relationship between the major economic areas. So, who knows?

On the forecast for decline of Japanese growth after 2010, this is purely speculative, and you would have to make all kinds of assumptions which are highly doubtful. We don't know the speed of technological change, which is an important determinant of growth, for instance. We also don't know the way of regional integration that will take place between Japan and other Asian countries. So, I would not, on the face of it, put a decline as the main probability. And for the Asian region as a whole, as has been pointed out, there is a high growth potential. First, in most countries, the growth in the labor force is high, in most countries the labor force is highly literate and well trained, and in most countries there is an ingrained commercial tradition. So, Asian people are mostly entrepreneurs. So these are the ingredients for fast developments. Of course, it's up to the governments to pursue policies that make these potential to be realized. So my guess would be, growth will continue, rather than decline.

Questioner : *The Asian countries now think that it is important to nurture small and medium enterprises (SMEs) just like in Japan, South Korea and Taiwan. I would like to ask Mr. Sophonpanich and Mr. Dallara. I believe that the Asian crisis of 1997 was worsened partly by the fact that the European and American banks suddenly withdrew short-term funds, and by the IMF policy of persisting in the same policy towards these Asian countries as was used for Latin America. As the economies of the region began to recover, it was said that the recovery was greatly helped by the fact that none of the Japanese manufacturing companies investing in these countries withdrew from the region and that they supported the factories that are the cornerstone of the manufacturing industry. Since the quality of people in Asia is quite high, I believe there is a great possibility for high economic growth in Asia once direct investment into the manufacturing sector begins to increase, not just from within the region but*

from Japan, the US and Europe. I hear that American and European corporate investors are concerned about the high risk in the region. But wouldn't it help the global economy if American and European manufacturing companies make more direct investment into Asian markets?

Chartsiri : Yes, certainly the experience in Thailand is that the Japanese investment in Thailand has helped Thailand over the last few years. The support by the Japanese companies to the joint venture partners and through their operation in Thailand has been a meaningful factor that helps stimulate economy, including also helps driving the export sector in Thailand. The performance of export from Thailand from the automobile industry and electronic industry has a large part been contributed by the Japanese joint ventures. In that respect, you are correct. The Japanese ventures in Thailand did not pull out, and actually put more money and re-locate, and put more people and resources into the economy.

As far as the SME's in Thailand, I think we are not at the same level where SME's in Japan are. But they are an important part to be framed into the society and into the component of the economy, because many of the larger companies have been, or in the process of being taken over by foreign companies. In some instances, it is also important to help rebuild entrepreneurship among these people in Thailand so that they will have an opportunity maybe 5 years from now, 10 years from now. And the most important part is not really on the financial side, but how can they be competitive, what sort of management, technique, technology, and marketing network that will be required, and this has been the emphasis that the government, including the private sector and banks, are trying to help assisting the SME's. We have been receiving some support from the Japanese authorities in that regard as well.

Gyohten : Last year, almost exactly a year ago, Prime Minister Obuchi sent an East Asian Economic Recovery Mission headed by Mr. Okuda, Chairman of the

Toyota Motor Industry, to study the prospects for East Asian economic recovery and how Japan can contribute to it. Mr. Takagaki and I were both members of this mission and visited the whole East Asian region. I was deeply impressed by how eager the governments and the business communities were in nurturing small and medium enterprises just as has been mentioned now. The role of small and medium enterprises in technology reform especially in the manufacturing sector and, so to say, raising human resources is especially significant in developing countries. I would like to report that one of the principal conclusions of the report presented by the Okuda mission after returning to Japan was to nurture small and medium enterprises.

Dallara : Just very briefly, because I think that Chartsiri and Mr. Gyoten and the questionor have made a strong case for foreign direct investment to be the backbone of future capital flows into East Asia. And I think, as we see, that although there is a role for short term capital, it needs to be a limited role. It will be important that the success of small and medium enterprises depend on part on de-regulation and competition, just as in Japan as the “keiretsu” structures have gradually loosened, this has created a more positive environment. Similarly, traditional corporate oligopolistic structures in East Asia need to give way to more competitive environments to really provide the fuel for small and medium size enterprise and for foreign direct investment more generally. Issues like corporate governance and minority shareholder rights are not just abstract. They are so important in influencing the attitude of foreign investors, and I think that the governments of East Asia have made real progress, but a lot remains to be done to recognize that, however politically difficult it is, there is no substitute for creating a more open environment for foreign investment here.

