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The 18th International Financial Symposium

"Perspectives of the World Financial Crisis--- Wither to go"

Institute for International Monetary Affairs

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Contents

Preface

Institute for International Monetary Affairs and the Japan Center for Economic Research held a symposium on April 8, 2009, at the Auditorium of Japan Bankers Association, entitled as “Perspectives of the World Financial Crisis---Wither to Go”. We had Mr. Richard W. Fisher as a special guest who spoke on “The Economic Situation of the United States and the Federal Reserve’s Response”, touching the policy measures the U.S. Financial authorities have taken thus far and the prospect of the U.S. economy. He was joined in the panel discussion by Mr. Toyoo Gyohten, President of IIMA, and Ms. Yuri Okina, Research Director and Chief Senior Economist of the Japan Research Institute, Limited and Mr. Akira Kojima, Senior Fellow of JCER. They discussed a wide variety of themes ranging from the importance of micro economic policy and fostering entrepreneurs, to education, while proposing desirable financial and fiscal policy measures to overcome the current economic crisis.

This is a full record of the proceedings of the symposium. We sincerely hope this paper would help your business and academic considerations.

June, 2009

Institute for International Monetary Affairs

Profiles of the Panelists

Richard W. Fisher, President and CEO of the Federal Reserve Bank of Dallas

After graduated with honors from Harvard Univ., Mr. Fisher received an MBA from Stanford Univ. and started his career in Brown Brothers Harriman & Co. in 1975. From 1978 to 1979, he worked as an assistant to the Secretary of the Treasury during the Carter administration. In 1987 he created Fisher Capital Management and Fisher Ewing Partners. In 1997, he rejoined the government and served as deputy U.S. Trade Representative with the rank of ambassador until 2001. After working as vice chairman of Kissinger McLarty Associates, he assumed the office of the current position in 2005.

Yuri Okina, Research Director and Chief Senior Economist of the Japan Research Institute, Limited

Ms. Okina received both a B.S. in Economics and an MBA from Keio Univ. She entered the Bank of Japan in 1984. After joining Japan Research Institute (JRI) in 1994, she became chief senior economist in 2000 and research director in 2006. Concurrently she worked as a member of Industrial Revitalization Commission (IRCJ) during 2003-2007. She serves many other governmental committees including Financial System Council and Government Tax Council.

Toyoo Gyohten, President of the Institute for International Monetary Affairs

After graduated from the University of Tokyo, Mr. Gyohten joined the Ministry of Finance (MOF) in 1955 to become Vice Minister of Finance for International Affairs in 1986. After retirement from MOF in 1989, he taught as visiting professor at Harvard Univ. and Princeton Univ. He was chairman of the Bank of Tokyo, Ltd in 1992. Since 1995, he has been the president of IIMA and concurrently he serves as senior advisor of the Bank of Tokyo-Mitsubishi UFJ, Ltd. In 2008, he has been appointed as a special advisor to the Cabinet, as special envoy of the Prime Minister.

Akira Kojima, Special Advisor to the Japan Center for Economic Research

Mr. Kojima graduated from Waseda Univ. and studied at Manchester Univ. as a British Council Scholar. Serving for many years as an editor at NIKKEI both domestically and internationally, he became managing director and editor in chief in 2000, then senior managing director and editor in chief in 2003. In 2004 he became chairman of JCER. Since 2008, he has been in the current position and concurrently, serves as corporate adviser to NIKKEI.

1. Opening Remarks
Mr. Toyoo Gyohten, President of IIMA

Ladies and gentlemen, it is indeed a great honor for us to welcome President and CEO of the Federal Reserve Bank of Dallas, Mr. Richard W. Fisher. We are also very much pleased that we are able to welcome such a large turnout for this very special symposium. On behalf of the joint organizers of the Japan Center for Economic Research and the Institute for International Monetary Affairs, and the supporting organizer, the Japanese Bankers Association, I would like to offer my sincere words of welcome and gratitude.

The reason why we are able to host this symposium is as follows. In October, 2008, there was a World Bank-IMF Assembly. And it just happened that I met with President Fisher, and he happened to mention that he planned to visit Japan in April, 2009. Upon hearing that I thought it would be an excellent opportunity and I entreated him to join us for a special symposium. Coming back to Japan, I talked about my plan to my colleagues at the Japan Center for Economic Research and the Japanese Bankers Association. Both of these organizations were very generous in accepting my offer to serve as co-organizer as well as the supporter of this symposium, so let me extend my heartiest gratitude to them.

It began on such a personal note, but we have been friends for the last 35 years, and in the meantime, I learned a great deal from my good friend, President Fisher, and he is one of the people that I most respect. I believe it was back in 1991, when I happened to visit Dallas, Texas, where he was residing just after he returned from Japan. As I recall, 1991 was the time when the Japanese bubble economy was in its heyday. The Nikkei Average had hit its peak and begun to decline from that peak, but the majority of the Japanese people had not imagined that this could trigger a major recession subsequently. Upon my visit, President Fisher said that the Japanese bubble economy was, at last, beginning to show signs of ending. I recall he said, in a half exasperated and half impressed way, that the Japanese businessmen were too bullish.

For another thing, he had driven me around in his car to see the sights in the suburbs of Dallas. That was the time when there was a crisis with the collapse of the Savings & Loans bubbles in the United States. And even in the suburbs of Dallas, there were many high-rise buildings which were financed by those S & Ls that collapsed. It was as if it were a ghost town of many high rises under construction and with no lights. President Fisher pointed out these ghost-like high rise buildings and said that this was a Christmas present from the Federal Government to the citizens of Dallas It was because the S & Ls had provided lending to borrowers of the buildings ended up in bankruptcy and the Federal Government provided public finance to auction them off at market price. I thought he really put it in a very brilliant way.

Another thing which struck me was like this. By that time, the so-called ETC, an electronic card, was already being used by drivers on expressways in Dallas when you pass tolls, and a company Mr. Fisher ran with his partner had already signed a contract to provide ETC gates. Here in Japan, some 18 years ago, people had knowledge about the so-called IT, but they were largely lagging behind on how to actually apply IT to business setting. When I experienced using this ETC to pass the tolls on expressways, I was worried that unless Japan made great efforts to catch up in this field, it would be left far behind of the IT development.

So these are the three episodes back in the early 1990's. I really think President Fisher is a man of vision. And he is a man with a tremendous amount of experience, both in the public sector as well as in the private sector. He has left behind a galaxy of extraordinary achievements wherever he went. So it is very fortunate for all of us that we were able to invite the current President and CEO of the Federal Reserve Bank of Dallas here to Japan at this particular timing of cherry blossoms. I sincerely hope that all of the audience will enjoy his presentation although the time is limited. With this I would like to conclude my opening remarks on behalf of the organizers, and I would like to express my sincere gratitude to the speaker, to the panelists, and to the members of the audience. Thank you very much.

2. Special Presentation

"The Economic Situation of the United States and the Federal Reserve's Response—Proactive beyond the conventional monetary policy" [1]

Mr. Richard W. Fisher, President and CEO of the Federal Reserve Bank of Dallas

リチャード・フィシャーと申します。銀行に勤めています。"My name is Richard Fisher. I work for a bank."

I hope I said that better than my son James, who, upon our family's arrival in Tokyo in 1990, promptly spoke his first Japanese words:

私の犬は鼻がとても長いです,

which turned out to mean: "My dog has a very long snout."

Domo. Thank you. I am delighted to be here, together with my colleague, Mark Wynne, who is the director of the Federal Reserve Bank of Dallas' Globalization and Monetary Policy Institute.

I first came to Japan with President Carter for the G-7 Summit hosted by Prime Minister Ohira in June of 1979. That experience whetted my appetite for Japanese culture. So after I returned to the private sector and had established an investment management firm in Dallas, I came back with my family to reside in Tokyo under the aegis of the Japan Society for most of 1990—arriving here shortly after the Nikkei Dow reached its all-time peak of 38,915. This gave me an invaluable opportunity to simultaneously learn about your country while providing my colleagues at Fisher Capital Management in Dallas insights into a financial market reversal of epic proportions—insights gleaned from an office kindly provided me by Nomura Research as well as from the bleachers on the various baseball fields where my teenage son played for the Minato Moose team in the Tokyo Senior Boys Spring League.[2]

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[1] This speech text is fully quoted from Federal Reserve Bank of Dallas homepage http://dallasfed.org/news/speeches/fisher/2009/fs090408.cfm

[2] That experience served our firm well. In 1990, we eked out a return of 0.6 percent versus a decline of 3.1 percent for the total return of the S&P 500 and a decline of 34.8 percent in the dollar equivalent of the

Seven years later, I rejoined the government and served President Clinton as deputy U.S. trade representative in numerous bilateral negotiations with your government. I also served as cochair with Deputy Foreign Minister Haraguchi of the multiyear, joint commission set up by Prime Minister Hashimoto and President Clinton on deregulation and competition. In this commission, we wrestled with everything from laws governing retail stores to electricity distribution to bid rigging in construction to financial deregulation and even what I referred to then as "mini-micro" issues—ranging from auditing standards to regulations governing law firms. I consider it a significant accomplishment for both sides that, today, one of the few issues from that agenda that remains unresolved is the matter of providing a level playing field for private insurance companies as they seek to compete with Japan Post Life Insurance, which like the rest of the Postal Savings system is now in a 10-year process of privatization.

