

SPFUSA 10th Anniversary Asian Voices Seminar

“The United States and East Asia: Growing Together or Growing Apart”

Keiji Iwatake: Good afternoon. My name is Keiji Iwatake, and I'm the director of the Sasakawa Peace Foundation USA. I'd like to welcome you to our Asian Voices Seminar. Today's seminar commemorates our Foundation's 10th anniversary. We are pleased to have with us today from Japan, Mr. Setsuya Tabuchi, Chairman of the Sasakawa Peace Foundation, Mr. Gen Takahashi, Chairman of the Board of Counselors of the Sasakawa Peace Foundation, Mr. Akira Iriyama, President of the Sasakawa Peace Foundation, and Mr. Reizo Utagawa, Executive Director of the Nippon Foundation, which has generously supported our Foundation.

For those of you who may be attending our seminar for the first time, let me provide you with some background. The series began three years ago with the support of the Sasakawa Peace Foundation, Japan. This seminar series provides a forum for presenting Asian viewpoints on timely and important issues that affect the U.S.-Asia relationship. Previous seminars have included such topics as the North-South Korea engagement, U.S.-China Cooperation after 9/11, and Japan-Asia foreign policy. Our mission is to promote better understanding between Asia and the United States. Today we are fortunate to have four distinguished speakers from China, Japan, and the United States.

At this time I'd like to introduce the moderator of today's seminar. Dr. John Ikenberry is the Peter F. Krogh Professor of Geopolitics and Global Justice at Georgetown University. He's been the advisor and moderator of the series from its inception. John.

John Ikenberry: Thank you very much, Keiji. It's a pleasure to be here and to welcome you this afternoon to this 10th anniversary event.

We have had a very stimulating three years of Asian Voices seminars, ranging across the topics and across the region, Northeast Asia, Southeast Asia, security, cultural issues, democracy, economic issues.

And today we are very pleased to pull back a little bit and take a broad view of the region and its shifting character. And to focus in the broadest sense on the changing relationship between “The United States and East Asia, Growing Together or Growing Apart” to pose the question of this seminar. And to discuss this big topic, we are pleased to have four very distinguished speakers who specialize in different aspects of this broad issue, and we look forward to their comments today.

As our main speaker this afternoon, it's a pleasure to introduce and welcome my dear old friend, Professor T.J. Pempel, who I've known for many years and whose work has been a great inspiration to me. Professor Pempel is one of the country's leading experts on Japan and East Asia. He for many years was at Cornell, and after stops at the University of Colorado, and Washington, and Wisconsin, he has now set up shop at the University of California at Berkeley as director of the Institute for East Asian Studies and professor of political science. This is one of the premier positions in this country focused on politics and issues of East Asia. So this is a great honor to have him here today.

Educated at Columbia for his various degrees, he has been a prolific author over the decades, focusing on, in particular, the political economy of Japan and the broader region. His most recent major book is *Regime Shift: Comparative Dynamics of Japanese Political Economy*. He's the editor of a very interesting and important book on the politics of the East

Asian financial crisis. And most recently he is the leader of two large projects that will culminate in edited volumes, one on the question of regionalism and bilateralism in East Asia entitled, appropriately enough, *Beyond Bilateralism*.

It's an important book, particularly because I have a chapter in it. And another book of lesser importance, but nonetheless still interesting, *Remapping Asia*, which deals with the changing character of East Asia, the various ways in which the region is identified and conceptualized by people who occupy positions within it.

I would also like to introduce our three panelists, who will both discuss, and react, and present their own ideas. First it's a great pleasure to welcome Mr. Richard Koo, who is chief economist of Nomura Research Institute, the research arm of Nomura Securities in Tokyo. Before joining Nomura, Mr. Koo was an economist with the Federal Reserve Bank of New York. And in addition to that over the years he's had some very interesting work, including playing roles, advisory roles, with several Japanese prime ministers to study the future of the Japanese economy; this despite the fact that he is an American citizen.

He is the author of several books on the Japanese economy, and he writes regularly for several periodicals, including *The Los Angeles Times*. He's also the author of a forthcoming book on the Japanese economy, tentatively entitled, as I understand it, *A Balance Sheet Recession*. He has very strong views and informed views of the Japanese economy. He holds educational degrees from Berkeley and Johns Hopkins. And finally in financial circles, he has been identified and ranked as one of the top, indeed the most important of economists covering Japan in the Nikkei ratings, rankings from the mid- and late 1990s.

I'm also happy to introduce Professor Jia from China, from Peking University, where he is professor and associate dean of the School of

International Studies. Mr. Jia has also been here before. He was a speaker here in the Asian Voices series very soon after 9/11 last year, and he has been a friend of ours over the years. Then last year as well, he was a visiting fellow at the Brookings Institution.

He has taught at the University of Vermont, and Cornell, and the University of California, San Diego. He is vice president of the China Association for American Studies, and he is on the board of many leading journals, and is a very well known and important figure in China foreign policy and international relations circles, and including circles here in the United States. A leading scholar of U.S.-China relations, he is the author of a recent book, *Unrealized Rapprochement: Sino-American Relations*.

Finally I would like to welcome Mr. Sugisaki, who is the deputy managing director of the IMF and has been so since March of 1997. His early career really began and traveled through very important and ascending positions in the Japanese Ministry of Finance. In 1997, he was the personal assistant to the president of the Asian Development Bank, and he has been appointed a special advisor, beginning in 1994, with the managing director of the IMF. He holds a degree from the University of Tokyo and Columbia University.

So we are very pleased to have this distinguished group of speakers to address these broad issues of "America and East Asia: Growing Together or Growing Apart." And I would like to turn the floor over to Professor Pempel, who will speak for 30 minutes or so, and then I will be the timekeeper, and then I will turn it over to our three discussants, who will each speak for about 12 minutes. And then we will turn it over to you for question and answer.

So Professor Pempel, the floor is yours.

T.J Pempel: Thank you very much, John. I appreciate the kind introduction despite the

fact that you seem to put an awful lot of stress on how old our friendship is. I also want to thank the Sasakawa Peace Foundation for inviting me in and for putting together this program.

The title, as I'm sure all of you know from the program, says the "The United States and Asia: Growing Together or Growing Apart." And before I actually begin the substance of my remarks, I'd like to make two quick observations. I guess the first of these in answering the question is that I'm really reminded of the Henny Youngman one-liner. When asked, "how's your wife", Henny Youngman always would reply, "compared to what?"

And certainly when we ask about the U.S.-Asia relationship, I think an awful lot of how we assess it depends on what our benchmark is. And for me personally in my remarks today, I'm going to use two very different benchmarks. The first of these will be really to try and look at the long-term structural relationship between the two regions—the U.S. and Asia—over, let's say, the last 20 to 25 years.

U.S. and Asia Have Been Growing Together

And to jump to the punchline, I think the evidence is unambiguously that for the most part, the U.S. and Asia were growing together rather than growing apart, despite numerous frictions over that 20 to 25 year period. But I would raise more questions about the state of the relationship in the last two years, and I will try to suggest to you why I think there has been some increase in the distance between the two countries. So that's the first question, compared to what, or what's the time period.

The second point I simply want to make is that a lot depends on your perspective on the issue. And in this regard, I'm reminded of the clearly apocryphal story that God has decided that He was going to destroy the world because the political leaders had messed it up so badly.

And He decided before doing that He would call together three of the most important leaders and allow them a couple of days to inform their populace.

So he called together George W. Bush, Jiang Zemin and Prime Minister Koizumi, announced that the world was going to end in three days. Immediately the three men returned to their respective constituencies, and George Bush began by saying, I have good news and bad news for the American people. The good news is there is a God, and my Christian supporters will be very happy to know that. The bad news is that He is going to destroy the world before my opportunity for reelection.

Jiang Zemin returned to China and said, I have bad news and even worse news. The bad news for us in an atheistic society is that there is a God. Even worse, He is going to destroy the world before I have a chance to hand over the mantle at the 16th Party Congress to my successor.

Prime Minister Koizumi returned to Japan and said, I have good news and even better news. The good news is there is a God, and He is still convinced that Japan is important, and I am one of the three most important people in the world. And the even better news is that Japan's non-performing loan problem will end in three days.

