

The Problems of the Japanese Economy and Their Implications for Korea

Toyoo Gyohten

Good morning, ladies and gentlemen and thank you very much Dr. SaKong for your nice introduction. It is a great pleasure for me to be here this morning to address such a distinguished and powerful group representing the Korean economy, Korean journalism and Korean politics. I think it is particularly fortunate for me to be given this opportunity on the very day when President Kim Young Sam is making a historic and successful trip to my country. Dr. SaKong asked me to tell you what went wrong with the Japanese economy. I'm certainly going to tell you that something went wrong, but not all. Since my time is rather limited, I think I'll focus on two issues and open the floor for questions afterwards. The two issues are: 1) current structural problems the Japanese economy is facing now, and 2) trade frictions between Japan and the United States which are attracting much attention these days.

As you know very well, there are many factors which contributed to the remarkable development of the Japanese economy since the end of the World War II. I can cite many of them but in my view, there are five most important elements.

The first element is the very close working relationship maintained between the government and private business. The second is the cooperative association among different business

corporations, sometimes called “keiretsu” in Japanese, or “strategic alliance” in English. Thirdly, I think there was a very remarkable non-confrontational association among different interest groups which supported corporation activities. They are : management, employees, banks, contractors, customers and shareholders. These so-called different stakeholders within the corporation’s framework did maintain close association which was not acrimonious nor antagonistic among themselves. They cooperated for the benefit of the future development of the corporation. The fourth element was a very strong sense of employee loyalty to the company. Of course, this loyalty was supported by the stable, long-term employment system. Finally, the fifth element, in my view, is the very dynamic and aggressive corporate strategy aiming at a greater market share. And this strategy was structured on the assumption that the market will continue to grow and there will always be very inexpensive, low cost capital available.

Certainly, these rather unique elements in the Japanese economy helped the rapid expansion of the Japanese economy during the last thirty, forty years. However, in recent years, both international and domestic situations have been changing, and as a result, these elements are faced with quite serious challenges not only in the international scene but also in the domestic market. In the international market, these unique characteristics of the Japanese economy are viewed as a source of the lack of transparency in the Japanese market and as a source of discriminatory character in the Japanese market against outsiders. And as a result, as you well know, there has

been strong international criticism toward these elements of the Japanese market. In the past, the people of Japan have grown to feel that they have greatly sacrificed their individual or family life for the sake of the company. They are now more aware that as an individual or as a family member, they deserve to enjoy a richer and more comfortable life of their own rather than spend at least twelve, thirteen, fourteen hours a day for the company. Also, as economic growth becomes much slower and the population is aging, there is no assurance that the market will keep growing forever and no assurance that capital will always be available at a low cost. There is on-going financial deregulation which tends to push up the cost of deposit and when the stock market suffers severe ups and downs, the equity financing can no longer be a very easy way to arrange capital for business corporations. In other words, all of those traditional elements which supported rapid growth of the Japanese economy are now faced with many difficulties.

I think the most serious challenge now facing the Japanese economy is probably the issue of identifying themselves as a model of capitalism, or a model of the market economy, which is compatible with other models of market economies in the world, while maintaining its vitality and dynamism simultaneously. I believe it will be critically important to make these two objectives compatible in the Japanese economy.

Now, how can they do that? It is not an easy job. Let's take the case of the first element I mentioned — the close working relationship between the government and private business. I

think everyone would agree that if the government and private business can work closely, it will help the economy. However, one cannot ignore the risk involved in this close relationship between the two. In Japan, we have unfortunately seen many occasions in which this close relationship developed into a kind of collusion creating many scandals involving politicians, bureaucrats and private businessmen. Take the case of the keiretsu association. It is certainly true that if companies can work together closely in a friendly manner, it is good. But if that association becomes very exclusive and discriminatory, outsiders would feel this as unfair and as something that should be disposed. As for employee loyalty, I certainly hope that all the employees, not only in Japan but Korea and elsewhere, can maintain their attachment, love and loyalty to the company he or she works for. However, when the economy is not booming and many companies have to restructure their organization by reducing manpower and reducing wages, how can you expect your employees to maintain that strong loyalty to the company? Well, as I said, it is quite a difficult task for all of us, but we have to try and select the last elements we have to maintain, and concentrate on the elements that need improvement or discarding in order to make our system more workable with the rest of the world.