And I think the regional institutions, regional leadership from Japan, organizations like the Asian Development Bank, can play a role in catalyzing small and medium enterprise financing. I noticed we had with us, quietly sitting

on the first row, one of the distinguished former presidents of the ADB, Mr. Mitsuo Sato, who played such an instrumental role in leading the ADB through this enormously difficult period of supporting Asia during the crisis, and has put into place programs that can support small and medium enterprises as well as many other supportive programs for foreign investment in Asia.

Questioner : *I regret that China has not yet been mentioned by this panel, which is discussing the sustainability of the Asian economy. Will China, which will increasingly be stronger in the 21st century, become a stable factor for the growth of the East Asian economy or an unstable factor? Also when we look at her relationship with Japan, China could begin to show hegemonic tendencies. What effects could this have? Also, Prime Minister Mahathir has criticized the IMF, saying that Malaysia could have been in a devastating condition if it had accepted the IMF prescription. How do you regard his criticism? Could anyone of you comment on these two points?*

Gyohten : Needless to say, it is impossible to disregard China when discussing any aspect of East Asian problems. However, three hours timeframe of this symposium seemed too short to cover China extensively. But since the question is raised, I would like to ask any of the panelists to comment briefly on the role of China in the East Asian economic development, the inherent risks and expectations.

Takagaki : I had various discussions before going to Beijing last month. As you all know, the Chinese economy slowed down in 1997 and 98, and some said that this is the limit of the Chinese economy. However, since then, the government has applied an aggressive fiscal policy to stimulate the economy and a flexible financial policy, and the economic growth rate for 1999 is predicted to be just above 8%, which means it is back to an 8% cycle. However, what I actually want to point out at a time when they are about to

review their five year economic plan which sets the target of 8%, is that this 8% target could be too high. Too high a target for growth rate will put a burden on various fiscal areas, so there is now an argument that instead of being too ambitious it is better to aim for stable growth. I think China has recently become very sensible in this respect. There is now forthright discussion. Although the outcome of these arguments is still 8%, there is at least a very open recognition of the rationale and logic of the economic tide among policy makers.

Reform of state-run corporations and dealing with the non-performing assets of financial institutions are also critical issues. When we comment that it is too ambitious to get rid of the bad assets in three years, that this is too big a problem to be dealt with in three years, the Chinese representatives say that three years is just a target, that this is an expression of their ambition in dealing with the problem. As Mr. Dallara commented that self-sustaining recovery in East Asian countries is possible if they meet the necessary conditions, I believe the same can be said of China if they meet specific conditions. If we assume that China will continue its reform and liberalization, and join the WTO, I do not think that they will fall into a serious crisis, although I personally think that flying a flag of 8% is too ambitious.

Neiss : China has been relatively little affected by the Asian crisis, and it has continued a very high growth rate, 7 to 8%, but it is still taking place this year, and it's the best forecast for next year. So in this way, China has made a contribution to the stability in the region during the crisis. In addition, China did not let its currency depreciate, as was widely feared, and if it has been done in the midst of the crisis, it would have added further element of instability. Now, at the same time, of course, China has become an increasingly strong competitor of Asian countries in third markets. Now, China needs a high growth rate, and so far they have been able to do that through export expansion and through the expansion of public investment. They need the rate to absorb a very fast growing

labor force, but also to absorb the labor that will become redundant in the process of state enterprise reform. The medium-term major challenge, economic challenge in China, is the reform of state economic enterprises and the reform of the banking system. And here are some potential risks. But if this process goes well, there is no doubt, China will be an increasingly important player, not only in Asia, but in the world economy.

Now the question has been asked, will China's role be positive or will it be negative, constructive or disruptive? Now, I think the international community has clearly decided that if China is fully integrated into the global economy, then China will play a very positive role because this, after all, is in China's own best interest. And therefore the accession of China to WTO symbolizes this consensus of the international community and it will accelerate China's integration.

Mizoguchi : I agree that in the first phase of the Asian crisis, there were cases where the IMF's prescription was not appropriate. However, after Japan and some other Asian countries vigorously indicated their misgivings, the IMF began to grasp the situation in Asia more accurately and adjusted its position. So, at this point, I do not think that there are any differences of opinion between the IMF and its major members on the IMF's thinking or policy positions. For example, the restriction applied by Malaysia on capital outflow became a contentious issue. However, after repeated discussions, there is now more or less an acceptance that such a restriction is helpful during a crisis.