Let me start by suggesting what I think are the most important trends between the United States and Asia over roughly the last 20 or 25 years, and why I think they have generally moved the two regions closer together. Just for those of you who keep nice tidy notes, let me give you the three of them at the very beginning, and then elaborate on each of them.

The first is that I think there have been changes in the geopolitical or the geostrategic character of Asia and the Asia Pacific that have generally moved the two closer together. The second thing that I want to stress is the

importance in the rise of private capital flows, private financial flows across borders. And the third thing I want to stress is the rise in Asian regionalism and regional organizations. And let me say a few things about each of these in order.

Changes in Geostrategic Character of Asia

In terms of changes in geopolitics, while it's not automatically included in geopolitical or geostrategic thinking, I think a couple of things deserve to be underscored. The first of these is the tremendous macroeconomic growth that has occurred across Asia over the last 20 years or even longer. This, of course, started as a familiar story to all of us with Japan's tremendous recovery from the devastation of World War II, followed by Korea, Taiwan, Singapore, and Hong Kong. All of which began to enjoy double digit rises in their GNP growth for periods of a decade or more in the mid-70s to the mid-80s.

And then, of course, it was followed by the so-called MIT economies, Malaysia, Indonesia, and Thailand, in the late 80s to the early and mid-90s. And of course, we've had even more impressively the amazing rise in the economy of China, particularly the coastal regions of China, over the last decade plus. And in all of these ways, we've seen in Asia a tremendous rise in the economic productivity of a region that is really the only region in the world that has seen a substantial reallocation of resources across the globe.

The only other example that I can think of was the improved GNP, or the improved productivity, or the improved wealth of the Middle East following the oil crisis in the early to mid-1970s. But Japan and the rest of Asia have systematically become more important in the overall world GNP, overall world exports, and the like. And in essence, this has meant that Japan is a much richer, more industrialized, and even more middle-class region than it was in the 1960s or even the 1980s. That's one piece in the change in geopolitics.

Democracy Became More Pervasive Across Asia

A second thing that I think is important to stress is that democracy has become more pervasive across Asia over the last couple of decades as well. In the 1960s, early 1970s, there really was only one democracy in Asia, and that was Japan. Japan has now been joined by South Korea, by Taiwan, and increasingly a number of other countries, whether we're talking about the Philippines, Malaysia, Singapore, Thailand, etc., have at least become more democratic than they were before. And in essence, the region has become one in which far more countries share a common democratic orientation than was the case before. And as a result of this, if one believes the standard clichés that are prevailing in international relations theory, namely that democracies do not typically fight each other, this is a very positive development both for the Asian region as a whole and for U.S. relations with Asia.

And still a third piece of this first geostrategic change that I want to underscore is that changes in the power balance in Asia have generally been favorable to improved ties across the Pacific. When World War II ended, and for the first 20 plus years after the war, essentially U.S. relations with Asia were based on an alliance system that many have called a hub and spoke system. Everything from the Asian capitals that the U.S. was friendly with went back directly to Washington. Washington was the hub, and Tokyo, Seoul, Manila, etc., were spokes in this.

Changes in the Power Balance in Asia

But there were very few connections around the rest of Asia. The U.S. was far and away the preeminent power, and little by little as Japan's economy improved, Japan moved into a position where it was very much an economic Gulliver in a land of Lilliputs. But I think what we've seen since then—oh, and one last piece, of course, is the tremendous

bipolar character of the Asian region. The Soviet Union, China, Vietnam, North Korea are all poised as essentially strategic enemies to the United States, seen by many of the anti-Communist countries in the rest of Asia as potential threats, and planning accordingly in this bipolar world.

Bipolarity has ended, of course, with China's opening to economic reforms, with its break from the Soviet Union, with the collapse of the Soviet Empire, and with the collapse of the U.S.S.R. It's also been the case that the Asian hierarchy has been broken down as numerous other countries have risen in economic power, in strategic power, and while there is still a clear hierarchy within Asia, it's no longer at all the case that Japan is the unchallenged first among equals.

There's a great deal more competition between China and Japan for leadership in Asia. South Korea can make certain claims. ASEAN has become more cohesive, and in many instances, provides an element of leadership within the Asian region as a whole, so that in essence, it seems to me the Asian region has become far less hierarchical, far more tranquil, far more democratic. And in many ways, all of these things move Asia and the U.S. much closer together.

Changes in Global Finance

Let me say a few things about the changes in global finance. Basically the point that I want to make is that over the last decade to 15 years, there has been a profound shift in the relative power of the world's largest national banks and the movement of private capital. To give you a very stark statistical indication of this, in 1983 the five largest central banks in the world, U.S., UK, Japan, Germany, and Switzerland, had among them 139 billion dollars in foreign exchange. And that 139 billion in foreign exchange reserves compared to about 39 billion dollars a day in foreign exchange markets, foreign exchange transactions.

So if you look at it this way, the combined powers of government were roughly three to one over daily market movers. By 1986, the total reserves of these five largest banks were roughly equal to the average daily trade. And today the balance of power is completely reversed. There's about 1.8 trillion in daily trading activity compared to reserves that are about 278 billion among the five largest banks. So in effect the firepower, if you want, of the major reserve banks was three to one over markets in 1983. Now it's markets with a four to one advantage over the central banks.

Governments Have Less Control Over Exchange Rates

What this means among other things is that governments have far less control over exchange rates, over capital movements. Their individual corporations are far less dependent on government sources of funding for their activities. It becomes more and more difficult to speak of something called a national economic agenda. Far more economics becomes blurred across national boundaries, and there's been a denationalization, if you will, of capital flows. And companies are much freer to borrow, lend, or fund themselves in a wider variety of ways than they were in the past.

On the plus side, of course, this has meant much greater economic development in Asia, and it's also made for far more investment possibilities for U.S. investment houses across the world. And it's meant that Asian economies have become far more integrated into the broader global economies of North America, Western Europe, etc. And in general this has meant a certain measure of deregulation, a certain measure of greater openness.

The flip side of this increased financing, of course, came with the Asian economic crisis of 1997-98 insofar as economies that were increasingly integrated were simultaneously increasingly vulnerable to the shocks that hit one of them rippling across national borders

and taking others down with them. But I think what has happened in Asia is that countries have become far more conscious of the ways in which their economic security is at least as important as their military security. And they have begun to think about ways in which their entire agendas for policy are linked one element to another and how they are linked to one another, and increasingly how important the private sector funding is.

Multilateralism in Asia

Finally, let me say a word about multilateralism. In Asia, multilateralism probably can be seen as having started with the creation of ASEAN in 1967. But I think far more important for contemporary understanding was the debate that went on over the creation of the East Asian Economic Caucus versus the creation of APEC. Many of you will, I think, remember that within Asia in the late 1980s as the European Union came to crystallization, as NAFTA was formed in North America, there was a great deal of discussion within Asia that the EU and NAFTA would be highly protectionist, or at least be organized to discriminate against Asian exports. And that, therefore, it became incumbent upon the Asian economies to create an organization for themselves that would somehow provide economic collaboration that would give them an opportunity to compete as a region against the presumably more unified North America and the more presumably unified Western Europe.

The debate in Asia as it unfolded was between the idea of Prime Minister Mahathir of Malaysia to create an East Asian Economic Caucus from which Australia, New Zealand, Canada, and the United States would be explicitly excluded. What some cynics called a caucus without Caucasians, versus a proposal that eventually won for APEC. Which in fact was much more of an open regional organization that included the U.S., Canada, Australia, New Zealand, and increasingly has included countries along the Pacific Rim in Latin America, in essence breaking down

the notion that Asia would be a closed trading region.

But following on APEC have been a number of organizations that I think have gained increased salience within the Asian policy-making agenda: the Asian Regional Forum, the Asia Free Trade Association, which is at least bandied about. We've seen the formation of the so-called ASEAN plus three, APT. There are a number of track two dialogues that are going on in various parts of Asia to put together both private citizens and government officials in their private capacities to deal. This is an attempt to create possible solutions for a number of the problems that are faced in common by various Asian countries, whether they be environmental, financial, economic, crime, immigration, law of the seas, or whatever.

In all of these—and I probably should also add that China has been a very important player in this. And China has also created the so-called Shanghai Six as an important organization that doesn't get as much play in the U.S. involving China and several of the miscellaneous stans on its western border.