Today I have the honor of speaking to you in another capacity—as a representative of the central bank of the United States in my role as president of the Federal Reserve Bank of Dallas, one of the Federal Reserve's 12 operating banks.

Each of the bank presidents participates in the Federal Open Market Committee (or FOMC), the body that sets monetary policy for the United States. The tradition of the Federal Reserve is that each member of the FOMC speaks only for him or herself. I shall adhere to that tradition today. The observations I will offer today are my own and should be interpreted as a view only from the Federal Reserve Bank of Dallas—nothing more.

I have been fortunate to see both my own country and yours from several perspectives. I have learned enough about Japan from my different experiences here and my amateur study of Japanese history and literature to know that I do not know much. The first Western interpretation of Japan that I remember taking to heart was that of Lafcadio Hearn, who wrote of "the immense difficulty of perceiving and comprehending what underlies the surface of Japanese life."[3] I have worked with your government on trade issues, operated an investment fund from Tokyo, watched innumerable Japanese baseball games (I confess, at great risk in this audience of likely Giants fans, to being a fan of the Yakult Swallows, and even though they haven't won a

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Nikkei's total return. This set the stage for a 59.7 percent return in 1991 versus 31percent in the S&P 500 and 3.6 percent in the dollar equivalent of the Nikkei's total return—and anchored a run that, until I sold the firm in 1997, exceeded the return of the S&P 500 by almost 2 to 1. In this sense, I owe my personal financial security to lessons learned in Japan.

[3] *Japan: An Attempt at Interpretation*, by Lafcadio Hearn, Charles E. Tuttle & Co., 1959, p.1.

championship since 2001, I am hoping this 40th anniversary season for their franchise will be their lucky charm), read and re-read the classic works of Western interpreters like Hearn and [Edwin] Reischauer and [Karel] van Wolferen (and, my favorite as a baseball fan, Robert Whiting!) and studied the works of literary giants like Natsume Soseki and Tanizaki Jun'ichiro.[4] But I have barely scratched the surface of comprehending your rich and complex culture. These experiences have taught me enough, however, to be humble when addressing a Japanese audience of this distinction. So rather than prescribe policy to you, I will stick to describing the policy predicaments in which my own countrymen and women are immersed.

One of my favorite books in Japanese literature is Natsume Soseki's *Kokoro,* a gorgeous novel written in 1914, two years after the death of the Emperor Meiji and two years before the author's own death. Lafcardio Hearn offered what seems to me to be the best translation of the word *kokoro*—he defined it as "the heart of things." In this lecture, I shall try to quickly get to the heart of things occurring in the U.S. economy. I will then summarize the consequences for U.S. monetary policy. And then, if you permit me, I will endeavor to answer any questions you might have. Throughout, I will do my best to achieve the stylistic simplicity that Soseki-san achieved in *Kokoro,* though undoubtedly without the beauty that is implicit in that novel, for there is little of apparent beauty in our current economic and financial situation.

The data from the United States are grim. Our economy contracted at an annual rate of 6.3 percent in the fourth quarter of last year. I expect that when the numbers are properly tallied, we will have contracted at a very similar rate in the quarter just ended. Unemployment is rising. We currently have roughly 13.2 million people without jobs, which equates to an unemployment rate of 8.5 percent. I expect the unemployment rate to continue rising to a level that could surpass 10 percent by year-end. Among other things, this has compounded the problem of the much-watched housing market, where many of the problems we have encountered in our financial markets germinated: The most recent release of the Case-Shiller index reveals that home price declines accelerated in the 20 metropolitan districts tracked, falling 19 percent on a year-over-year basis for the three-month period ended in January. But the problem with our economy is more pervasive. The men and women who operate our businesses and create and sustain employment have assumed a defensive crouch. Confronted by dyspeptic financial markets, they are doing the best they can to preserve their margins

[4] Two exemplary works by Tanizaki Jun'ichiro are *Naomi*, Alfred A. Knopf Inc., 1985, and *In Praise of Shadows,* Leete's Island Books Inc., 1977.

by cutting costs (most significantly, the cost of labor), and running tight inventories, rationalizing supply lines, deferring all but the most necessary capital expenditures and, in general, avoiding risk. The result is an American economy in stasis. Nothing is being ventured, and nothing is being gained.

Of course, not helping matters is the implosion of our export markets, which are vital to the growth of an economy positioned to sell high-value-added goods and services—as well as agricultural and other basic goods—to others. The World Bank is predicting that the global economy will contract by 1.7 percent this year, and global trade by 6.1 percent.[5] This will be the first time since the 1940s that we have witnessed such a deep and synchronized retrenchment of global economic activity, and this makes tougher the task of growing the U.S. economy.

One of our founding fathers, James Madison, a coauthor of the *Federalist Papers* and considered by many to be the father of the (American) Constitution, wrote that "the circulation of confidence is better than the circulation of money."[6] There is presently a palpable lack of circulating confidence in the business community in America.

In light of this, the Federal Reserve has assumed a dramatically proactive and highly innovative role in seeking to restore vibrancy in the credit markets while stemming economic decline. This is an unaccustomed thing for our central bank. Ordinarily, the men and women of the Federal Reserve are the most shy and modest of economic agents. We prefer to move incrementally rather than exponentially, and we have historically treasured conducting our deliberations quietly and away from the public limelight. But confronted with a dysfunctional financial market and an implosion in our economy, in rapid order we have undertaken a series of very visible and widely broadcast initiatives. Over a period of a little more than a year, we:

—Established a lending facility for primary securities dealers, taking in new forms of collateral to secure those loans;

—Initiated so-called swap lines with the central banks of 14 of our major trading partners, ranging from the Bank of Japan to the European Central Bank and the Bank of England to the Banco de México to the Monetary Authority of Singapore and the Korean Central Bank, to provide these foreign central banks with the capacity to deliver

[5] "As Global Economy Deteriorates, World Bank Predicts Sharply Slower Growth in Developing World in 2009; Weak Recovery in 2010," World Bank Press Release No. 2009/285/DEC, March 31, 2009.
[6] Speech in the Virginia Ratifying Convention on the Judicial Power, June 20, 1788.

U.S. dollar funding to financial institutions in their jurisdictions. We also have put in place swap agreements with four of our counterparts—the Bank of Japan, the European Central Bank, the Bank of England and the Swiss National Bank—to enable the Federal Reserve to provide up to 10 trillion yen, 80 billion euro, 30 billion in sterling and 40 billion in Swiss franc liquidity to U.S. financial institutions as a reciprocal prophylactic measure;

—Created facilities to backstop money market mutual funds;

—Initiated new measures in cooperation with the Treasury and the Federal Depost Insurance Corp. to strengthen the security of certain banks;

—Undertook a major program to purchase commercial paper, a critical component of the financial system;

—Began to pay interest on bank reserves;

—Announced we stood ready to purchase up to $100 billion of the direct obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks, then increased that sum to $200 billion;

—Announced we would buy $500 billion in mortgage-backed securities backed by Fannie, Freddie and Ginnie Mae, then increased *that* sum to $1.25 trillion;

—Announced, and just recently fleshed out, a new facility to support the issuance of asset-backed securities collateralized by student loans, auto loans, credit card loans and loans guaranteed by the Small Business Administration, a facility which we have since stated we were prepared to expand significantly to other types of securities and beyond our originally planned $200 billion to $1 trillion; and

—Began the process of purchasing up to $300 billion of longer-term Treasury securities over the next six months to help improve conditions in private credit markets.

And, in a series of steps, the FOMC reduced the fed funds rate to between zero and one-quarter of 1 percent, a process which I supported once it became clear that the immediate inflationary tide was ebbing. Simultaneously, at the request of the 12 Federal Reserve Banks, and again in a series of steps, the Board of Governors lowered the rate we charge banks to borrow from our discount windows, so as to lower the cost of credit to the economy.

All of this has meant expanding the Federal Reserve's balance sheet. As of today, the total footings of the Federal Reserve have expanded to roughly $2 trillion—more than a twofold increase from when we started in 2008. It is clear that we will grow our balance sheet even more as we complete our programs of purchasing longer-term Treasuries, expanding our holdings of mortgage-backed paper and purchasing larger amounts and different forms of asset-backed paper.