Questioner : *The so-called IT revolution is having an extensive impact around the world. How is it specifically influencing Asia at this point? How far can IT contribute to the recovery of the Asian economy? Could anyone from the panel comment on these points?*

Gyohten : Well, let me see. Mr. Chartsiri, do you think you can respond to that question from your own experience in Thailand? I think that would be the best way to describe the situation.

Chartsiri : In Thailand, yes, people have taken much recognition of the importance of the IT and its impact, but certainly it is not to the same extent that we have seen in Korea or in Taiwan, or in some other countries. I think we are probably a few steps behind that. At this point it's more of how can we get better mileage in going through the corporate restructuring, getting better efficiency, and at the same time, use the IT for that process, but not yet to the level, another level that has been experienced in Korea, for instance.

Dallara : I would just say that I think aggressive approaches to attracting IT investments from abroad have clearly paid dividends. If you look at Malaysia today, you see the strong IT foreign direct investment has strengthened the whole fabric of the Malaysian economy in many ways, and has given them a sense of economic stability and the capital flow, and I do think that governments around the region will need to provide incentives and reinforce the investment in IT, both from abroad and domestically, because it will be a way of East Asia sustaining its position at the front of the competition for global capital. I think the supplies to China are obviously in much more complicated context because their certain dimensions of IT raise concerns that they do not raise in other quarters. But I see this is key to the region, and key to the efficiency gains which corporations and financial institutions will need to realize to be competitive in the global economy.

Neiss : May I just add something to this topic from the point of view of the financial institutions? In the financial sector there is a general view that the IT revolution will bring fundamental changes, it will eliminate middleman, it will increase efficiency, it will lower cost. There is also general agreement that

Asian countries, and we talk about East Asian countries, are lagging behind their IT revolution in their advanced countries, but that these countries have all the pre-conditions to catch up. Again, as regards financial institutions, one opportunity that has been proven very useful is that an Asian institution enters a strategic partnership with a foreign institution. In this case the foreigner can bring in capital, technology, know-how, and the local institution can bring into this partnership, its specific knowledge of the local market, and its retail outlet network.

Questioner : *I have a question for Mr. Chartsiri Sophonpanich. Among the material distributed today, there is a list showing how governments are using public institutions to dispose of non-performing assets, but I understand that Thailand is leaving it up to each financial institution to deal with the problem. I believe establishing a public asset management institution is an effective method, and I wonder if Mr. Sophonpanich can give us his views on this point.*

Gyohten : Well, you touched upon that very delicate issue in your presentation, but I think you have to disclose more.

Chartsiri : I think this is the topic that is much debated at this point, especially now, that is political election is taking place. So then it's also something that has been much discussed. But the policy that has been taken thus far by the authorities has been that institutions work out its own problems, so use the market base approach. I think complication would be not only in terms of the fiscal clause, but also ones in dealing with the corporations, how to assist them. Thus far, I think it has been fine, taking this approach. I think, from this step onward, whether there should be a national AMC or not. It's still much debated, and it depends on what terms and conditions of the national AMC, should there be one. If the economic recovery can be maintained and sustained at certain level, I think then financial institutions probably will have the ability to earn the

income and earn their way out of problem, and at the same time solve the non-performing loans. Banks in Thailand have generally made all the minimum reserve requirement by the Central Bank which, in my view, would be sufficient to cover potential damage under certain economic scenario. But, yes, if there is one, it could be helpful, but exactly what sort of structure and terms and conditions, that will be delicate and not easy to come up with.

Questioner : *During the crisis, there was much talk and fears from the part of some Asian circles that it will lead to rush of foreign capital into system that has been completely closed, like the banking system in Thailand, or that there will be sort of re-colonization of East Asia by foreign corporation. And in fact if you look at the number of deals, there have been relatively few of them. One reason seems to be that the course taken by governments has been to use the taxpayer money to transfer the balance sheet from the private sector to the public sector, and this is shown in the level of domestic debt of those countries, which has risen from very, very low level to level that are still not high by, let's say, European or Japanese standards, but very high by historical standards. Now, the questions is rather provocative, but I wonder whether it's not due to the fact that the IMF has been, in a way, too lenient with those governments and those countries, and has given in too easily into allowing more lax budgetary policies. As you remember all, the IMF has been vehemently criticized for having imposed too stringent budgetary targets and monetary targets at the beginning, and then became more flexible. The result is that it has in fact slowed the process of corporate restructuring. But as we see in Korea, it has only been postponed, not solved. The problems are still there, and the Korean government has been forced to declare, I mean, to act through the banks to declare the whole Daewoo bankrupt. And now the Hyundai-Chaebol is also on the bridge. The question, of course, is directed to Hubert Neiss. Was it right to allow those governments to nationalize indirectly those corporates and banks, and to postpone the hard choice, the hard decision that has to be made? And the following*

questions is, how do you mobilize domestic resources if you don't want the foreigners to get in?