But the point of all of this is—and the last thing to say, I guess, on this regard is the so-called Shanghai Initiative, which many of you know came about in May of 2000 under which a number of the Asian countries, Asian economies, have agreed to various forms of bilateral debt swaps in an effort to empower them to do things that they felt that they did not do effectively as a region when they were confronted with the Asian economic crisis of '97, '98.

More Asians Making Decisions For Region

So in all of these ways, it seems to me Asia has moved collectively to seeing itself as more in control of its own collective agenda. More of the activities that affect Asian countries are, it seems to me, being subject to decision by Asians within the Asian region. And on

balance, this does provide Asia with a potential to challenge Washington on a number of points. But I think the broader perspective, if taken, suggests that this is a positive development for America and for Washington because of balance.

What has developed in multilateralism within Asia has not been a set of developments that have moved in opposition to the U.S. or in opposition to global financial and trade organizations. But rather they have sought to integrate the Asian region into the IMF, into the WTO, into APEC, and into relations with the United States. So broadly speaking as I look at these three trends, changes in geostrategic relations, the rise in private capital flows, and the rise in multilateralism within Asia, is to suggest that while in many cases problems have arisen over the last 20 or 25 years as a result of these developments, Japan posed an economic threat to the United States in the late 1980s when its foreign direct investments seemed to be gobbling up a whole host of trophy properties within the United States from Pebble Beach to Rockefeller Center, when the mid-West seemed to be turning into a rust belt.

For many in the United States, Asia's economic success seemed to be taken as a threat to the U.S., and in February of 1994 bilateral trade negotiations between Prime Minister Hosakawa and President Clinton failed for the first time in bilateral trade talks between the two of these. But on balance, all of these developments led to increased economic integration across the Pacific. Dealing with China between the United States and China had become far more positive. Security problems in Asia that concerned the United States have by no means disappeared.

There are still problems on the Korean peninsula. Cross-straits relations are far from completely smooth. There are territorial disputes in the Spratleys. Cambodia and Vietnam are still potential problem areas. But on balance, those problem areas have been

subject to far greater peaceful resolution than anything else. And it seems to me the role of ASEAN, for example, in helping to resolve the Vietnam-Cambodia conflict, and the role of the United Nations in resolving conflicts in Cambodia all suggest that on balance, developments in the Asia Pacific have been by and large far more positive, far more economic cooperation than military confrontation, more interest on both sides in settling contentious territorial issues without a reliance to military arms, and a greater reliance and regional and global organizations to resolve disputes.

And I think the broad brush terms that these present suggest a much more positive outcome from the standpoint of the United States than any American political leaders might have anticipated in 1945, or 1955, or even 1975, or 1980. As I say, not without problems, but the broad brush trends have generally been those of bringing Asia and the U.S. closer together, and for that reason I think we can applaud the general direction in which relations have moved over the last 20 to 25 years.

Significant Moving Apart in the Last Two Years

I want to suggest to you, however, that I think there has been a significant moving apart in the last two years or so since the inauguration of the Bush administration, and possibly even more acutely, in the period since September 11th. Clearly this is a matter subject to dispute, and I'm sure that—I'm looking around the audience, and at least one member of the Bush administration whom I expected to be here throwing tomatoes at me has not yet shown up. But I realize this is controversial. But let me suggest to you why I think there have been problems.

It seems to me the first thing that is seen by many Asians as creating more problems than resolving them was the initial tendency on the part of the Bush administration to move toward unilateralism and away from multilateralism. The host of multilateral

arrangements that the U.S. broached or breached goes on for quite a period of time, but refusing to abide by the Kyoto Protocol, ending the comprehensive test ban treaty, refusing to enforce the biological weapons convention, being uninterested in the landmine ban, unwilling to stop trafficking in small arms, and so forth, suggest that, I think, to many Asians that the U.S. was moving toward unilateralism and away from multilateralism. Moving toward making its own determinations of policy without consultation in a serious way with its allies, unilateral abrogation of treaties and the like.

The United States was carrying out what Richard Haas and the administration called a policy of a la carte multilateralism. Which seemed to be suggested that multilateralism was a smorgasbord from which you could choose the particular liverwurst or bratwurst that you wanted, but ignore the other items on the table.

Bush Administration Concerned With Conservative Elements

It seems to me there was also a great deal of emphasis within the early years of the administration on satisfying the more conservative elements socially within the Republican constituency. And this led to a number of international activities that I think played very poorly in Asia, for example, the U.S. insistence on not supporting any programs of international birth control or international reproductive activity that might include the use of contraception or the use of abortions, etc.

For a large part of the world that was suffering massive population explosions, this seemed to be a policy that was very dubiously perceived. And it seems to me that the overall orientation of the United States towards the AIDS crisis, for example, suggested that it was far less interested in providing drugs that might help to deal with the AIDS crisis in impoverished parts of the world at a reasonable rate than they were in ensuring profits for the corpora-

tions that had been the major producers of these pharmaceuticals and the like. So I think all of this began to play very poorly.

I also think, and I think it became much more important after September 11th, that the Bush administration's seemingly unquestioned support of the Ariel Sharon regime in Israel played very poorly. And it was certainly perceived within the Middle East, and I think by Muslims in Asia, as a policy direction that was, if not anti-Muslim, certainly carried many of the residues of what could be perceived as anti-Muslimism, and played very poorly, as they say, within the Arab street.

And I think probably the foreign policy orientation that was perceived most in Asia as moving away from closer Asian ties was President Bush's early embrace of Cardenas as America's first direction for foreign policy. Namely moving toward Mexico rather than moving across the Pacific, coupled with his snubbing of Kim Dae Jung and the sunshine policy that the South was attempting to utilize to bring the North out of what it saw as its hermetic cocoon. But Bush made it very clear that he did not find President Kim's efforts at financial assistance and closer ties to the North to be something that he wanted to endorse.

More Muddied U.S.-Asia Relationship

In the period since September 11th, I think things have become a little bit more muddied. And there are some, you know, as they say, some good signs and some bad signs. Clearly there was a move away from the unilateralism of the past, particularly with regard to Afghanistan. The U.S. put together a multilateral coalition in its so-called war against terror that brought in Japan, moved Japan very substantially forward on a number of defense measures that Japan had been reluctant to take in the past. And Japan very quickly signed on as a supporter of America's activities in Afghanistan.

China, relations with China improved as a

result of this. They did as well with the Soviet Union, both the Soviet Union and China using the so-called war on terrorism for their own domestic reasons as well, but quite happy to sign on to a set of policies that presumably would allow them to deal with what they saw as deviationist forces or internal terrorist operations in Chechnya or in Xinjiang. In the west of China, and Australia, New Zealand, etc., were also woven into this multilateral coalition.

The U.S. was also very quick to decide that many years of avoiding the United Nations in refusing to pay its dues should be changed. The UN dues were paid. The U.S. rejoined UNESCO, and there seemed to be a number of moves by the U.S. toward becoming more multilateral. By the same token I think with regard to the moves against Iraq, there was a resurgence of a perception of unilateralism, a declaration, in effect, that if nobody else wants to go with us, we will go alone.

Increasing Reliance on Traditional Military Force

The lines are drawn in black and white. And increasingly the reliance was on traditional military buildups, the reliance on traditional military force. And I think that played exceptionally poorly with China, with Russia. It did not play well with South Korea or Japan. And I think the only thing that one can say by way of addition to this is that the latest resolution of the United Nations on Iraq does seem to suggest that within the internal circles within the Bush administration, Colin Powell is carrying a little bit more weight than Rumsfeld and company, and the U.S. policy now seems to have taken on more respect for multilateralism than it initially did. But I think the flipping and flopping on multilateral versus unilateral approaches is one that is very difficult for many in Asia to accept.

And I think in addition, I think it's been extremely difficult for countries with substantial Muslim populations to agree with

American policy, whether we're talking about Malaysia and the difficulties that Mahathir faces. You'd better not say anything about Middle Eastern policy in Washington, D.C. or the forces will get you. What was it that the queen said to the butler? There are forces in this country about which we know very little? Okay, I will proceed with temerity.