In that sense, for any economy including the Japanese, there are certainly some factors which remain as the fundamental source of strength of that economy. First, we must maintain a certain level of savings in our economy. I don't know of any economy which has succeeded without saving enough. Of

course, excess savings creates an imbalance but I think a serious lack of savings will always create an intractable and lasting damage to that economy.

Second, we have to maintain a high standard of labor ethics. I think education matters a lot, but by whatever means, we have to maintain a high level of work ethics. That means workers have to maintain a certain minimum amount of responsibility and pride regarding his/her specific duties. On the macroeconomic policy side, containing inflation and keeping a low real interest rate are the most important policy objectives.

And finally, we have to maintain reasonably sound fiscal and external positions. Fortunately, while the Japanese economy has many problems today such as cyclical downturn, the aftermath of the burst bubbles, and structural problems, I believe that it does maintain at least some of those important elements that I've mentioned : savings, labor ethics, low inflation, low interest rate, a strong external position, and a strong fiscal position. So, I personally believe that as long as the Japanese economy can maintain those elements, there is reasonable hope that in due course of time, our economy can return to a sustainable and sound path of development.

Now, let me turn to my second topic: US-Japan trade friction. I have to confess that it is not in a very comfortable situation. The problem is delicate and difficult because it is political on the one hand, but also very fundamental on the other hand. As you recall, Prime Minister Hosokawa and President Clinton held meetings in Washington last month. Unfortunately however, they failed to reach an agreement. I suspect the single most

important cause of this failure was that both sides could not fully appreciate each other's difficult domestic and political situation. President Clinton's political situation at home is not an easy one. The economy is recovering but still suffering from many problems including employment. And he has a big task amending the U.S. health care system. Meanwhile, his recent diplomatic exercises on many international issues with China, North Korea and Russia, have not been producing the most successful results. So I think his position at home, particularly his position *vis-à-vis* the Congress, is very delicate, thus binding his hands and preventing him from making any easy compromise with Japan on trade issues. Furthermore, a large and persistent trade deficit *vis-à-vis* Japan has certainly been a serious public issue at home.

Now as for Hosokawa, he is also in a very difficult political situation at home. The stability of his coalition government is not guaranteed. There are still much differences of views among parties which are forming his coalition. In particular, the socialist party has many dissenting views, for instance, on tax reform and on defense issues. Also, the Liberal Democratic Party is not always a supporter of the coalition. So, Hosokawa's hands are tied and he cannot take a very bold, decisive leadership role in these trade issues either. I am afraid that for both countries, the political aspects of trade issues have been played up too much and this in turn has frustrated negotiators from both sides. In addition, there is a certain sense of mutual mistrust between the two countries and each side is fed up with the other. American negotiators are fed up with the very

stubborn and inflexible Japanese bureaucrats, and Japanese negotiators are fed up with the very pugnacious American position. Instead of trying to solve the problem from the global perspective, Japanese negotiators think that the Americans are simply trying to materialize their specific corporation's business interest through official negotiations. There are simply too much political misunderstandings and misapprehension.

At the same time, we have to realize that the problem of trade imbalance, particularly the one between the United States and Japan, comes out of other rather fundamental issues than simply an issue of say, exchange rate, market access or macro policy. We have to remember that this imbalance has existed for the last 30 years. During these thirty years, the exchange rate between the dollar and the yen has changed from one dollar to 360 yen to one dollar to 105 yen today. So, there has been a tremendous exchange rate change but the problem didn't disappear. During the past thirty years, the Japanese economy maintained a much higher average growth rate in its domestic demand than the American economy. Nevertheless, the imbalance remains. Japan made many efforts to make its market more accessible to foreign exporters, and I admit there are still many hidden or invisible obstacles. However, I think it is fair to say that today's Japanese economy is more open than it was thirty years ago and this is reflected in the amount of imports. So, in spite of all these exchange rate changes, macroeconomic policies, and market accesses, the problem remains and, in absolute terms, imbalance is even increasing. Thus, we must think of something else.