By being so proactive in straying from our usual business of holding plain vanilla, mostly short-term Treasuries as assets and by shifting policy away from simple titrations of the fed funds rate, we have raised a few eyebrows. But these are complex, trying times. Our economy faces a tough road. We are the central bank of the largest economy in the world, and we are duty bound to apply every tool we can to clean up the mess that our financial system has become and get back on the track of sustainable economic growth with price stability.

This expansion of our balance sheet has given rise to concerns that we may be:

1) Planting the seeds of future inflation;
2) Setting the stage for a demise of the dollar; and
3) Placing the cherished independence of the Federal Reserve at risk.

I understand these concerns. And I have actively and loudly argued during deliberations of the FOMC that these risks represent a real and present danger. But I am here to tell you that I am not alone. The committee members—from the regional bankers like me to its chairman, Ben Bernanke, and other governors—are each and every one determined not to violate the basic tenets of Federal Reserve sanctity.

Let me address each of these concerns in order.

First, with regard to the potential inflationary consequences of our actions: Our assignment is to conduct monetary policy so as to engender sustainable, non-inflationary job growth. Presently, the risk is deflationary job destruction. We have undertaken measures to counter that risk. And we seek to do so in a way that will not ignite the embers of either a future destructive inflation or a debasement of our currency.

I have a reputation for being the most “hawkish” participant in the deliberations of the Federal Open Market Committee, and I have a record that substantiates that reputation, having voted five times against rate cuts during the commodity-driven price boom of 2008. I consider inflation an evil spirit that rots the core of economic prosperity and must never, ever be countenanced. But it is clear to me that in this environment, inflation is unlikely to present a serious threat given the pervasive bias in the U.S. economy toward wage cuts and freezes, rising unemployment, the widespread loss in wealth that has resulted from both the housing and equity market corrections, continually declining consumption and business investment, and the anemic condition of the banking and credit system, all of which reinforce downside price pressures in a global economy groaning with excess capacity.

For as far ahead as I trust my forecasting ability (that is to say, the next couple of years), the problem with regard to maintaining price stability most certainly is not inflation.

With regard to the fate of the dollar and the willingness of others to continue purchasing dollar denominated debt, we realize that by purchasing Treasuries in volumes and of durations that are atypical, we are at risk of being perceived as monetizing the fiscal largesse of our Congress. And we are acutely aware that by intervening in the mortgage-backed securities and other markets that we are at risk of being perceived as blurring the lines between fiscal and monetary policy. We realize that this may give rise to some apprehension among large holders of Treasuries and agency paper such as your government and others in the Asian Pacific region.

And yet, let me remind you that over the past year since we began in earnest the process of using the new tools I have just articulated, the dollar has appreciated 17 percent against the euro and 29 percent against the British pound. Among the major currencies, the dollar has depreciated against only one currency, Japan’s, and by 2.4 percent.

Here are some numbers for you to contemplate: If a Japanese investor had purchased a three-month U.S. Treasury bill in March of 2008 and rolled it over every three months until the end of this past month, the return would have been slim to none—about –1.4 percent. That is hardly inspiring. But, had that same investor purchased and rolled over a three-month euro-area central government bond, the investment would have resulted in a loss of 16 percent. A Chinese investor investing in euro bonds would have had the same experience. A Korean investor investing in the same manner would have earned a return of 21 percent in euro but would have earned a 42 percent return in won terms had he invested in three-month Treasury bills.

Certainly for the past year to date, fears of debasement of fixed-income portfolios invested in dollar-denominated public debt have proven unfounded. To be sure, an investment in comparable maturities in yen would have earned a modest positive return of 0.47 percent for a Japanese investor. But, adjusted for liquidity, that is hardly sufficient incentive for not having a predominance of the world's most significant currency in a portfolio.

I would add that a foreign investor who moved out on the Treasury yield curve would have enjoyed superior returns to those just cited. In yen terms, 10-year sovereign Japanese paper earned a return of 2 percent from March of 2008 to March of this year. Ten-year euro sovereigns would have earned a return of *negative* 11.5 percent in yen terms. The equivalent return would have been a *positive* 10.4 percent for the Japanese investor in 10-year U.S. Treasuries. If I may paraphrase Andrew Mellon, at least for the period over which the Fed has been applying its new tools, it has been quite true that "gentlemen prefer American bonds."

But that is in the past. As to the future, the underlying math becomes more complex: The net new supply of Treasury debt is predicted to expand by $2.5 trillion dollars in the current fiscal year, versus $788 billion in the last fiscal year and only $145 billion in FY2007.[7] All things being equal, this would result in a move upward in yield and downward in price, providing negative returns absent any foreign exchange factor. But all things are not equal. For starters, the problems facing the largest competitive currency, the euro, are perhaps even more substantial than those confronting the United States. I will point to Spain and Ireland as examples of euro-area economies that led the European pack on the upside and now are cascading rapidly downhill. In the case of Japan, you are as aware as anybody of the economic and fiscal and political

[7] "Fed Home Loan Purchases Fail to Keep Mortgage Rates from Rising," *Financial Times*, Feb. 9, 2009.

predicament you are faced with; I will say no more. My point is that demand for Treasuries and other official paper of U.S. government issuers will be determined by their attractiveness relative to alternatives, and they may well be judged more, rather than less, attractive under most reasonable future scenarios.

Moreover, both the fate of budget imbalances and the potential for total returns earned by investing in U.S. securities depend on the efficacy of the fiscal policies Congress has advanced. These policies are designed to jump-start the economy while laying the groundwork for permanent structural reform. Time will tell if they achieve this multipurpose goal. If they do, they will engender economic growth and concomitant confidence in the fixed-income and equity markets for private securities. In addition, tax flows will be restored and confidence boosted in the path of deficit reduction envisioned by the current administration in its budget projections. If these policies don't jump-start the economy, then I am confident that the reaction within fixed-income markets will force those with the power to tax and spend, the Congress, to readjust their fiscal policies.

I offer as evidence the revelation that came to the fiercely partisan Democratic operative James Carville during the Clinton administration. He said that were he to be reincarnated and wished to be the most powerful of all, he would come back not as a president or a pope but as the bond market, for "[the bond market] can intimidate anybody."[8] I suspect this respect for the power of bond markets remains true for the Obama administration and the current Congress.

As to the independence of the Federal Reserve, let me remind you that in 2013, we will celebrate our 100th anniversary as the central bank of the United States. We are not as established as an ongoing entity as the Bank of England, nor as young as institutions such as the People's Bank of China. This is not to say we are superior or always exemplary, but we are an elder in this business. We seek to be worthy of the veneration traditionally given to an elder. To this end, we feel it necessary to guard our ongoing independence.

We have recently agreed with the U.S. Treasury to an accord to work together to support the goals of preserving both monetary and financial stability.[9] In this endeavor, it is the Federal Reserve's job to maintain monetary stability, while the Treasury will enable the Fed to sterilize the impacts of its lending and securities purchases on the

[8] James Carville, as quoted in the *Wall Street Journal*, Feb. 25, 1993.
[9] Federal Reserve Board and Department of the Treasury joint press release, March 23, 2009.

supply of bank reserves. In essence, the Federal Reserve will not monetize the growth of the assets on its balance sheet that has been, and will continue to be, necessary to jump-start the credit markets that are so essential to the recovery of the U.S. and global economies. To put it another way, the Federal Reserve is in the process of acquiring the tools to short-circuit any inflationary consequences of its balance sheet growth.

In contemplating the future of the American economy and our ability to overcome our current financial predicament, I take great comfort in knowing that we have faced far tougher tasks and have always accomplished them. It is true that we Americans often confront storms of our making. We occasionally falter and get blown off course. But we never give up. And we always come roaring back stronger, leaner and more efficient than we were before. For 233 years, the people of the United States have demonstrated that they are masters of the process of creative destruction that the economist Joseph Schumpeter articulated as the key to success for any economy. Our recent presidential election demonstrates that we are still possessed of a vibrancy and adaptability that the French social philosopher Alexis de Tocqueville found so inspiring in the early 19th century. As an American, I may be insufficiently humble, but I consider our track record and our adaptability the stuff of an eventual recovery that will take my country to new levels of prosperity. I am confident that the innovative policies being pursued by the Federal Reserve will facilitate and, indeed, expedite the recovery process.

One of the unique cultural artifacts that I found intriguing while I was here in Japan in 1990 was the senninbari. For the Western press that is here, these are the “thousand stitch cloths” that originated during the Sino-Japanese War. By tradition, they consisted of a strip of white cloth embellished with 1,000 French stitches sewn with red thread by a thousand women and given to soldiers to ward off bullets and ensure a safe return. There should be no doubt that we at the Federal Reserve, like central bankers everywhere, are subject to attack by the bullets of a severe global recession and financial turbulence. Perhaps we could use senninbari to protect us. But as symbolically and emotionally meaningful as they might have been, senninbari were no substitute for prudent maneuvering on the battlefield. As part of the team working very hard to successfully maneuver our central bank through the current financial battlefield, my colleagues and I are committed to the utmost to conducting monetary policy not only so as to ward off the bullets and other threats to our economy but to emerge from this stressful period with an American economy that is stronger and better and that plays an important role in renewing the vibrancy of the global economy.