I think the situation in Indonesia, the situation in the Philippines, the situation in Malaysia is one that's rather problematic. And I think the decision by the United States to prosecute not only the war against terrorism, against the Taliban, against Al-Qaeda, which are relatively clearly identifiable as a new form of non-state terrorist threat to many parts of the civilized world, I think much of Southeast Asia can sign on to that. I think it's far more difficult for them to sign on to policies that seem to pit Sharon against the Palestinians.

It seems very difficult for many in Asia to understand why Iraq's violations of UN resolutions are more serious than Israel's violations of UN resolutions when it comes to the United States, etc. And I think even after the Bali bombing, there's a certain skepticism on the part of Indonesia as to whether it wants to go along with the U.S. agenda.

U.S. Should Be Careful of Global Overreach

Now obviously the cynics will say, what can Asia do to stop the United States? And clearly with the United States now spending more on its military hardware than the next 10 largest spenders combined, there's no question but that the U.S. has a unilateral preponderance of military force around the world from which or against which no particular country is likely to want to stand up and take action. But I think it's important for the United States and the current administration to be somewhat careful about the dangers of global overreach. I think there's a very clear danger of missing the war on terrorism by the attacks on Iraq.

I think there's a very real risk that by focusing particularly heavily on military solutions to global problems and failing to look at diplomatic non-traditional economic foreign aid, cultural, and other ways to deal with potential problems around the world, the risk becomes that of the carpenter who had only a hammer so that every problem began to look like a nail.

And I think the danger with the current policies being pursued by the administration are that everything will look like a solution that can be handled militarily. And it's within areas that do not require or are not amenable to military solutions that the U.S. runs the risk of alienating some of its Asian allies.

I think there's a certain amount of skepticism in China about the recent U.S. policies of the new strategic doctrine that challenges long-held and very sacred notions of sovereignty by China. Japan is very sick of hearing about the problem of its non-performing loans, particularly if no one in the current administration seems interested in providing any form of aid, assistance, or support for Japan doing this. Korea is, I think, still reeling from some of the difficulties of Larry Summers forcing down Korea's throat a recovery package that in Larry Summers' words did more to restructure the Korean economy than 20 years of bilateral negotiations between the two countries. The plus side for Korea, of course, is that its economy is doing much better now than it would've probably done had it not taken the IMF's advice.

But the point here is simply that to the extent that the U.S. acts unilaterally, and acts militarily, and allows its focus to be diverted from maintaining cooperative and positive relations with Asia, and focusing its attention primarily on the Middle East, and focusing on military solutions to problems, the risk is there that relations between the United States and Asia that have taken very positive turns over 20 or 25 years, and around which a number of positive institutions have been created and a

number of positive investments have been made, all of these run the risk of being eroded in a very short measure of time. And it seems to me that in the long run, it becomes incumbent upon the administration to look toward Asia and take Asia far more seriously than it seems to be doing now because the potential for Asia to provide a positive support base for the United States on a host of issues is, I think, far greater than is being currently appreciated.

Let me stop on that note and pass it off to our discussants.

Richard Koo: After such an overwhelming coverage, I don't know what else is left there to say. But I am an economist, not a political scientist, even though that was my original major at Berkeley.

Looking from economic perspective, I'd like to say few things about the Asian region, and then a little bit more on Japan, since that's the area that I've been covering most closely.

American Consumers Key to GDP Growth in Asia

Professor Pempel talked about all this great growth in GDP in Asia, and that's all true. But all of those countries in Asia benefited greatly from the availability of the U.S. market. And it is really this reason that everybody wants to talk to Washington first instead of Tokyo, or Beijing, or anyone else in that region because there's not a single country in Asia who've succeeded in managing economic growth without tapping American consumers.

Japan first found a formula that you export to the United States and make yourself very rich and was doing very well. Taiwanese realized it second, South Koreans third, and the whole gang, China recently. Even it seems like North Korea wants to get onto the bandwagon. Vietnamese are already on the bandwagon.

What that means is that the so-called hub and

spoke that Professor Pempel talked about is not just military. It's very much economic. I mean, these people might not love the blue jeans of a democracy, but without American consumers buying their wares, it's very unlikely that these economies will grow. And so if you look from the economic terms, in economic terms we always think current account surplus, trade surplus is better than trade deficit, current account deficit.

But in political terms, it's the other way around. If you're offering the markets, if you're running a current account deficit, you are offering something to the other guy, and that's why they have to treat you as a very important customer.

Chinese Growth Could Erode U.S. Influence

From this perspective, the only challenge that can possibly happen to the United States is when China grows large enough to offer the markets almost as attractive as the U.S. market today. When that happens, some people, when they get a call from Washington, will say, well, yes, I understand, but let me talk to Beijing first, and then I'll call you back. You know, something like that will happen perhaps.

But given the size of the Chinese economy at the moment, which is still a fraction of the U.S. economy, or even a fraction of the Japanese economy, that probably won't happen for another five or 10 years. But if anything can happen, this is where U.S. influence in Asia could be eroded or, for that matter, around the world. If China really opens up its market, it will grow very large. And if consumers are willing to buy a lot of foreign products, which is probably going to be the case, then some of the influence that the United States had will be eroded because then China becomes a very much more important customer than the U.S.

Japan actually had a chance to do that, especially when during its bubble days, you

had tremendous domestic demand. But I'm afraid that they were not able to convince some of the farmers and a few of their constituents, and so they missed the chance. But China can do it probably five, ten years down the road. But at the moment, even the Chinese economy is still very much dependent on the U.S. So even though Chinese leaders might not like what George Bush is doing to make sure that American market remain open to the Chinese products, I think they will go along with U.S. policies for the time being.

Japan: An Urgent Issue

I think a much more urgent issue is in the sense that what I just described will not be changed for another five to ten years. A much more urgent issue, I think, is about Japan. And that is that the most important U.S. economic and military ally in Asia is Japan, and this economy is sinking very, very rapidly. And if Japan is not going to be a viable economy in years to come, some people in the United States will have to think about what's the proper way to deal with Asia now that if the assumption is that Japan will be sinking.

So the question is, is Japan really sinking or is this just a temporary phenomenon? A lot of the people in this town I understand talk about the need for structural reform, and then get rid of all these non-performing loan problems, and then the Japanese economy would get its act together. Sitting in Japan in the financial market in particular, I must say that that description misses the mark quite a bit.

I think there are a lot of structural problems in Japan. I was one of the most outspoken advocates of structural reform over the years. But that's probably about 20 percent of the problem. Seventy, 80 percent of the problem is something else altogether. I call it the balance sheet problem. And since the United States is beginning to look like Japan in so many ways, I'd like to dwell upon a little bit about these balance sheet problems.

Companies Paying Down Debt at Zero Percent

Today 70 to 80 percent of Japanese companies are paying down debt at zero percent interest rates. Just think about that. Companies, 70, 80 percent of the companies in the country paying down debt when the interest rate is almost zero. It's a world that is not in our textbooks. Certainly we never learned this is in economic textbooks. Companies are supposed to be borrowing money at zero percent rate and investing in all sorts of things.

But just the opposite is happening. Why is that? Because starting with the 1990s, asset prices collapsed in Japan, the bursting of the bubble. Commercial real estate prices in Japan have gone down by 85 percent national average—85 percent. So compared to the peak days, we only have 15 percent of the value left. All these companies borrowed money to buy those assets. Those loans are still on their books. Assets all the way down. Some of the companies are actually bankrupt if you just take a snapshot of it.

But the definition of bankruptcies, there are two definitions of bankruptcies I think—your main line of business is really bad, then your balance sheet is bad. Then these guys have to leave the scene. They are no longer viable. But there's a possibility that your main line of business is still very good, or reasonably good, but your balance sheet is out of whack. That's the Japanese case. Japan is still running the largest trade surplus in the world, although the Chinese are catching up quickly. So competitiveness, all of that is still there.

Balance Sheet Is Out of Whack

But the balance sheet is completely out of whack because of what happened to asset prices at home. Any corporate executive, whether he's Japanese, or Taiwanese, or American, or Chinese, I think they will do the same thing if you put that kind of corporate executive in that kind of situation where your

main line of business is still good. You have a reasonable cash flow, but your balance sheet is completely out of whack because of what happened to asset prices at home. Those people will use the cash flow from the main line of business to pay down debt because if you continue to pay down debt, at some point your balance sheet will be balanced again. You can say, whew, I'm out of this problem. I'm no longer in the negative equity territory. But when you're in that process, you keep your head low, quietly pay down the debt as quickly as possible. And that's what's happening to the whole country.