In my view, the single most important cause of this imbalance lies in the fact that there is a tremendous gap in the supply capacity between the American manufacturing industry and the Japanese manufacturing industry. For American manufacturing companies, roughly 25% of their capacities are now outside of the United States. For the Japanese manufacturing industries, the corresponding ratio is still only 6%. And by the way, the corresponding ratio for German manufacturing industries is 15%. That means during the last 30 years since the 1960s, there has been a tremendous outplanting by the American manufacturing industries out of the United States into Europe and Asia. As a result, there is a rather serious gap in the supply capacity. To put it simply, Japan is producing more than it consumes while the United States is producing less than it consumes. This is the fundamental cause of the trade deficit which results in the problems of industrial structure, and savings and investment between the two economies. I don't have time to dwell upon this issue too long, but what I want to stress here is that this trade issue has many facets such as exchange rate, macroeconomic policy, and market access. They are all relevant, but none of them can solve the problem by itself.

We have to address the issue as a more fundamental structural problem of both economies. What I regret most is that in these ongoing and persistent talks between the United States and Japan, we have failed so far to address the issue as a fundamental problem. I hope that these issues I've mentioned — the structural problems of the Japanese economy and the nature of the trade imbalance and friction between the US and

Japan — would certainly serve as a good source of lesson for my Korean friends because the Korean economy is also very dynamic with its growing international status. As Korea grows to this international eminence, it's inevitable that people outside of this country will hope to see you play a more responsible and more compatible role. And, in order to achieve that goal while maintaining your own dynamic economy, I think it's inevitable problems. I don't think Japan has solved its problems. As I mentioned before, we are just starting to resolve these issues. We have a long way to go, but I'd like to conclude my presentation assuring you that we are very much aware of the problems and we will try our best to solve them.

So, Dr. SaKong, I think I'll stop here and open the floor for questions. Thank you very much.

Discussions

Q Dr. Suk Mo Koo (Vice President, Korea Economic Institute)

As Dr. SaKong mentioned, you made your point pretty clear in a short amount of time. I admire your talent and wisdom. I have three questions.

One is on how to cope and maintain a strong Japanese economy. You emphasize the importance of savings, which I agree with, but Japan does not invest enough to make savings equal to its domestic investment. That's why Japan has a huge surplus which causes external frictions. I think high savings is necessary, but equally, Japan should also spend and invest more so that external surplus is minimized. I wish you would mention more of the importance of investment on trade issues.

Second, the basic imbalance arises from the gap between the supply capacity in the US and that in Japan, but you've only mentioned the supply capacity in a very narrow sense as the supply capacity of manufacturing. However, agriculture and services are more important than manufacturing nowadays. Manufacturing supply capacity is important, but Japan do not open up enough in the agriculture and service sectors.

What I'd like to say lastly is that a close strategic alliance between Japan and Korea should be developed. Nowadays, the

proximity between markets, suppliers and consumers are becoming more important. We should pay greater attention to cooperating with countries in this region. So, I hope you'd mention your view about closer cooperation among countries in this region.

A Mr. Gyohten

Those three questions are most pertinent and I'm very glad that Dr. Koo raised them.

On the first issue of savings, I agree with you completely, in the sense that no country should save too much. And I think I mentioned that point in my presentation as well. I stressed that we should save enough to finance necessary investment because we see in this world many countries that are not saving enough and that lack of savings is creating serious global problems. I think countries such as the United States, Russia, and other reforming economies are not saving enough, and this automatically means that in other countries there will have to be excess savings. If everybody just likes to spend without trying to save, then I am afraid the world economy may create a serious problem for all of us. So, what I've been stressing is that for those countries that do have the willingness and ability to save enough, they should maintain that practice.

Now, on the trade issue. Again, I think you made a very good point. I specifically used this terminology of trade because I intentionally excluded invisible trade and services. Certainly,

if you include service in visible trade, the picture can become quite different. For instance, between the United States and Japan, Japan runs a sizeable deficit on invisible trade. So, if you include both kinds of visible and invisible trade, the balance in economics is then called the current account. This would then mean that imbalance between these two countries would be much smaller. Some people even argue that the US is running a surplus. I agree with that because the economic structure in many countries, particularly the developed economies, is moving quickly from those tangible industries to invisible service industries. Therefore, it will become all the more important to think comprehensively which means including the service sectors.