And now, in the tradition that is the hallmark of central bankers everywhere, I will do my best to avoid answering any questions you may have.

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Goseichou arigato gozaimashita. Thank you very much.

3. Panel Discussion

<Panelists>

Toyoo Gyohten, President of the Institute for International Monetary Affairs

Richard Fisher, President and CEO of the Federal Reserve Bank of Dallas

Yuri Okina, Research Director and Chief Senior Economist of the Japan Research Institute, Limited

<Moderator>

Akira Kojima, Special Advisor to the Japan Center for Economic Research

Mr. Kojima

Although we are now in the prime time of spring with cherry blossoms in full bloom, the financial market is still in the cold winter. What is waiting for us going ahead, what does the future hold for us? People would like to know that. President Fisher referred to "sennninbari", the thousand stitch cloths but as a saying of "a stitch in time saves nine" shows, timing is important in the financial crisis. It also reminds me of the Threadneedle Street where the Bank of England is located. I think Mr. Mervyn King, the Governor of the BOE, took a long stitch in time but he has been faced with a harsh criticism as a Naked King. Anyway we have heard very confident speech from Mr. Fisher, so we would like to hear comments from other panelists on what President Fisher presented as well as what they are thinking about the present crisis. I would like to invite Ms. Okina to speak first.

Ms. Okina

Thank you for very valuable presentation, President Fisher. I really appreciate your comments on how you see the U.S. economic trend. I understand how serious it looks to you. And also we understand the methodology and tools applied by the FED. They will help the credit easing. And you gave a very straightforward presentation on all these topics of the current financial crisis which has attracted a great deal of attention around the world. At the same time, there are various sources for concern in the marketplace and you talked about three of them: inflationary concern, potential debasement of the dollar, and the impact on the independence of the FED.

On the recognition of the current crisis, I totally agree with your assessment. I believe it is indeed serious, and there is an uncertainty as to where we go from now on. But this relates not just to the United States, but to Europe and Japan as well. The original sub-prime loan impact was not so extensive in Japan but relevant losses were generated. Japan is an economy dependent on exports. So the downturn since the collapse of Lehman Brothers has been quite extensive here in Japan as well.

As far as the responses are concerned, I think there have been differences in methodology applied for this current crisis and the previous ones. The issue here is that the financial system since the year 2000 has undergone a major transformation. To begin with, as Mr. Gyohten talked about the previous crises of the S&L's of the U.S., in the financial crisis we saw in 1980's and also in the early 1990's ,there were problem loans in real estates, and the banking sector was severely affected, but the other markets and the other sectors of the economy remained unaffected. Therefore the U.S. economy was able to ride over the financial crisis. And the securitization has evolved further since the crisis. And in the United States we saw a large number of new players entering the market place, and they became very active globally. In the past the indirect financing in the markets was basically decoupled from the direct financing, but today we have a very intricate financial system in the market place. As a result, unlike in the past, new ideas are required to counter the current crisis with regard to the monetary policy and prudential policy. That is my impression.

Now, as far as the monetary policy taken by the United States is concerned, this is indeed a complete credit easing. This is to really repair the various channels of financing in addition to the bank sponsored intermediation. In that sense, the Fed must be prudent, not to take credit risks. They also had to intervene in the CP market as well as in the ABS. And in the CP market the interest rate has already come down to bring the de facto credit easing effect. And this measure has actually facilitated the credibility of the credit. In the past, the central bank was the lender of last resort to the banking sector. In the current crisis, however, I think the central bank has really transformed its functions with adopting the unconventional measures. And I believe this also is a response to the fact that the financial system itself has undergone a major transformation.

Now, on the so-called prudential policy, a measure to maintain a credit reliability. Although this was not mentioned, I believe even the prudential policy has also changed, which, I think, is due to the fact that there was a lack of preparation. I think not much attention had been given to this issue by the non-bank institutions which were systematically as important as banks. This was the case with the Lehman Brothers, an investment bank, and also the AIG, an insurance company. As far as these non-bank institutions are concerned, I believe the measures were not fully employed in the past. But since the fall of 2008, with the injection of public money, and with the introduction of the scheme to decouple toxic assets, I think we are going forward. The government is going to be more focused on non-bank type of financial institutions, which are all very important systematic players. So, that's a major development. On these various measures, we would like to pose subsequent questions to President Fisher. One is on the decoupling of toxic assets – the so-called Geithner Plan; I wonder how this would evolve. I wonder what your thoughts are about the Geithner Plan to decouple toxic assets. The other is on the bonuses paid to the executives of the AIG and others. In Japan we experienced similar problems in the past, because the Japanese people were against the injection of public money into banks. I wonder how the United States is going to resolve this issue going forward. I would very much appreciate your thoughts later on.

Now, from the standpoint of comparison with Japan, let me mention as follows. With regard to the financial policy, here in Japan, the Bank of Japan has taken measures to overcome the crisis by maintaining communications with the market players. Both in Japan and the United States we have had quantitative easing policy. However, perhaps the strategies behind the quantitative easing in Japan and in the United States were somewhat different. In the case of Japan, quantitative easing was primarily focused on current accounts of the banks, i.e. the debit side of the central bank's balance sheet and Japan tried to pursue excess liquidity strategy over a long term. Of course this quantitative easing in Japan did have the impact and the effect of stabilizing the financial system. However some say this really didn't have the intended results. Now in the United States, you are adopting not so much the quantitative easing. You are rather primarily focused on credit easing as in the comments of Chairman Bernanke. So I wonder how you assess the differences in the policies adopted by the Japanese authorities and by the U.S. authorities. That's another question which I wish to pose to you.

Now as far as the future is concerned, a scheme has now been put in place with further injection of public money and the decoupling of toxic assets. Finance and economy must go hand in hand for the recovery. I wonder how financial integrity and growth could become consistent. This is a major challenge to you and a major point of interest for Japan as well. So I wonder what your thoughts are about that as well.

Now here in Japan, we did inject public money and financial system was stabilized to a certain degree. However, it took a very long period before economic growth was regenerated. Actually the growth was brought on by the recovery in the global economy, because this led to the growth in exports. At the same time, however, the corporate community pursued restructuring and introduced new money for the core sector of their business so that they could really regenerate themselves, which also contributed to the recovery. Now in the United States, the companies like GM and Chrysler must pursue the road for rebirth and this is going to be a very critical process. Bearing that in mind, I wonder what path the U.S. economy could follow going forward.

I also wonder how U.S., Europe, and Asia can maintain and explore a balanced path for recovery. I would appreciate any impressions you might have. Thank you.

Mr. Fisher

Thank you, Okina-san. You asked 5 questions, and I'll take them in reverse orders, if I may.

The first happens to deal with the issue of corporate restructuring. I think it's very important to remember that jobs are created in the United States by small businesswomen and men. Large corporations sustain employment, small businesses, mostly private, non-publicly held, create businesses. That's the dynamic of our economy, that's point number one. Point number two is the capital plant, the machine of the United States. It's the human brain. Only 11 percent of our economy versus, say 22 percent here in Japan, is manufacturing, only 5 percent is oil and gas and mining, and only 1 percent is agriculture. The rest is all high value-added services. There are as many people employed in the legal profession as there are in the automobile profession in the United States. That frightens most of us. But that is a reality. And incidentally, in 2007, legal services provided two times as GDP contribution as the automobile industry. So, the answer to your question on corporate structuring is what I referred to in my speech, which is mustering and creating the conditions both from a tax and other incentives standpoint and providing functioning markets that are applied to enable small and medium sized businesswomen and men to create the new jobs that move us up the value added ladder that gives us comparative advantage in the global economy. To that regard, this is why the commercial paper facility we created was so important in terms of our own program, as well as some of the asset backed security. In this issue we are attempting to work into the market place, and I would ask you to bear that in mind. I think there is obviously an enormous amount of attention paid to these monolithic large organizations, GM and so on, but don't get our economy turned upside down. Again, that's how our jobs have been created in America. I'm not saying anything about GM or about Ford, but future lies with comings we haven't even thought of yet. Who would have dreamed the Google or the Microsoft would be that size? Literally they were created by kids in the garages or the dormitories at universities. That's what drives our economy.

You asked about fiscal policy in the relation with the monetary policy. In a way, we had a transition period between administrations where the only game in town was monetary policy. We were waiting for the new administration to come into power, (active is this administration I must add,) and always knowing along the way that in monetary policy accommodative techniques are necessary but they have been insufficient to the task. Fiscal policy is critical. How you tax and spend the people's money and how you implement the fiscal policy is always a critical vital step. And the objective, of course, is to do so in a way that, as I said in my speech, provides a spark in the economy, helps for intermediate term and longer term the transition to a new economy, and doesn't give rise for concerns that deficit spending will get out of control, or very importantly, that the Central Bank will be imposed upon it the task of monetizing those deficits. We are and every member of Congress is well aware that the latter course of action has destroyed great cultures like ancient Rome or other cultures like modern Zimbabwe. And I don't think anybody is interested in that, so the trick to fiscal policy is to provide the spark, provide the right incentives, get the smaller and medium-sized business creating jobs again, and create the dynamism in the economy without planting the seeds of inflation.