Today the Japanese corporations are net creditors to the banking system to the tune of 20 trillion yen a year. That's four percent of GDP. So we don't even have to have banks because everybody's paying down debt. In that kind of situation, and Japanese households are still saving money, companies paying back debt, no one is borrowing the money that the households have saved. And that's the deflationary gap. In older economies, you have the household sector saving money, the companies borrowing money, and that's how the economy moves forward, whether in United States, Japan, or anywhere else.

But in Japan today, we have a household sector saving money, companies not borrowing money. Not only they're not borrowing money, they're paying back debt. So whatever money the household sector saves, that becomes the deflationary gap. If you don't build this quickly, the whole thing just collapses into a great depression.

The last time we have seen anything like this is during the Great Depression. After the New York stock market collapsed, everybody borrowed money to play this New York stock market in those days. Everybody was left with debt. Everybody stopped paying down debt. The whole economy contracted. That's exactly what is happening in Japan. When you are in this kind of situation, the government

sector, which is not part of the private sector, has to do the opposite of the private sector.

There's no two ways about it because you cannot tell the companies not to pay down debt. At the micro level, they're doing the right things. But collectively, then you get into the fallacy of composition problems. Even though they are doing the right things collectively, the economy shrinks. But if the government, which is not part of the fallacy of composition, takes the opposite action, then you can stabilize the economy.

And that's what we learned in the 1930s. That's basically what the Japanese government has been doing, not knowing what they were doing, but in the end, in retrospect, that's what they were doing. They were too successful at it. Japan lost something like 1,200 trillion yen of wealth. That's about almost three year's worth of Japanese GDP. But because the government took this action from the very beginning and kept on filling this gap every year, every year the household sector is saving, companies are not borrowing, but government came in and filled the gap.

Companies Must Finish Repairing Their Balance Sheets

Next year, the same thing happens. Why does the same thing happen the next year—because the asset prices fell 85 percent. So one or two years of paying down debt by the companies is not going to be enough to repair the balance sheets. It's going to take five years, 10 years to repair this kind of damage. But without companies finishing this balance sheet repair, there's no way in the world an economy like this can reenter a self-sustaining growth. You have to have at least half of the companies in the economy looking forward for economies to move forward. If you have the companies—if most of the companies are looking backward, we're not going to get an economy recovery no matter what happens.

So this is a step that we have to go through.

Companies have paid down debt very significantly. The balance sheets are much cleaner now than they were five or 10 years ago. But this is like drowning in the water. You may be 30 meters under the water, then from there you recover to about five meters under the water, but you're still under the water. You still cannot breathe. You have to have your head out of the water, then you can say, whew, I'm out of the problem.

The balance sheet problem is basically of this nature. You have to come out of the water. You have to be out of the negative equity territory before you can start looking forward again. And I'm afraid that's where Japan is at the moment. Another two more or three more years of fiscal help, keeping the economy going so that companies have the revenue to pay down debt, most of this problem will be behind us.

Unfortunately, the current government of Mr. Koizumi doesn't seem to understand these macro problems, and are increasingly moving away from, I think, the treatment that was working into something that is totally different. And that's why I'm afraid the economy's weakening, the stock market is falling, interest rates are falling to the lowest level in the history of mankind. But my guess is that people are beginning to realize that the right approach is to fill the gap of household sector savings that the company is not borrowing. And once that point is appreciated, I think the Japanese economy should come out of these problems in the next few years.

Japan's Micro Economy Improving

What this means is that even though the macro is very bad because everybody is paying down debt, the micro is getting better everyday. But because everybody is doing the right thing with the micro, that's why we have a macro problem. So at some point when the balance sheet problems are over, my guess is the Japanese companies will come out strongly as ever.

They are trying to pay down debt, pay down such a large amount of debt that right now they're keeping their heads low, trying to pay down debt as quickly as possible and quietly as possible. That's why you don't see them on lot of the front pages of newspapers, but that doesn't mean they've been complacent or postponing problems. If they're postponing problems and not paying down debt, there's no reason for the Japanese economy to be in recession.

I see the same thing happening in the United States as well. After Enron, after IT, so many U.S. companies are looking at their balance sheets. They're no longer maximizing profits, they're minimizing debt. But once you're in that situation, the invisible hands will start moving in the opposite direction compared to companies maximizing profits. And we see in this country that Greenspan lowers rates to these very low levels, corporate demands for funds failing to pick up just like in Japan over the last 10, 12 years.

So with more and more people realizing that these things can happen, that the majority of companies are looking backwards instead of forward, once these things are appreciated, then I think people will begin to see that maybe Japan wasn't such a hopeless case after all. That some of the policies that Japan has put in over the last few years were not so wrong after all. And once those views become more widely appreciated, then maybe Japan can move away from, in my view, excessive emphasis on structural reform back to more realistic macro policies.

Actually if you look at Asia, Taiwan has the same problem. Taiwanese interest rates are the lowest since the founding of the Republic of China in 1911. No one is borrowing money because everybody wants to repair their balance sheets. A lot of Asian countries have the same thing. Thailand, it's same thing. Very low interest rates, very weak demand for funds.

So when everybody begins to share this

problem and we begin to realize that, even though this is not in economic textbooks, these things can happen after the bursting of a major asset bubble. Maybe people will begin to view situations differently, possibly positively, and with that, with more kind advice from the outside. I think the Japanese economy should be on the recovery path. Thank you.

Qingguo Jia: Thank you very much. It's a great honor and privilege to be here and to address this distinguished audience. Many thanks to the Sasakawa Peace Foundation for this opportunity.

I'm also very excited because Professor Pempel was teaching at Cornell University years ago when I was a graduate student. And so it is a great honor to share this panel with him.

The question we are addressing today is "The United States and Asia: Growing Together or Growing Apart?" Professor Pempel's answer is that the longer trend is that the two regions are growing together, but the short-term development is that we're growing apart somewhat.

I agree with him on the general thrust of the argument. However, I also want to point out that the reality beneath the broader trends is rather complex. That is to say, there have been forces challenging both the longer trend and also short-term development over the years. And aspects of the relationship between the U.S. and Asia may develop in different directions at the same time.

Dichotomy Between Economy and Politics in U.S.-China Relations

You see a dichotomy between the economy and politics in the case of China-U.S. relations. Because I'm a student of U.S.-China relations, I would expand this point in light of the development of U.S.-China relations over the years.

First, in terms of the broader trend of the relationship that has been between China and

the United States, there have been expanding ties and reduced differences over the years, especially since Nixon's visit to China in 1972, especially since the normalization of relations between the two countries in 1979.

When we talk about expanding ties, we're talking about growing trade relations between the two countries, growing investment in China on the part of American businesses, and emerging investment on the part of Chinese companies in the U.S. And also growing travel across the Pacific between the two countries, and expanding institutional and personal exchange relationships across the Pacific as well.

Reduced Differences Between China and the U.S.

Because of the growing ties and expanding ties, we're seeing reducing differences between the two countries. This happens at both the material level and also the level of values. In terms of the material level, if you go to China, you'll see a lot of familiar symbols now: McDonalds, Pizza Hut, among other things, and big Hollywood pictures, video gods. And, of course, more and more Buick sedans are riding Chinese streets. The living standard has increased in China. The gap between China and the United States in terms of living standards has reduced over the years.

If you talk about interests of the two countries, there have been more and more overlapping interests, more common interests than before. Both countries are important members of international organizations, especially in both the political arena and also the economic and security arenas. China shares with the United States a lot of interest in maintaining and promoting peace, stability, and prosperity. China was intensely concerned, for example, about the stock market situation after 9/11 because if the stock market in New York did not perform well, this would hurt the Chinese economy as well. There has been growing interdependence between the two countries.

China Has Embraced More American Values

At the level of values, China has changed a great deal over the years and has embraced more and more a set of values which the U.S. has been standing for. On the question of market principles, I think the Chinese are embracing the free market principles. Adam Smith and Richard Ricardo are more popular nowadays in China. Probably more people know about them in China than in the United States.