On agriculture, there are not many apologies that I can make. I think the same applies to Korea. But in that respect, I think both of us — both Japan and Korea — should be proud of ourselves in that we have started to make significant steps since the end of last year's Uruguay Round negotiation. Certainly, they are painful steps and they are probably not sufficient, but I think they were quite important steps. I think we should send a message to the rest of the world, particularly to our friends in Europe and America where the protection of agriculture is still very extensive and even rampant, that we have to cooperate to solve this very difficult problem on a much more global level.

Now, I could not agree more on your third point because the very source of dynamism in East Asia so far has been the growing movement towards a horizontal division of labor. Many

people think that East Asia is a very vertical region with wide differences in the level of economic development and that countries are chasing after the one which is moving ahead. Yes, it is true that competition is fierce, but the future source of dynamism for this region probably will come from a wider scope for intraregional investment and trade and also from the basis of a more horizontal division of labor. I stress this because, as I mentioned in my presentation, one of the greatest challenges for the Japanese economy is how to modify our industrial structure. Moving from a traditional, mechanical type of manufacturing to a more technology-oriented, service-related type of manufacturing means that there will be greater room for imports of those types of products from other countries. And this process will certainly help a greater flow of trade and investment within countries in this region. So in that sense, the success of Japan's economic remodeling and restructuring will also help stimulate the regional development as a whole. I certainly am a bit concerned about this global trend toward regionalism in Europe or in North America, and I think that it will be inevitable for East Asia in that there will be a *de facto* growth of regionalism. And for East Asia, regionalization should remain as a *de facto* process, not as an artificial institutionalization trying to discriminate against outsiders. I think this is very important for this part of the world. But, of course, further expansion of intraregional trade and investment is good, as long as it is done on a natural basis and by an open principle. That would be something very much welcomed. In that sense, I fully agree that the economic and other relations between Korea and Japan should be geared more towards enhancing wider

horizontal division of labor and greater interregional expansion.

Q **Mr. Jae Woong Lee** (Vice Chairman, Coryo Securities Co., Ltd.)

Chairman Gyohten, I appreciate your transparent and frank speech. I would like to ask two questions.

First, regarding the first issue, Mr. Chairman wisely pointed out five elements for the classical merits of the Japanese economic growth. Do you really believe that these old paradigm or old philosophy of these five elements can change to a new paradigm, an international paradigm in the future? Since that old paradigm was formed in 1882, Commodore Perry came, and the Meiji Era came. It has been long-rooted for more than 100 years by education, culture, etc., so can this metaphysical thing change very rapidly. This is my first question.

The second question is related to the exchange rate. You state that the Japanese yen made an appreciation from 360 down to the 100 level. An absolute calculation is an arithmetic one. The yen appreciated about 260 to the US dollar. If this absolute figure is applied to the present level, can 105 yen go down to 0 or \$1 down to 1 yen? That is difficult. It means a purchasing power parody between the U.S. and Japan should be taken into consideration, and if this Japanese yen gets stronger and stronger as the dollar did threefold in the eras of 1970 or 1980, can the Japanese economy maintain it? This subject can also relate to the first issue of the Japanese philosophy or paradigm

that can change from domestic interests to international interests. I would like to hear your lofty opinion on those two points.

A Mr. Gyohten

I am afraid that I might not be able to give you a lofty opinion on those questions, but I'll try. I have to confess that you made a very penetrating observation about the Japanese ability to change its strong, time-honored traditions which are certainly deeply embedded in every facets of life, including the economic one. It is certainly true that there are many people in Japan who argue that trying to modify those fundamental elements of the Japanese economic philosophy will be tantamount to discarding everything and it will be absolutely impossible for Japan to become another Europe or another America. Each country, each market, does have its own history, distinct culture, and traditions. And so I think it is absolutely impossible to imagine that some day all different economies and all different markets in the world will converge into one single homogeneous one. I don't think that day will come. What I have been arguing for is that although differences and competition will remain, we have to create a situation where all participants feel that reasonable level and fair conditions for competition are secured. As I said, one serious defect of the Japanese system was in fact that the Japanese system certainly worked extremely well in the kind of situation which could be more or less secluded from the outside. When we had participants who shared a common value standard, common

knowledge, and a common philosophy, the system did work extremely well.