On your third point, the difference between the Bank of Japan and the Federal Reserve in their approaches taken, we'd like to say that we have learned from our Japanese colleagues, the initial response in Japan. If I am using an accounting terminology, it was to focus on the right hand side of the balance sheet. You know this better than me because you've been in this business longer than I have, and you're more understanding than I am. We have emphasized the left hand side of our balance sheet. That is, we have built up our different asset interventions, the different facilities with the consequence that the right hand side of the balance sheet grows. We have intervened in the specific parts of the market. I won't use the word "sectors," because we don't wish to prefer any one sector to another, but obviously we are addressing mortgage bank securities as the heart of the genesis of the problem. And our objective has been that, if you use an anatomical example, our patient was in the emergency room, in something of a coma, and since liquidity is the blood of capitalism, we provided the transfusion to keep the patient alive, get it off the table, and get it walking again so that hopefully it will now proceed on its own power. You certainly see this with our commercial paper facility, one of the basic instruments of finance. And that's been our approach rather than just to ease and build up the right hand side of the balance sheet. Let me show you one of the jokes you find in American business community now with regard to balance sheets, and I hope this translates properly. A lot of people like to say the problem with balance sheets of corporate America, not of the Federal Reserve, is that nothing on the right is right since nothing on the left is left. Nonetheless, we have emphasized the left hand side of the balance sheet in order to inject the blood supply of the credit mechanism, and to get it back to speed. Your central bank has adopted different methodologies in the first round. But that's been our direct first approach with the consequence that the right hand side of the balance sheet has grown.

With regard to the other two questions, first I'll deal with your first, which is the decoupling of toxic assets. Secretary Geithner used to be a central banker. Therefore he has unique insights that are only available to central bankers. He certainly understands the importance of maintaining the independence of the central bank. Through his many years' experience as the head of the New York Fed, my counterpart in New York, he has plentiful insights into some of the dislocations of the marketplace. And none of these plans are perfect, but every one is an attempt to remove what is hindering a restoration of proactive lending policy by our credit institutions. And I know it's very easy to sit as an audience and criticize a Minister of Finance, or a Secretary of Treasury, or a central banker, but the objective again is to free up the credit system, particularly the banking system to lend once again. Now I want to remind you that in the United States, unlike in Japan, over two-thirds of our assets are not in the banking system. They used to be, but they are in the so-called shadow banking system, which you refer to. And that gets to the point of what will happen next. You are right in your criticism that the regulators, including the Federal Reserve, did not see a lot of this coming or did not understand it as sufficiently as we should have. I suspect that it'll be corrected in the new regulatory structure that will likely be forthcoming, and that's the subject of another discussion.

Finally on the issue of bonuses paid to executives, the one I would least like to talk about, not being the recipient of a large bonus myself. I think we have to be very careful in the United States not to criminalize capitalism. What's made us unique is that we have harnessed capitalism over 233 years in different manifestations. And we have always lionized, or looked up to those that are successful. We have never been a society driven by envy. This is a European curse, which is not part of the American culture. I'll give you an example, which will surprise you and I hope you are familiar with this example here. One of the successful people in the United States is a woman named Oprah Winfrey. I know nobody who is envious of or dislikes Oprah Winfrey. She has made hundreds upon hundreds of millions of dollars. Or, Bill Gates: Two totally self-made people. We aspire to be like them, we don't wish to tear them down. And to be sure, if somebody has their hand out and ask for taxpayers' money, they will be subject to political exigencies and to political measurements. But my hope, my prayer, and my expectation is that this will not be extended to those that are successful in creating something out of nothing. If that begins to happen in our society, then all the things I spoke about the magic that Pope felt and noticed when he first came to the United States will be placed at risk. So I fully do not expect that to happen. But thank you for your questions.

Mr. Kojima

Thank you so much President Fisher. As a central banker, you have given us very rich responses more than we had expected. Now let's go on to Mr. Gyohten, let's hear what he has to say.

Mr. Gyohten

Thank you. As Mr. Kojima and President Fisher have mentioned, I also see our reality is quite severe still. Why had the things turned out this way? There are many things people are saying, and I wouldn't venture to repeat them. But one thing I would like to say to you is that most of the responsibility lies in the people like ourselves who have been involved in the economy. Let's think about why the bubble had started around the housing. It's not the first time that mortgage has caused a bubble, but one largest difference this time is that the background of such bubbles and their bursts was quite different from the past ones. We were not aware of the changes that had occurred in our environment and background. Environment has changed. For one thing the globalization is one of the big changes that occurred in the background, and for another there were big changes in the financial world. In the financial market, a greater range of products have been traded, and players have changed greatly in the meantime. Unfortunately, both of the public and private sectors were not able to grasp all the changes which were occurring. That's why there was a delay in responding to the crisis. So what is important at this time? What should we do at this juncture? Of course this time the crisis had started in the United States. So the U.S. may have to share the largest role in overcoming this crisis, and bear the largest chunk of the responsibility, if I may say so. And everyone is looking at the United States for their responses. That's the first point.

There are two things I would like to add. First has to do with the financial area, and another has to do with the real sector of the economy. With regard to the financial area, as mentioned by President Fisher, the largest problem we are faced with is the credit contraction. The credit is not functioning smoothly throughout the market. There are many reasons behind this credit crunch. One of them I can cite is that the confidence has evaporated within the market. Why does it come? It's because the market players are becoming suspicious of each others' balance sheets. As mentioned by President Fisher, nothing is right on the right hand side of the balance sheet. The contents of the balance sheet are not known to others, the people are becoming suspicious about the contents of the balance sheet of others, and there is no solution in sight at this time. So what should we do at this time? I would say that the answer would be quite obvious and simple. For the first thing, sufficient liquidity needs to be provided to the economy. Secondly, balance sheet has to be made more transparent, and has to be presented in a better way to understand that toxic assets have been totally removed from it. Thirdly, someone, be it in the public sector or in the private sector, has to fill in the gap of the shortfall of the capital. So those three things, a kind of 3-part package answer, will be needed in order to tide over the current financial crisis.

As I look back, in spring of 07, the crisis had surfaced and the initial responses taken by the authority unfortunately were insufficient in various different elements. I would say that the actions taken then were too little, too late. And also the target for the policy has been laid out in the wrong direction. But since the end of last year when the new administration took office, I would say that the policies taken were in the right directions in providing liquidity as well as centering around the FED in various different ways as mentioned by President Fisher. Non-conventional tools have been applied to take a proactive approach. So I think much progress has been noted.

The second point is on the removal of the toxic assets. Geithner Plan was announced, and we are watching whether this program will be well functioning or not. We have to see how you will play out. But anyway the stage has been prepared at least, the actors are now on the stage, so the drama is about to begin. That is the situation.

The third point is the filling of the gap of the capital. According to the mass media reporting, the Treasury Department is now performing stress test on the financial institutions, and the outcome will be presented shortly, and I'm sure that the responses will be announced accordingly. So this will constitute the next stage. So if we give heed to all of these three points, then broadly speaking, I would say that, we already know the whereabouts of the problems in the United States vis-à-vis the financial crisis, and also the direction for resolving those problems has been set clearly, and steps are now being taken. But if I draw a baseball analogy, I would say that, in terms of reality, maybe we are at the fourth or fifth inning of a baseball game. That's my hunch.

One more point I would like to say is that in the current crisis, not only the financial market, but real economy need to be considered. Of course it started with mortgage and housing markets, but it also reflected the real economy. It's not a matter of a central bank, but policies may have been taken too late because housing prices went down quite significantly, inviting defaults in mortgages and foreclosures of the houses, and further decline was likely in the housing market. Despite that, the responses to deal with the housing market decline were not taken speedily. I think they came a little too late, which was an unfortunate thing. This housing problem needs to be resolved by all means. Otherwise the financial market problem will not be solved, because the trigger of the crisis was the securitization of the mortgages.