And also the rule of law is a principle the Chinese government has been promoting in China for some time. Years ago, you know, during the Cultural Revolution, rule of law was sort of abolished. Laws were abolished. The court was not functional, and no lawyers, very few undereducated judges. Now we have a system of law and, of course, a better trained and increasing number of lawyers and judges.

And also the question of human rights. The Chinese government has been saying that we are also promoting human rights in China. We hope to improve human rights. But, of course, we have our own situations. We want to do it according to the situation in China rather than just follow the U.S. advice. But at the conceptual level, the Chinese government doesn't see a difference anymore between China and the United States on the need of promoting human rights.

On the question of democracy, the Chinese government has also been saying that this is a goal that we are working on, that we are promoting. And we have problems. We are trying to lay the foundations for a better democratic system in China.

Values Must Serve China's Interests

So on the conceptual level, the gap between China and the United States has been narrowed. We don't have fundamental differences in terms of these values. What we

have is that we have different situations, and the Chinese government has been insisting that we want to promote these values, but they must serve China's interest as well. So for the longer term, China and the United States have grown closer together. Of course, there are many differences and many major differences remain. However, the two countries have never shared so much in common in the history of their relationship.

Having said this, I should also mention that between the late 1980s and before 9/11, the relationship had witnessed increasing tensions instead of reduced tensions. There were all kinds of allegations in the United States against China during that period of time on a whole range of issues, human rights, prison labor, proliferation, campaign contributions, espionage, theft of military technologies, Taiwan, etc.

On the Chinese side, the Chinese are very frustrated and, of course, they complained that the U.S. was interfering in Chinese internal affairs, a violation of sovereignty of China, and also some young Chinese became upset. They published a book called, *The China That Can Say No*, following the title of the book in Japan, *The Japan That Can Say No*. And there are quite a few crises in the relationship, the Yinhe incident, the linkage between the MFN and human rights, Lee Teng-hui's visit to the United States, embassy bombing, and EP3, etc.

At the popular level, popular attitudes in the two countries were also moving in the wrong direction. In the U.S., many Americans think about China as a sort of potential threat, and, of course, in China many Chinese regard the U.S. as a sort of international bully.

Increasing Tension Between China and the U.S.

There are efforts on the part of the two governments to try to rescue the relationship on the part of President Jiang, and President

Clinton, especially. They had summits in 1997, 1998, and as a result of the efforts, the relationship improved. But the general trend during the entire 1990s and the beginning of the 21st century was increasing tensions.

Since 9/11 this situation has changed somewhat. There has been increasing cooperation between the two countries, especially on the question of anti-terrorism. But at the same time, we also see brewing tension on the Taiwan question, and also efforts on the part of some people in the Bush administration to hedge against the so-called China threat. And to these people, they believe that terrorism is a temporary threat, and China is the longer and the real threat.

So they have been working more closely, pushing forth the official relationship between the United States and Taiwan, and especially trying to develop the military relationship between the two. And that has laid the foundation for future problems in the days to come.

And during this period of time, we see a process of growing together between China and the United States on the question of anti-terrorism, and trade, and people to people contacts. At the same time, of course, growing apart on the question of Taiwan and security relations.

China and the U.S. Will Grow Together

Looking toward the future, I think in the short run the relationship in general is okay, but then we may have a crisis brewing on the Taiwan issue. In the longer run, I'm more optimistic. I think the two countries are going to grow together. As China changes, the gap between China and the United States reduces, and greater room will emerge for cooperation. There will be problems between the two countries, but they are more likely to cooperate and to be partners than to be strategic competitors.

So the broader trends are there, but at the same time the realities are more complex with cross cutting currents and forcing the relationship to move in a less linear fashion than we conceptualize generally. Thank you very much.

Shigemitsu Sugisaki: Well, thank you very much. I first like to say thanks to the Sasakawa Peace Foundation for inviting me to this forum, and actually I was drafted by a friend of mine, who is the head of the Sasakawa Peace Foundation, a college mate and buddy, Mr. Iriyama. And that draft was done not even by a piece of paper, but just three lines in an e-mail, saying you have to be here. And I'm very delighted to be here.

As Professor Pempel has eloquently highlighted, that the response to the question posed to us today can be addressed in several ways. Being an economist, I will concentrate my remarks on the economic aspects. And let me go straight to the bottom line. If the question is whether policymakers in the U.S. and East Asia should think in terms of growing together or growing apart, there can be only one viable strategy, and that has to be one of growing together I believe. To do otherwise would be to turn our backs on the wealth of evidence that trade openness has contributed importantly to rapid economic growth, higher productivity, and thereby reducing poverty and raising living standards.

East Asian Countries Examples of Trade Openness

Indeed, the Asian crisis notwithstanding, several East Asian countries remain among the most competitive examples of the sustained benefit of trade openness, and outward oriented development policies. Compare East Asia with the Middle East, for example. The Middle East certainly has benefited from oil, which enabled them to have a higher per capita income, but their growth has been very low. Given their abundant resources, I'm sure they could do much better.

So my general message to policy makers is not to be discouraged by the current world global slowdown and collapse of the high-tech sector, and to continue embracing a philosophy of growing together through full and active participation in the increasingly open multi-lateral trading system. This includes continuing the efforts to reduce trade barriers and resisting appeals from special interests for trade protectionist policies.

A strategy of growing together is quite consistent with countries' efforts to diversify trade markets and to achieve a better balance between domestic and external demand. Indeed, East Asia has already made significant progress in this direction over the last two decades as evidenced by the marked increase in intra-regional trade and more recently by the rapid growth in exports to China. Neighboring Asian countries exports to China are expanding at the rate of 50 percent, which is phenomenal. And I don't think that's a sustainable rate, but still this trend will continue.

Of course these trends partly reflect the processing of products for eventual sale outside the region and, therefore, probably overstate the extent of true diversification. Over time, however, I expect intra-regional trade will continue to increase in importance, thereby helping to reduce the vulnerability of the East Asian economies to external shocks, and hopefully also contribute to a reduction in global current account imbalances.

Let me now turn to the conditions for stronger recovery in East Asia that would help strengthen the economic ties between the United States and East Asia.

Global Economic Outlook

First and foremost is a global economic outlook, including the outlook for Japan. Here the projection of the Fund's staff at the time of annual meetings last September pointed to a continued moderate recovery in global gross

to 3.7 percent next year compared with 2.8 percent expected in this year.

A number of downside risks to this outlook were highlighted, including concern about impact on demand of the weakening in global financial markets in recent months, the continued difficulties in parts of Latin America and global geographical, geopolitical uncertainties. Recent data suggests that the recovery is still intact, but could be a bit weaker than we were thinking a couple months ago.

Also only a weak recovery is foreseen for Japan next year. Its growth is projected at about one percent. In light of that, yesterday's announcement of GDP number, this year's growth could be a bit larger than our previous forecast. But next year's projection could be a bit lower than this number.

Resolution of Japan's Structural Problems

Successful resolution of Japan's difficult structural problems would provide an important source of growth stimulus to the East Asia region, one that has been missing in recent years. However, getting there will require a comprehensive strategy that addresses the deep-rooted problems that are contributing to sustained deflation and outputs stagnation in that country.

This strategy needs to include resolute action to resolve banking sector weaknesses, and accelerate bad debt workouts, and corporate restructuring, combined with maintenance of a fully supportive macro economic stance. Bold action in all these areas would be very much welcomed, and there have been several encouraging signs and steps taken recently by the Japanese authorities.

To me, the real issue is that there are too many borrowers who do not have the capacity to pay down debt. Those are the companies in sectors where there is a lack of competition. It's construction, or real estate, or large retail

sector, including the financial sector. And particularly that the competition with the foreign investors is lacking in those areas.

Turning to the policies that are under the control of the East Asian countries themselves, let me highlight the three general areas. The first is a continued pursuit of sustainable macro economic policies. For most countries, inflationary pressures throughout the region are low, allowing monetary policy to remain accommodating. On the fiscal side, the policy priorities vary across countries given that they have very different starting points. For countries such as Korea, with a strong underlying fiscal position, there is ample room to allow the automatic stabilizers to work if the recovery weakens.