But the very reason why we are facing this problem today comes from the fact that the Japanese economy grew so big and became a key international player. We can no longer claim that we can survive within this secluded atmosphere, and we are no longer in the laboratory. So, if that is the case, we have to face reality. Although I am not arguing that we have to change everything which is different from others, in many respects I do argue that others have to change to accommodate themselves to some aspects of the Japanese style. That is why I stress the importance for the Japanese, first of all, to select which element of our system should be upheld. For that, I think we have to make great efforts to convince others that this particular element of our system is better and is applicable to others, so why doesn't everybody join it?

You must have recently heard that American or European industries are coming back, regaining their competitiveness *vis-à-vis* the Japanese. I think this is very welcomed because if you look into the nature of their success stories, you will find that, on the one hand, they very thoroughly studied the Japanese system and did not hesitate to adopt those elements which they thought useful. At the same time, they tried to maintain the strength of their own system. I think in the case of the American industry, their utmost strength lies in the climate where the individual initiative can be respected and can be encouraged much more than the Japanese system. So, if you

look into successful American corporations which achieved this comeback, you will find a combination of willingness to learn from others and to maintain one's own traditional strength. For the Japanese and the Korean economy, I argue for this willingness to try to make their systems more compatible, and at the same time, more applicable to other models. These days, the discussion about the different models of capitalism is very popular and I don't know to what extent it has relevance. But, I think it is very important that people are coming to realize that there are different models, but at the same time, I believe there must be some global compatibility that everybody has to strive after.

On the second question about the exchange rate, I do not think the Japanese yen will continue to strengthen *vis-à-vis* other currencies at the same pace it has done in the past. It is very difficult to argue what the optimal level of exchange rate is for any currency, because when an economy is not completely open, there can be a variety of exchange rates called "optimal". In that sense, the Japanese yen is one example. Certainly, if you calculate the Japanese yen and the American dollar based upon the prices of traded manufactured goods, say cars or electronic gears, I think 100 yen is not out of line. But, if you calculate the purchasing parity on the basis of say the price of land or the price of rice, you will get probably 300 or 400 yen per dollar because those commodities are not traded. Furthermore, I don't think the yen exchange rate *vis-à-vis* the dollar will continue to rise that much in the future. Fundamentally speaking, the exchange rate over the long run, will be decided

by the inflation gap. There is no question about that. So, as long as our economy maintains lower inflation rates *vis-à-vis* its trading partners, over time the issue of principle will not apply to the day-to-day exchange rate because the day-to-day exchange rate as you very well know is totally controlled by millions and zillions of information that are political, economic, and military. You really cannot try to interpret the exchange rate movement only as a matter of economy. It's a matter of politics or a matter of information. I don't think the Japanese economy can survive at the exchange rate of one yen to one dollar now and I don't think the present level of one dollar to 100-110 yen range is out of line. I think the Japanese economy can survive at that level of exchange rate. Of course, we have to make greater efforts to have that exchange rate better reflected in our domestic price level, particularly for those non-tradeable goods. If that is done, I think the 100-110 yen per dollar exchange rate is a sustainable range of exchange rate for the Japanese economy.

Q Dr. Il SaKong (Chairman and CEO, Institute for Global Economics)

While others think about their questions, let me pose this question. The US economy today is quite different from what we used to see in the 1960s and '70s in the sense that the US economy is much more open today. Trade dependency in the '60s was 5 to 6%, but today it is almost 16 to 17%, which is even higher than trade dependency for Japan. And therefore, the US has problems with the mounting trade and fiscal deficit,

particularly the fiscal deficit. Thus, the classical Keynesian policy has a limit in its application.

Relatedly, consumers and the business sector are heavily indebted, therefore the interest rate policy has a limit as well. Recently, what they try to do is to rely more on exports. So, we used to think this “export-led growth strategy” only for the developing nations, but now even US economic policy circles, including the US Congress, are talking about export-led growth for the United States. I don’t think this situation will change in the near future. Also, the Japanese surplus won’t easily disappear in the near future. And therefore, what we are going to see is that there will be continuous conflicts in the trade area between Japan and the United States. Given this situation, don’t you think something should be done particularly on the part of Japan? I know Prime Minister Hosokawa has a political constraint, but I think you need some kind of a bold leadership in changing this very difficult situation. Otherwise, we are going to see the accelerating pace of the US’s, so-called aggressive unilateralism, which is not good for Japan and the rest of the world. Today, the only leadership we can expect is from Japan. I know in reality, it will be very difficult but something has to be done. If you were the prime minister, what would you do?