So financial market and real economy need to be addressed at the same time. Responses are now beginning to be taken, but in order to completely solve the problems, we will need more time and further effort as well as sizable amount of additional funds. This is a precious opportunity, so I would like to ask a question to President Fisher. I would like to think about what would happen after the crisis has been overcome in the coming period. This is certainly a very difficult period, but someday this crisis will be overcome. We will see the comeback of the economy to an equilibrium state eventually. What will be the state of the American economy and the global economy after the crisis? This is a very important point. For some time now people have been raising this issue, and we need to think seriously about what lies ahead beyond the solving of the crisis. What is the largest point of interests people have vis-à-vis the post crisis is what will be the future structure of the U.S. economy. What will happen to the relationship between savings and investment? The U.S. household was a driver behind the big consumption in the United States and as a result the United States had run a great deficit in its balance of payments which caused the big global imbalances. The U.S. abundantly imported Asian goods and accumulated the dollar-denominated debts which had been recycled back as an investment. That was the basic mechanism under which the global economy had been run and caused the problem. Probably learning from the experience this time, the U.S. households are trying to curtail their debts very rapidly. Saving rate at U.S. households is actually picking up. So what I am interested in is: what would be the future of the U.S. economy in 5 years time and 10 years time? After the crisis is over, would it be the case that the U.S. economy would return to the excessive consumption society that involves both good points and bad points or do you see the U.S. household behavior would change greatly? If it does, then it will give a great implication to the rest of the world. So as far as I know, the views are divided among the U.S. experts, but at least, three factors, i.e., the rising equity prices, the rising asset prices and easy availability of the credit, which had supported the large consumption of the U.S. households, have been evaporating. Maybe in the foreseeable future, those three things will not come back, and if so the structural change caused by no more rich consumption of the U.S. households will bring profound and big problems.

I'm interested to know because that would give grave implications on the future of Japanese economy.

Now, let me go on to my next point, which was also covered by President Fisher's presentation. What will be the future state of finances? For the past decade or so, people used to say that capitalism has become a financial capitalism, and the role played by the financial sector has become too big globally. That was one of the reasons why the crisis had emerged this time with many things breaking down. In the financial markets people are desperately deleveraging themselves by compressing their debts, which has in parallel invited the credit crunch in the United States. The major financial institutions, one after another, are collapsing, and those investment banks are no longer existent essentially. Ten years ago no one had imagined that the things would turn out this way. This is the magnitude of the changes occurring at this time, and in parallel, people are discussing the issues of strengthening financial supervision oversight and financial regulations inclusive of the executive compensation and so forth. What would become of this huge wave of change surrounding the financial business in the coming 5-10 years time? Is it like a pendulum which is now swaying in one direction, but once things get normalized, would come back to the original position? Or will the finance go through further great changes globally? For instance, in the financial sector, will a conventional type of business method, based on the mutual relationship, come back again as the mainstream and the finances that are based on the leverage go into a decline for a substantially prolonged period? What about the future of private equity, hedge funds and so forth? Many things are still left in the dark. We don't know what would happen in the future. To those who are engaged in the financial sector, I'm sure that the future development of the financial system in the global economy will be of great interest. So I would like to pose this question to President Fisher, and ask for his personal view.

Thirdly, let me come back to the issue of the U.S. dollar. It was already mentioned by you, and so I don't press you further, but if time permits, maybe you can elaborate on it. I will stop here on this matter as it's not the main theme of today.

Lastly, may I pose the next question? Maybe I'm talking about much broader thing than the finance, and I would like to ask you as a reputable statesman who have been actively engaged in the world affairs, rather than the President of a Federal Reserve Bank of the United States. I'm talking about the balance of power globally. What will become of it? As is often reported on the G20 Summit held just the other day, there are many things which symbolize the new state of the balance of power. Earlier President Fisher was confident in saying to us that the American style of society or market capitalism has a good capability to renew itself and produce new things. I strongly hope that would indeed be the case but I still have some suspicion about what is likely to be the case as far as the global balance of power is concerned. So I don’t know how to answer, but anyway as one of the leaders of the United States, I would like to ask President Fisher what he thinks about the changing balance of power in the world going ahead. Maybe the things that we have observed are just temporary aberration, not a permanent change, but what is your view? Do you think the world would change fundamentally over time, for example, as the Asian role centering around China would grow in the future? Sorry for touching upon very broad and big questions, perhaps I cannot expect President Fisher to answer all of my questions, but I just wanted to share with you my question.

Mr. Kojima

Thank you, Mr. Gyohten. I have to host a series of symposiums going ahead in order to cover all the questions raised. Rather than supplying on liquidity, we have an excessive supply of questions at this time. But President Fisher, would you like to answer some of them at this time?

Mr. Fisher

I’m to answer Gyohten-san’s questions. I’ll give the best effort that I can.

First, I don’t like to refer to which inning we are in in baseball games. That’s the faux pas that I made when I first joined the central bank. I will remind you, however, if my memory is correct, that the longest professional baseball game played in the United States was 39 innings long, and it ended in a tie. So, we’ll skip the inning’s analogy, the baseball analogy.

You asked a couple of questions, and I’ll try to sort through them, but one of the things you asked was what we need to do. One way to answer that, Gyohten-san, is to say, what we need not to do. Let me remind you that the Great Depression is in the memory of many people. If you are young, you read about it. If you were alive at the time, you remember it either directly or through your parents. The one that worries me the most is what’s called the Long Depression. And the Long Depression had an interesting history. It started with mortgage finance. These were the buildings that were built mostly in the Hungarian-Austrian Empire, and the great buildings we see today in Paris and Vienna and Germany were built with mortgage-like-instruments, and fell under the way to their own excessive issuance, led to a financial recession of global proportions, that was proceeding as a recession and ended up in a depression that lasted for 26 years. Why? Because Otto von Bismarck, the Chancellor of Germany took the initiative to close off the German markets according to the demands of the German farmers and the then makers of manufactured goods that were simple by today's standards. The French responded and a man named Benjamin Harrison ran for the presidency in the year 1888 on a protectionism platform, put in law when he became President a protectionist act, and this created a great depression that lasted much longer than what we call the Great Depression. So my answer to your question is, as we struggle to provide a restoration of the credit system, as all of our countries, and we are not alone, work to put together fiscal packages, the one thing we cannot afford to do is protectionism, and I mean this not in words, but in action, and already there are violations of the words that have been given and bad actions. We cannot resort to protectionism, either in goods and services, which is the simplest way to analyze it, or by virtue of the way in the financial markets, or the movement of people, because I think that indeed would make the current situation if not good, significantly worse.

With regard to your question about the financial system, I'd like to remind my colleagues and also audiences that money as we know it was created over 2000 years ago by the ancient Lydian Civilization. The reason I mention that is because incredibly some 2000 and 20 or so years ago, they named their currency the *electrum*. Today money is electronic impulse. It's not asset backed, and in fact the successor generation in the United States doesn't write checks or even use cash. I know this because the Dallas Federal Reserve is one of the 4 check processing centers in the United States and our business is declining and will disappear in short order. There will be no paper checks in America. So we have our own *electrum*. The *electrum* or any electronic impulse by virtue of an American innovation called the internet, and by virtue of the commercialization by Americans of that medium, by what I call the two Steves, Steve Jobs and Steve Wosniak, the creators of Apple, allow money as we know it electronically to be moved around the world at a click of a mouse. Therefore one has to say about the future state of finance, that it will remain liquid, it will defy every possible, innovative factor of national authority, and we have to somehow deal with one of the barriers, which is that all of the central banks, the Bank of Japan, the Bank of England, the European Central Bank, the Federal Reserve Bank of the United States, the Reserve

Bank of Australia, are governed by sovereign authorities that have a very difficult time really implementing or dealing with globalization, and might threaten their exercise of sovereign authority within their Diet, or their Congress, or their Parliament, or whatever structure they might have. And I think that will be one of the frontiers that will have to be breached at some point.

You mentioned in your kind introduction of me your visit to Dallas, and my comment to you that those buildings were a gift of the Federal Government. There is no crisis resulted in the failure in my district alone of 800 max in the 11th Federal Reserve district. Now if you were to come to visit my city today, you would see the most modern city in America with two-thirds of the buildings having been built in the last 30 years and an airport that rivals Hong Kong and Singapore in terms of its efficiency, total broad band access, and an area that created one-third of all the private sector jobs in America in 2007. My point is this. We tend to be preoccupied with the current crisis. We tend to ignore the creative side of creative destruction. My reference of Joseph Schumpeter was not a reference to Anglo-American capitalism. It was a reference to whatever proceeds to have a successful economy. The Chinese will have to master creative destruction, as the Japanese literally did it after the Second World War from nothing, as the Americans have done for over, as I said, 233 years. This isn't Anglo-American capitalism. It's a simple economic proposition that to have successful macro-economies, you have to have many micros to succeed. So the effort is going to have to be to provide the financial where-with-all and the fiscal stimulus and support for macro economic expansion to make many, many micros.