In other cases, such as China and Thailand, somewhat greater weight needs to be given to the implementation of medium-term fiscal consolidation. And in cases such as Indonesia and the Philippines, where public debt levels are already very high, the overriding priority should be to set the public debt firmly on a downward path.

The second area I should mention is exchange rate policy. Since the Asian crisis, many countries have moved to adopt a floating exchange rate regime, which has provided important flexibility in dealing with both external shocks, including the global slow down, and fluctuations in major currency exchange rates, and also domestic shocks, such as last year's political transition in Indonesia. I believe that this is an appropriate approach, and countries should firmly resist pressures to return to the exchange rate regimes of the past.

The third area, and which I believe is the most important area, is structural reform. This encompasses many aspects, and the priority varies from country to country. In general, however, it is important to recognize that external involvement in most cases has become more demanding. For one thing,

beyond the immediate timing and strengths of the U.S. recovery, it is far from clear that the United States can be expected to play the same engine of growth going forward as it played during much of the 1990s.

For another, prospect for recovery in private capital flows to emerging markets remains uncertain. And within the East Asian region, China has emerged as a major competitor for FDI flows so that the neighboring countries should make their utmost efforts to attract foreign capital in its competition with China.

Structural Reforms High Priority for All Countries

Against this background, pushing ahead with structural reforms, including to address weaknesses that were often overlooked prior to the Asian crisis becomes all the more important and represents a high priority for all countries. Here, I would highlight several areas.

First is a need for further progress in corporate and banking restructuring, and to address still high levels of corporate debt, and in some cases, non-performing loans. Second, related priority is to strengthen insolvency laws, both to facilitate loan workouts and to provide an efficient framework for handling distressed borrowers in the future. Third, more progress is also needed in some countries in returning banks back to private ownership and strengthening the regulatory framework. Fourth, strengthening of corporate governance, the judicial system, and the rule of law are also priority areas. These reforms lie at the heart of efforts to create a favorable environment for a sustained recovery of private investment, including from abroad, thereby setting the stage for a durable and robust recovery.

Before concluding, let me say a few words on the issue of regionalism versus globalism. Since the Asian crisis, there has been a marked proliferation in the number of forums established to promote dialogue on economical and financial issues involving policy makers from

the region. Professor Pempel touched upon these forums and issues for discussing. Some, such as ASEAN and ASEAN plus 3 represent exclusively Asian efforts to strengthen dialogue and policy cooperation, while others, including APEC, the Manila Framework Group, which basically discussed the policy coordination and assessment of each individual country's economic policies and performance, and ASEM, Asia-Europe Meeting.

Forums Have Fostered Improved Common Understanding

Those groups involve officials from outside as well as from within that region. These forums have no doubt done much to foster an improved common understanding of developments and issues affecting the region. At the same time, it is important to keep in mind that Asia does not represent a single uniform group with common interests; rather, there is considerable diversity in terms of an individual country's situation and interests. That's why ASEAN's economic integration process has been so slow since it was established some 33 years ago.

Reflecting this diversity, I believe it is important for policy makers in East Asia to look beyond the region and to take a broader global focus in their discussions; in that sense, groups such as APEC have the potential to play a valuable role in this regard. And this multilateralism is what Asia is asking for when the Asian leaders discuss terrorism or other geopolitical issues with President Bush. So they should not only blame the unilateralism taken by the United States government from time to time, but they should think of themselves before they do it.

I will conclude on this note. Growing together is clearly the way forward. But the policy agenda is a challenging one. And all countries need to play their part, both for return to the robust growth and rising living standards in Asia and for the benefit of the world as a whole. Thank you very much.

Q & A

Ikenberry: Thank you very much. We're going to turn now to the audience for questions and comments, and we have some microphones. I would just summarize some of the themes that seem to have emerged. One on Japan, where there is obviously a big debate about the sources of weakness and the policies that need to be pursued. But also a sort of a lurking question of what the implications are for the region if Japan continues to drift or, as Mr. Koo suggested, sink downward given the economic problems and the underlying demographic changes.

What are the implications for the region of a Japan that is not as central economically or geopolitically? China clearly is growing, putting pressure on the region. Countries that have emphasized export-oriented labor, low labor industry, are finding some of that industry being hallowed out by movement onto the continent, into the PRC.

I was just in Taiwan, and the worry about hallowing out is on everybody's minds. In fact, it's one of the worries that has led to a kind of blockage in Taipei reciprocating the seemingly conciliatory gesture by Jiang Zemin to move forward on cross border, cross strait linkages.

But ironically perhaps, China's rise, its economic growth in the future may be providing some impetus towards greater regional cooperation, if only to find a kind bulwark in which to contain or integrate China.

And then finally, the issue of the United States, which as Professor Pempel has emphasized, is its attention may be elsewhere. It doesn't have its attention directed at the region. It may be emblematic of that that Secretary of State Powell canceled his trip to Seoul and other parts of the region because of the pending issue regarding Iraq.

Let us open this up for discussion, for

questions. Please identify yourself, and ask a question, and we'll allow the panelists to kind of relate to each as they answer those questions, please.

Questioner: I have a short question for Professor Jia and another short question for Professor Pempel.

Last month, eight scholars from Brookings Institution visited Beijing. It was headed by Strobe Talbot, former Deputy Secretary of State, now president of Brookings. And earlier this week, I heard the one issue—well, from them, which was raised during their debate in Beijing. The issue is, some of the Chinese participants said, now China enjoys a good relationship with the United States, and President Jiang is now one of the only handful of heads of state who have been invited to Crawford, Texas.

That's good, but this change took place almost abruptly after 9/11. And now the Bush administration rarely criticizes China's human rights record or other long-standing issues. They've been very quiet. And the same thing happened with Pakistan. Before 9/11, Pakistan had been subjected to unilateral sanctions by the United States. One is as a result of the nuclear testing in 1998, the other as a result of the coup in 1999. And even though nothing changed before and after September 11th of 2001, U.S. policy towards Pakistan changed drastically. So the Chinese participants said to the delegation from the Brookings Institution, if something happens again in the near future, although China has absolutely nothing to do with that event, there is a possibility the U.S. policy toward China could be changed again.

My question for Professor Jia is how deeply seated this concern or fear is among the people in China. And my question for Mr. Pempel is, are you or U.S. opinion leaders aware of the existence of this type of concern among the people outside the borders of the United States?

U.S.-China Relationship Changed Rapidly After 9/11

Jia: Well, thank you very much for the question. The relationship between China and the United States did experience a rapid change after 9/11. My argument for—my explanation for this change is that the U.S. priorities changed. The U.S. is now focused on international terrorism. And will it change again soon because of a sudden event? Unlikely because international terrorism is posing a serious long-term threat not only to the United States, but also to the rest of the world. And the United States, as the most dominant country in the world, is the primary target of international terrorism. It has to show the responsibility and leadership to fight against international terrorism, and, of course, as long as the U.S. priority is on this, it's unlikely to focus on China as a sort of military or potential threat.

And in the longer run, I think that because of China's changes over the years, China has become more similar to the United States and shared more and more interests in common with the United States. I don't think the two countries are on a path of becoming enemies. I think it takes leadership and will on the part of the leaders of the two countries to work out the relationship and to promote the common interests. And I think the future might be a positive one instead of just a dire realistic trap. Thank you.

Pempel: I share the view that the entire question of the war on terrorism is something that's probably not likely to change in the short run. I would add, though, that I think the decision to begin a military buildup against Iraq suggests that targets in the current administration can shift more rapidly than perhaps we appreciate. And I'm not sure that the terrorism threat is going to go away, but I think it is possible that the attention span of the administration will be very quickly reconfigured.

And it seems to me the implication of your question was, when you asked if I was aware of how seriously critics from outside of the United States are concerned about the phlegmatic quality of American policy, I should point out that, a, I'm not a representative of this administration. And while I hold a U.S. passport, I also live in Berkeley, which is not generally considered part of the greater United States. It certainly is not part of the red zone. So I'm not sure that my views carry a great deal of weight within the beltway. But I am aware of this, and part of my role, I think, is to try to carry that message as best I can to Americans.

Questioner: Thank you. I have two questions, one for Dr. Koo and then the other for Professor Jia.