A Mr. Gyohten

I am not a prime minister and I will not become a prime minister as I cannot answer that question in that hypothetical situation. Nevertheless, as you know very well Dr. SaKong, the fundamental or only explanation of international imbalance is

imbalance in savings and investment in each economy. This savings-investment balance is the singular explanation of the international imbalance and there is no question about that. When we try to solve this problem, one thing I cannot stress enough is that this is a problem for all parties concerned. If we are discussing the bilateral situation, one country in surplus, one country in deficit, the problem must be addressed from both sides because the problem certainly lies in both economies and that should be the very basis of our argument on this issue.

Having said that, I quite agree with your analysis that in the United States today, when you have a large budget that is a fiscal deficit reflected in the large external deficit, under normal circumstances you have to contract and impose tight monetary and fiscal policies in order to rectify the situation. But, the United States cannot do that for both domestic and international reasons. It is true that the trading partners of the United States, including Japan and Korea, do not want to see the American economy contract. So, the dilemma for American economic policy is that on the one hand, they must contract, but on the other hand, they cannot contract. The only solution out of this dilemma is to increase external demand, that is, net exports. You are quite right. Here comes the strong American request or desire to expand its exports and they are asking their trading partners to open their markets and increase their demands so that American exports will grow. This is the background of the situation and I agree with you.

In order to see that succeed, I think both the United States and our other trading partners should cooperate. On the part of

Japan, I think answers are not very difficult to find; I think everything good has already been said. That is, Japan should try more to deregulate a variety of official or non-official regulations existing in all sectors of the economy so that domestic demand will be housed. Also, Japan should pursue more active macroeconomic policy so that the growth of the domestic demand will be stimulated and sustained. I think they are all right. So, what Prime Minister Hosokawa has been trying to do is exactly along that line. The problem is, like in other countries, there is not quite a favorable environment for him to take all of these policy steps.

As I said, in order to stimulate the domestic demand, certainly a tax cut will be one meaningful and probably useful measure as long as you do not run into too much fiscal deterioration. He, in cooperation with the finance ministry, came up with the idea of roughly a 25% income tax cut advanced by three years, and a consumption tax raise from 3% to 7% after three years. This tax package, I have to say, was favorably received by probably the majority of the Japanese businessmen, politicians, and others. This idea was killed by differences of views within his coalition government. It ended up with just one year income tax cut and nothing else. Everything else was postponed. And I was told that American negotiators were very offended by that because Prime Minister Hosokawa could not deliver his tax cut message. But, I have to sympathize with him and say that American resentment or reaction is not fair. What I am saying is that yes, I think the Japanese are quite anxious to see that their government can exercise clear-cut and decisive policies so

that Japan can play a dual role in sustaining the global economy. But, we also have to face reality and admit that in every democratic country, we know that democracy is sometimes very inefficient as it takes time. So, what we probably need when we come to this negotiation between democratic countries is patience for others' situations. Although I am not the prime minister, I hope our prime minister is of the view that he appreciates the kind of recommendation like the one Dr. SaKong made and is very anxious to be able to come up with this expectation.

Q Dr. Il SaKong

I fully sympathize with what you say and with the Japanese situation. Also, I don't like what I call 'Western-style US unilateralism'. As you said, the Japanese people generally support the idea of doing something different. If that is the case, I don't know about your constitution but what about taking a referendum, for example, I know a very influential person in Washington policy circles who always tells me that the harder you push the Japanese, the more the Japanese yield. That is exactly what happened in the recent cellular phone deal in which you came out very strong saying 'no' but eventually yielded and caved in. If that is the situation, then the US will keep pushing hard. That is why I say "Can't you do something?", particularly if the Japanese people are generally supporting the idea of something needs to be done. Maybe I am saying it because of my ignorance of the Japanese political system. But, we are going to see the rising trend of this

aggressive US unilateralism and I think Super 301 will be reinstated. Americans are saying that this is targeted specifically to solve what they call the “unique problem of Japan”, as President Clinton stated when he went to Europe. The last time Jeffrey Garten came to Singapore, he said that it’s not for ASEAN, not for any country except for Japan. I think that it is true, but at the same time, the tool is there and Super 301 can be applied to any country, and when that happens, it will not be good for the world. Thinking wishfully, I would like to see Japan take some bold initiative so that we can get over with this terrible situation.