One last point, you mentioned the old lady of Threadneedle Street, (this reflects your British education by the way,) the Bank of England, and you mentioned Mervyn King, whom I hold personally a very, very high regard. But it does raise the issue of Gyohten-san's point of the speed with which we reacted. Without taking anything away from our colleagues, and again without giving offense for being typically American in bragging on my country, I don't think people can say that the Federal Reserve was slow to react. We were the first out of the gate. And I listed for you the different actions that we took. Now, whether those are sufficient or not, time will tell. We are beginning to see some healthy signs, some stirring of what are called green shoots. That word is being used too often presently. But what markets have found the settling seems to be not that we did so much. We were slow in doing it, but we did so much. And then it raises a question that I attempted to address in my speech. So I think it's very important to bear in mind, first of all, human behavior has not changed since the ancient Lydians invented what we know as currency. When you have a great moderation as what's called yields come down, it is a human instinct, whether you are Asian or Anglo-Saxon or whatever culture, to reach out further in the yield curve, first to pick up the yield on your money, secondly as the yield curve is flat to take the additional risk, and thirdly to work under the false assumption that history does not repeat itself, which it always does. And fourth, to make the assumption that economists by having evolved their field had developed a newer science rather than what it did, which is a sophisticated art form. I was taught by Prof. John Kenneth Galbraith at Harvard as an undergraduate, and he used to say that the econometrics in economic forecasting was invented to make astrology look respectable. And I think it's a bit harsh, but not totally inaccurate. So, one has to take faith in the basic human instinct of all societies, whether they are Anglo-American or other, to improve their living standards and to figure out regimes that make that possible.

As to the broader question you asked about the balance of power, again I think the balance of power will either stay or shift to those that are the masters of creative destruction. And I won't make the claim that the United States will maintain its hegemonic position in the world, but I would say that we have as good a chance as anybody else to continuing to provide whatever balance we have provided to the world, and whatever instability we have provided to the world. After we recover from this current situation I don't see that is changing, and I think people are too eager to sell it short, mainly because it's an easy target to criticize.

And then lastly with regard to the U.S. Dollar, no comment, thank you.

Mr. Kojima

Well, thank you so much. So I see that we are now covering a broader field in our discussion. Let me just make one comment as well as ask some questions myself. We've been talking about the balance of power. But let's go back to the issue of balance of payments. Once again, as mentioned by Mr. Gyohten, I would like to focus on the global imbalance issue. We've been hearing that the U.S. market has always been there as the market of last resort, but now the U.S. is becoming the spender of last resort. They accumulated debt and made excessive consumption, and had consumed more than what was meant for, and the deficit has been accumulated, and financed externally. Such a thing can be maintained only for one or two years by most countries, but the U.S. has been in this state ever since 1970's. In 1971, the gold-dollar convertibility was abolished, and ever since the U.S. Dollar had enjoyed a privileged status, which enabled the United States to maintain this pattern to this day for. For a long time the U.S. has been running a deficit, and this deficit has been financed by the overseas funds flowing into the United States. The U.S. has been borrowing the dollar-denominated debts, but the U.S. has no foreign exchange risk, and was able to continue to accumulate the debt. And as a result of that, the global imbalances have continued and they are still getting larger. We may say the dollar enjoyed a privileged status as the key currency of the world, and that caused a loss of self-discipline on the part of the U.S. Mr. Gyohten touched the world of the post crisis era, and when we think about the long standing structural issue of the post crisis era, we cannot avoid thinking about how the world should address the global imbalances and the privileged status of the U.S. Dollar. One way to look at this issue is that the de-leveraging process is going on in the U.S., which resulted in the credit contraction in that process. Not only the de-leveraging of the financial sector, but de-leveraging by the household has begun. Will the adjustment of the global imbalance then cause the de-leveraging of the national economy on its external front? If so, how should we accept and address that process? What do you think this process going? I would like to raise it to you.

And also in connection with Japan, may I say the following. When we compare the lost decade or 15 years for Japan with the present case of the U.S. there are crucial differences. In the case of Japan, the lenders were the financial institutions regulated by BOJ or the Ministry of Finance of Japan. So in Japan, there is almost no shadow banking involved in Japan as compared with the U.S. And in the case of Japan, the financial institutions continued to hold on their loan assets. They didn't diversify them by using the securitized product, so it was always easy to know where the loans had been held and where there were the risks. The yen was not a key currency, and that was a 100 percent Japanese financial institutions' problem. In that sense, there was a big difference and there were not so many lessons to be learned from the Japanese case except for the lessons of failure. You returned to the United States after the peak of the Japanese bubble, which burst soon after and the NPL had emerged. It was after 7 to 8 years' passage that the responses were taken seriously at last to tackle the NPL issue, and that lapse of unattended time produced various problems of Japan's lost decade and thereafter. Let's me ask you about the U.S. economy. As was mentioned by Ms. Okina, Japan had taken a long time in tiding over the business cycle after the burst of the bubble. But as Mr. Gyohten mentioned earlier, Japan was able to grow by the expansion of export but at the same time there was an adjustment in employment; companies reduced the regular employment and increased lower-waged non-regular workers' employment, which enabled them to suppress the total wage cost; labor cost had gone down, and it was converted to variable cost rather than a fixed cost which contributed to the improvement of the quality of the balance sheet for the Japanese companies.

But on the other hand, the balance sheet of the household had deteriorated. Looking at the statistics of the household, the total income of a household decreased, every year since 1998 through 2005. In that process the Japanese savings rate of the household decreased from 16 percent to 2 to 3 percent. So at the expense of the household balance sheet, the corporate balance sheet got improved as well as the financial institutions' balance sheet. But in case of the United States, it is the balance sheet of the household that needs to be improved. The household still have a huge debt vis-à-vis the GDP. If you look at the consumption, it increased from 60 percent of 15 years ago to 70 percent because household consumption had been financed by debt. How do they pay it back? In the income environment which is getting worse for the American people right now, they have to cut on spending. The U.S. economy used to be the spender of last resort for the world, but now spending need to be persistently reduced in order to improve the balance sheet of the household in the United States. That process has just begun, and it seems to me that the process will continue for a substantially long time to come. What do you think about this?

I have a last question about the dollar. I'm not talking about the value of the dollar, how much it would go up or go down. The dollar denominated securities are still relatively attractive and drawing funds, but the short term strength of the dollar at this time, maybe has been driven by just a short time factor. The American financial market is still frozen and not functioning well. So the hedge fund and others have had a trouble in raising dollar funds in the market. They cannot do it within the U.S. market, so they go outside of the U.S. to raise the dollar funds by sell their external assets in yen or in euro and convert it to dollar, thus creating demand for the dollar. In other words, it maybe represents that the dollar supply within the U.S. market is not enough so that financial institutions are going abroad to sell their assets and buy the dollar at the overseas market. If that is the case, then maybe it's just a short-term factor that supports the strength of the dollar and once market gets normalized, this picture will change drastically. At the same time, in the adjustment process of the global imbalance, I am afraid that the dollar would not maintain its strength, and become weaker over a long period of time. What do you think of my prediction as one of the views to understand the present situation? Sorry I gave you a good supply of questions once again

Mr. Fisher

No central bank official and no Finance Ministry official should ever comment on the direction of currencies. I will just remind you as I mentioned in my speech that questions as compared to what, and leave it at that.

On the issue of leverage, your views are absolutely right. Leverage is a physical principle. You use it to lever a power to achieve greater force, or to ramp up growth. And I think it's pretty clear, given the de-leveraging, as you referred to in our system, and given the response of households to harbor the resources as much as possible by increasing their savings and therefore spending less, that the growth path one could envision going forward would not be on the same slope that we had before since we are on the lower slope. Until confidences are rebuilt, human behavior and instincts reassert themselves, people forget the past, which takes a long time, and then you start engaging in what is proto-typical repeated behavior through our time in all societies. So one could say going forward that one would see a lower path of growth and the growth rates that we are able to achieve for a very prolonged period in the largest business expansion, at least in one of the prolonged business periods in our history.

Putting these two things together in terms of confidence in our future and our currency, my personal opinion is that it's a function of how quickly and sustainably we restore economic growth, how well we do it without impairing price stability, and of course how well we continue to implement or improve upon the rule of law. Investors will look to place their money where they can earn the best return with the least amount of uncertainty. And this is our job and your job and others to make our home countries attractive in a world where we are not going to have the equivalent of Esperanto, is a language which is a one single currency, such as the SDR as a tradable currency for commercial purposes, or for investment purposes for average citizens, and so we will have different currencies. And when I say compared to what, the currencies and the countries that will do the best in attracting investment will be those that are for the best possible returns.