Gyohten : Thank you. Bert, I'm afraid you have to volunteer to respond to that question first. Well, you can either approve or disapprove IMF policies now and then Charles will have the floor.

Neiss : To answer the question straightforward, yes, it was right for the governments to come in, in the case of systemic financial crisis and rescue the system, and use public money to the extent necessary. As far as private money is concerned the government was also right to open the market for foreign money or domestic money to come in, and participate in the rescue of banks. But that is all the government can do, the government cannot force deals. They will be left up to the participants in the market. And it is regrettable that not enough deals could be concluded, but some could in Thailand, in Korea, to some extent in Indonesia. But the role of government to support the financial system is the same in any country, whether there is a banking crisis in Sweden or Finland, or U.S. or Japan, in the end, the government has to step in to rescue the system.

Dallara : I think it's a bit unfair. I agree with the premise that perhaps too much has been accumulated in an effort to avoid more foreign equity coming in, but I think that if criticism is due, it probably should be directed toward the government, and not to the IMF. I think sometimes we expect the IMF to do too much in these circumstances, and the reality is that once the exports begin to pick up a lot of steam and private capital comes back, IMF leverage declines. This happens all around the world. And they listen to the IMF, but perhaps not quite as carefully as they did in the fall of 1997 or the spring of 1998. I think the IMF accomplished a tremendous amount in creating initial momentum for reform. But I do think the governments have been, in some cases, too cautious to welcome foreign equity, especially into the private financial sector. I recall a

comment made to me by a Mexican official some years ago when Mexican banks were resisting foreign investment. And this senior finance official said, “You know, we will have an open, competitive, efficient financial system in this country if it takes every one of our banks being sold to foreigners.” Now, I thought that was a drastic comment, and I think it’s unnecessary to go that far. But I think often times the interest of consumers of financial products are lost in the face of vested interest in the banking sectors in these countries, and I think that some additional push in this directions by the government leaders is needed.

Takagaki : May I make a point on something that caught my attention in relation to a question by a member of the Japan Small and Medium Enterprise Corporation. It is true that the importance of direct investment was seriously recognized when the Asian crisis occurred. However, it is completely wrong that once the crisis erupted, Japanese banks withdrew one after another from the crisis struck countries and made the situation worse. For example, in South Korea and Thailand, Japanese banks fully cooperated with the European and American banks and took positive measures to stay in the markets by, for example, signing an agreement to sustain their balance of investment. I am glad to say that there were acknowledgements of these endeavors when our mission visited these countries.

Let me make another comment. While I was writing on the role of Japanese banks in Asia as a preparation for this symposium, there was a conundrum to which I could not draw a conclusion. In the 21st century, besides the larger financial institutions, there will be other Japanese financial institutions such as regional financial institutions, trust banks and The Norinchukin Bank that will maintain their involvement in Asia. In other words, the relationship between Japan and the other Asian countries will become more diverse and at the same time, closer. How are we to evaluate the relationship in areas outside the global banking field? The situation is complicated by the fact that for the capital ratio,

BIS applies one criteria for banks doing overseas business and another for those not doing such business. What are the options for regional financial institutions concerning overseas business, especially in Asia? This is a question that has not yet been answered.

Questioner : *If the American economy, which has served to absorb exports from Asia, slows down, can the export driven system, which had traditionally been the key factor in the Asian economic growth, continue to support a sustainable recovery in Asia?*

Neiss : Of course, exports will continue to play an essential part in the region's development. That is one of the reasons why the trend to global liberalization is supported by far-seeing people. Second, exports alone will not do it. The sustained Asian recovery and further progress will have to be based on domestic investment, which in time will bring forth consumption anyway, because domestic investment embodying technological changes and innovation is very important for sustained longer term growth.

Gyohten : I think time is up, and I am afraid we must end the symposium. I would like to thank our five panellists again for providing us with their very enlightening views, and also the participants from the floor for the exciting discussion. Thank you.

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〒103-0021 東京都中央区日本橋本石町1-3-2
Tel: 03-3245-6934 Fax: 03-3231-5422
e-mail: admin@iima.or.jp
URL: <http://www.iima.or.jp>