A Mr. Gyohten

Well, I think you’ve touched upon a very important point. Again, one thing I would like to stress is that this problem of trade friction certainly does have a great political element and at the same time, is a very fundamental economic problem. What I foresee in the coming years is that there will be a continuous and substantial transferring of the Japanese industry to nations outside of Japan. And I have been arguing to my American friends that it is very important for the administration of the United States to introduce measures to encourage the transfer of production facilities into the United States, but unfortunately, so far, they have not done enough. So, as a result, because Europe is rather stagnant and there are bigger business opportunities that can be found in Asia, I would suspect that there will be greater investment in Asia by Japanese industry. What will happen? It will certainly be good for us to see the

faster development of Asia as a whole and the greater level of horizontal division of labor. But if the United States, on their part, does not try to improve their own fundamental savings and investment imbalance, the problem would not be simply reducing Japanese surplus, but creating another imbalance with other countries. I am sure that with this yen appreciation so far, the Japanese surplus will decline. I am 100% sure about that. And unless the deficit countries rectify their own S-I imbalance, they will become another Japan. I think you are quite right. The unilateral action from those political reasons will not disappear even with the disappearance of Japanese surplus, because that will not result into the disappearance of the global imbalance.

So, I see the point that Japan's reaction to those trends has been rather frustrating from the individual point of view, and I wish I could have done otherwise. However, we have to face reality. And yet, I think the growing consciousness of the nature of this problem can certainly help improve the situation. At the same time, we haven't mentioned the importance of the global market integration and the highly increased interdependence among economies. We should not forget how far we have come along on this. Already, interdependence between the Japanese manufacturing industry and the American manufacturing industry including autos is extremely strong. If you talk to anybody in that industry, I am sure you will be convinced that the interdependence between them is now very close and certainly inseparable. I think recognition of this trend of globalization and interdependence will certainly help the respective country's

policymakers to take more mutually supportive policy measures at home.

Q Dr. Seung-Chul Ahn (Chairman, Citizens Bank)

Mr. Gyohten, we understand that you are not only a distinguished economist but also a distinguished banker of international recognition. So, I'd like to benefit from your talent and expertise in this area. We understand that the Japanese financial system has gone through fundamental restructuring since the mid-1980s and your financial system has met many problems in the process of formation and collapse of the bubble economy. Korea is now in that stage of financial restructuring. I'd like to gain some lessons from the experience of Japan's financial restructuring for the design of our financial restructuring. I would appreciate your brief opinion about what has gone right and what has gone wrong in Japan's financial restructuring.

A Mr. Gyohten

I don't think I can briefly answer all the wide and far-reaching implications involved in your question. But from our experiences since the 1980s, there are several lessons we've learned in Japan. Ironically, in certain areas, I strongly feel that our deregulation was too slow. We focused too much on possible distortions which may be created by deregulation, and so we tried to pave the way completely before we took the step. But in many cases, I think we discovered that, after all, the system

was flexible enough to adapt itself to the new situation so we did not have to pay excessive attention to possible distortions. In other words, we could have probably taken more courageous and quicker steps.

Having said that, I have to add that when you proceed with this process of deregulation, you have to see to it that the basic strength of the system is maintained. When I say basic strength in the case of the financial service industry, I mean that it is a matter of credibility of those who run the institutions and also the willingness on the part of the market participants to accept greater responsibility for the risks involved. Deregulation always implies greater risk. You have to be sure that the market participants — customers, investors, depositors, borrowers and bankers — are all quite aware of this increased risk and are prepared to take on the following responsibilities.

Lastly, regulatory authorities should try their best to ensure that the industry and institutions do have a sufficient amount of prudence and strength so that greater risks which come as the result of deregulations can be managed and absorbed. I think these are some of the major lessons we've learned from our experiences.

Thank you.