As to what might make our country attractive which Gyohten-san mentioned in terms of the future, I would way the single most important thing, and this is a personal view, is the quality of our higher educational institutions. We are a high value added service driven economy. We are currently blessed with having what is arguably, and I say arguably because there are great universities in countries elsewhere, but probably 98 of the top 100 universities of the world. They are where ideas come from. These are where high value added products come from. This is where the internet founders came from. It's where Microsoft came from. It's where Apple came from, and so on. Even though they were college dropouts, by the way, but through the university system and cultures that are inculcated in those university systems. My greatest interest and also one of my greatest fears is whether or not we will be able to maintain that intellectual breeding ground, which is advanced education in America, undergraduate and post-graduate, because we have no rivals. If you look at Genoa, or you look at Heidelberg, or you look at my alma mater, I'll get a bad letter for this, but Oxford University, they are not what they used to be. And leader in the world education is the university system in the United States, taking this away from the great universities in Japan. This is why there is so much emphasis, for example, in Tsuinghua and all the other universities in China, aspiring to be the Harvard of their country. But to me that's where the future lies. And this gets to the question that was asked in terms of what we do with our savings. The question is, how do you deploy those savings once you've accumulated them. The accumulation of those savings dampens demand. It doesn't make Japan very happy because we buy less durable products that you export. It doesn't make China very happy because we buy less consumer products. And it doesn't make others very happy because we cut back on our expenditures for high IT value added products. The issue, however, is how we deploy those savings in the long run. And I would hope we would invest those savings as a people into improving what I said earlier which is this capital plant which is the only thing that drives us into the future in a high value added society. So I hope I have avoided answering your questions, but those are my answers.

Q and A.

Q: I have one question about the financial regulation. People are talking about for making a comprehensive, single independent financial regulatory authority. Well, markets and people are inter-connected, so it's only natural that one can think about the world's single regulatory body. But do you think it's a realistic view or not? For example, when you audit and oversight an individual holding company, do you think that inter-connectivity can be grasped or not? Maybe the direction might be right, but do you think financial regulation can catch up with changes and dynamism occurring in the financial market? Any views on this, please.

Mr. Fisher

Good and relevant and timely question, because as was pointed out by the panel, the markets got ahead of the regulators. Incidentally I happen to know your FSA director here, Sato-san, and I think very highly of him. And I am somehow envious of the simplicity of and the excellence of your regulatory structure in relationship with the Bank of Japan and the FSA. We have a mare's-nest of regulatory authorities in the United States. And it will have to be rationalized. The idea of having the Federal Reserve and parts of the Treasury and FDIC, and even though we cooperate well together, alone working in certain segments of the banking sector, and the idea of having an SEC that oversees securities section and other authorities that see different securities, trading companies and so on, is due to the confluence of behaviors and involvement that each of those institutions has.

Clearly the regulatory structures are going to be redefined. There have been proposals in terms of a general outline put forward by the Secretary of Treasury. We have argued at the central bank. The decision makers will be the Congress of the United States, particularly Congressman Frank and his committee in the Lower House and Chairman Dodd in the Upper House. And I fully expect that two things will happen. There will be an attempt to achieve greater simplicity and to rationalize our own regulatory structure. I'm equally certain that there will be attempts by those who currently regulate to fight off change. That's the nature of bureaucracy. I expect that out of that discussion further responsibilities will be given to the Federal Reserve. And our

task will be to accept responsibilities that we are able to handle. And that's a question of man and woman power, and organizational structure, etc. I don't want to go into those details. I suspect that there will be an effort to have some oversight of overall system at risk within our markets. Now I said there is no such thing within our markets, and therefore we have to be conscious of what systemic risk has been posed by the global interaction of which we are all fully aware and of which I spoke. There is a real constraint to the idealistic proposition that there might be a global regulatory authority, and I referred to that earlier. That is, you have your Diet, we have our Congress, the British have their Parliament, and the Europeans have all separate sovereign powers. And so I think we have to be realistic. First we need to reform within our own country, a regulatory structure, and make it simpler. And then secondly, we have to figure out a way to exchange views and if not cooperate, certainly be aware of what will be done elsewhere. I would say I would offer and suggest that we at the Federal Reserve have taken that initiative ourselves. We have enhanced cooperation with the other central banks of the world, and that's reflected in the swap agreements we have with the 14 other central banks I mentioned, and even now the foreign currency swap agreements we have with the Bank of Japan, and the Swiss, and the Brits, and the ECB. So, all of us can intellectually make a case for a certain greater amount of globalized regulatory authority. But we have to deal with and respect our sovereign legislatures, and what they are willing to consider and willing to tolerate, and also what their duties are to protect their individual citizens.

So, the short answer is yes, the regulatory structure was insufficient, we now know that, and that it will now have to be improved and simplified. But there are probably limits to the ability to globalize real regulatory disciplines as opposed to have rules of the road. Being a former trade negotiator, I have an enormous respect for the WTO. The WTO of course sets the rules of the road, to use the sailors' term. And then within the rules of the road, competition is allowed. It's an imperfect structure, but it has improved the ability to conduct trade, and for the world to become further integrated. So there may be some lessons we can learn from these institutions that work, but I would ask you to bear in mind that there probably are limits that will be imposed, and I think those are quite understandable. Thank you for the question. Domo.

Q: Several times there were references to the so-called Geithner Plan. Now it seems that several funds on the borrowing side have shown interest in Geithner Plan. But the banks, who are the potential sellers, are not so enthusiastic over this plan, according to reports. So I would like to ask on the Geithner Plan and the results of its stress test coming fairly soon. Here in Japan, the FSA had a very rigorous inspection on the banks' balance sheet. And after this very rigorous test, the Japanese banks were able to decouple their non-performing loans. That's what the Japanese experienced. In the United States, it's probably the Treasury Department, not the FRB, that will be using the results of the stress test, But how will they use the results of stress test? How do you think the Geithner Plan would try to reflect the results of the stress test? That is the question which I would like to put forward to you.

Mr. Fisher

First please understand that the central bank and U.S. Treasury are totally different entities. We do not work on the same side. We work together, but we are separate. Having said that, we do have the responsibility for supervising bank holding companies and state member banks. And we also have new techniques for monitoring those access our credit facilities. And the results of these stress tests will be announced in a timely fashion. These are tests that are designed to test the capital adequacy under extreme duress, and that's been clearly articulated by the Secretary of the Treasury. We will, in turn, as part of that process, be trying to figure out what the solutions are, should such conditions arise, for additional capital bolstering measures that would be. We would leave that conclusion by the stress test.

When we talk about the Geithner Plan, when the press talks about the Geithner Plan, I think it's important not to get too confused. The first objective is to figure out the way to deal with the so-called "toxic assets," and there are many components to that proposal. The one you just referred to, which is making sure that the 19 largest institutions in the United States can meet the most extreme conditions should they materialize. It's not a forecast, and it's under extreme conditions.

There are other aspects of the test. One of them is the techniques for taking the toxic assets out of the system, for example what is known as the public private partnership interest. And again, these are conceptual designs that are now being attempted to be put in place, and we have to deal with both the interest of the buyers and disposers of those assets. The purpose of the exercise really is price discovery, at which prices we can clear them off the balance sheet. It is an imperfect process, and part of the price discovery business is discovering what people are going to bid, as well as what people are going to sell for. So that is the essence of and my interpretation of the Geithner Plan, as suggested by the Secretary of the Treasury, and we at the Federal Reserve have an interest in seeing obviously it would succeed. But time will tell if that's the right approach, and if it's not, then we'll go back to the drawing board and come back with the right approach.

Due to the intensity of the coverage, and the intensity of the problem that we are currently faced with, there is an enormous amount of focus on any one specific proposal or segment of a proposal that's made, without bearing in mind of the fact that we can always adapt those proposals to make sure that something works better than it might have worked when it was originally articulated. So I'm flattered as an American that the world is spending so much time focusing on the Geithner Plan. It indicates the urgency of the situation. But I would think of this as a way again to implement a price discovery process in such a manner that it accomplishes the goal of taking the toxic assets off the balance sheet to sufficient degree to allow the banking and overall credit system to regenerate what it does, which is to provide credit so that businesses can grow.

Mr. Kojima

I see that our time is almost up. So lastly I would give the last floor to Mr. Gyohten and Ms. Okina.

Mr. Gyohten

Now I would like to pay a respect to President Fisher on his remarks on the independence of the central banks. Protecting and safe-guarding the independence of central banks is important to any country in the world. And we learned from President Fisher today that at least in the case of the United States rather than resisting against the political pressure to defend the independence of the central bank, the Fed is taking a stance to be more proactively involved in policy makings, trying to take on the initiative in tackling the crisis. As the result it serves to raise the independence degree of the central bank of the U.S., and I have a high respect and I would like to endorse whole-heartedly the approach taken by the Federal Reserve Bank of the U.S.

Ms. Okina

The recovery of the global economy will be dependent on the recovery of the U.S. economy, and therefore the role played by the FRB is very important and enormous. And I see the financial policies you talked about embrace new ideas and new efforts. I sincerely hope that the authorities will lead the U.S. economy toward recovery and restore the functions of the financial system while maintaining good communication with the marketplace. And also as mentioned in the previous question, I believe that the financial system is going to be more globalized going forward, and there will be an increasing number of institutions which are systematically important. So the role of

FRB will not be limited just to the monetary policy. It will also include the management of systemic risk in the future. So no matter what form it might take, no matter who the players might be, I believe the role of the FRB can only get more important in the future and greater expectations will be placed on the FRB.　I look forward to your continued success.

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