The question for Dr. Koo is about the Japanese economy. Your argument is always very clear and powerful, but I think the lingering question is whether the quality of public expenditures matters or not.

And then the biggest dilemma for the Japanese government policies that I think maybe after the Maekawa Report, in the effort to change the Japanese economic structure to a more domestic demand oriented economy, the government spent a lot of money. But it actually worked to keep old inefficient sectors more firmly in place and maybe delayed or even reversed the structure of progress, structural reform progress. So if you really think the balance sheet problem is more important than the structural problem, do you have a specific prescription for the government fiscal policy in sort of minimizing this kind of downside aspect?

And then the question for Professor Jia is that you emphasize increasingly similarity in values and economic market rules and everything in China and the U.S. And I'm aware that China is playing a more active role in creating regional forum regional corporation initiatives. And then my question is, well,

at the same time, there was a inherent contradiction between the Chinese political system and these more and more market oriented economies.

Then my question is that, do you think that China, with its current, existing political system in place, can lead Asian regional initiatives? Do you think other Asian economies are comfortable with the Chinese leadership? Thank you.

Market Must Decide Which Industries to Shut Down

Koo: On the question of Japanese fiscal stimulus, first of all I'd like to say that all these people who would say there's so many old and inefficient industries that should be shut down, I don't plan to play God. That's for the market to decide, not for economists, not for analysts, not for the government officials to decide, unless you're a Communist central planner. It's for the market to decide. And if the economy is in full employment and if you want to start something totally new in the new economy, all your resources are fully employed. Then you have to kind of discourage some sectors, bring the people out from those sectors to some new sectors that you want to encourage through tax laws and other changes, regulations, deregulation and so forth.

But Japan is far from full employment, very far from full employment—3.7 million out of jobs, and they have huge numbers who are only partially employed, under employed. And as I indicated to you, as I tried to indicate here, interest rates are already the lowest in the history of mankind. The money's available anywhere. The people are available anywhere, resources are available. So there's no constraint in starting something new in Japan.

So why do you have to shut down an old one first when we don't have anything new yet? So we have to get to that problem first. Why we cannot start new companies in Japan when everything is available? And so before

shutting down the old companies, I'd like to see new companies come up first, and once that happens and the employment picture begins to tighten, the labor market begins to tighten, then maybe you can shut down some of the old ones, but not before that.

The other point about this fiscal stimulus is that, yes, it does give some sense of complacency to some companies because you really cannot pinpoint fiscal stimulus, but he's not supposed to get any benefit. That's very difficult to do in economics. Once you spend the money, then the money begins to circulate.

Japan's Economy Suffers from Two Diseases

I would argue that Japanese economy today has two diseases at the same time: diabetes and then pneumonia. The structural problem is the diabetes. This one takes a long time to make the person lean and mean again. And we all know where all those problems are. But we also have the pneumonia, which is the balance sheet problems. And if you don't deal with the balance sheet problems quickly, the whole thing will collapse into a great depression type scenario in no time.

And when you are faced with these two diseases, and these two can happen at the same time, and the treatment for the two actually contradict with each other. If you have pneumonia, you have to give this person a lot of nutrition so that he can recover. But if you have diabetes, you don't want to give him too much nutrition. It'll make the situation worse. But if you are faced with these two at the same time, I think I have to treat the pneumonia first. And once the pneumonia problem is over, then we can shift our resources and deal with the diabetes.

Unfortunately, the current government is only interested in diabetes. And that's why the economy is sinking. That's why the stock market is sinking because at the moment, only companies with clean balance sheets can

respond to the initiatives Mr. Koizumi and Mr. Takenaka are putting on the table. The other 70, 80 percent are still too busy repairing balance sheets. And if you don't look after the interests of 70, 80 percent, this part will be sinking, and only 20, 30 percent can respond to these new initiatives. But even those 20, 30 percent get scared when 70, 80 percent is sinking. So nothing happens.

So I would like to see Mr. Koizumi continue with the structure reform initiatives. I have nothing against that. But I want him to pay a little more attention to the pneumonia part, also, so that 70, 80 percent won't sink any further. Then the 20, 30 percent should feel a little better responding to the new challenge.

Jia: Thank you for the question. When you talk about the Chinese political leadership, I think it has improved a lot over the years as China has become more liberal and more democratic than any time in Chinese history. There's more enlightened leadership in the Chinese contest. And secondly, the Chinese government will continue to improve its leadership and political system in the days to come.

China Is Not Ready to Assume Leadership Role in Asia

As far as leadership for Asia, I don't think China is ready for assuming a leadership position in Asia. I think its focus now is more at the domestic problems. China is still changing rapidly and fundamentally. There are so many problems at home that the Chinese leaders' priorities are to take care of those issues at home. Even when leadership is required on the part of China, I don't think the nature, the type of leadership, China's political system in China matters that much. I will say that maybe an imperfect leadership for the world may be better because at least the leadership will not assume moral superiority when it tries to deal with problems in other countries.

Well, if I look at the recent case of Iraq in the

UN Security Council, China happens to be the chairman of the Security Council for the month. And, of course, China made a lot of efforts trying to coordinate various views and positions within the UN Security Council, which eventually facilitated this resolution on Iraq. So you call that leadership or coordinator's role, whatever.

But I don't think what type of political system really matters that much in terms of handling international situations more appropriately. Sometimes when you have a perfect leadership, when you have a morality combined with leadership, then sometimes you get into trouble because there is always this moral high ground combined with selfish interests. Then it becomes so messy, and leadership becomes hypocritical sometimes. So if you don't have the moral high ground, then at least you can coordinate with issues at a more pragmatic level. I don't know. I'm just kidding.

Ikenberry: I've got two questions.

Questioner: Okay, two quick questions. T.J., I must've lost your logic on one point about multilateralism and increased regionalism, and a weakening in hierarchy. I didn't quite get how that was drawing the U.S. and Asia closer together. It would seem to have the opposite effect. And the logic of that somehow zipped by me.

And for Mr. Koo, a fellow economist from Johns Hopkins, as Japanese companies are drawing down their debt from bookkeeping, which seems that assets ought to be coming down, too. Are we seeing that? And where would I look to see these debt figures coming down? I've been looking and haven't seen it. That may be a technical question. You can tell me later.

Ikenberry: The fellow right next to you, and then we'll bundle these.

Questioner: I'm a former staff member of the IMF, and now I'm a professor and

independent economic consultant. So my remarks are also of the economic order, and I have only one question following these remarks.

First of all, I think the slackening between the U.S. and Asia as you have observed in the last two years might be due more to the political problems, security problems of the U.S. rather than the relationship in my opinion.

Number two, I think that the interesting idea from Mr. Richard Koo about the balance sheet problem of the U.S. might resemble those of Japan. But I think two-thirds of GDP is due to personal consumption. So I guess the temporary weakness of the U.S. government might be more on the personal spending side rather than the business side. It's not quite yet a balance sheet problem, in my opinion, although it's an interesting idea to investigate.

So for me, following these observations, I'd like to ask you a question. Maybe now to promote more of a trade relationship between the U.S. and Asia, maybe it's time for Asia to show its own importance if you know, the U.S. sees that Europe cannot be the locomotive for the world economy. So I wonder whether the question of ASEAN plus China plus Japan might prove its existence and help to promote this new trade in the next few years. Thank you.

Asia's Ability to Solve Own Problems Benefits Relations Across Pacific

Pempel: Very quickly on the question of multilateralism and regionalism, there were a couple of slices in there, and I might've alighted over the central. The point about multilateralism that I want to stress is the fact, that at least as far as I'm concerned, to the extent that the countries of Asia join together in organizations that allow them ongoing dialogues and dealing on an ad hoc basis problem by problem with a variety of things, the overall level of tensions within Asia goes down. The overall necessity for the

United States somehow to step in, to quote, "solve," unquote, any particular problem that comes along goes down. In effect, Asia begins to solve its own problems in many ways, which I think contributes greatly to the overall improvement of relations across the Pacific.

And in terms of the hierarchy per se, I think the reduction in the role for Japan goes in a couple of ways. One, the U.S. can approach Asia and approach the countries of Asia, or approach sub regions in Asia, on a point by point basis without having necessarily to go through Japan or to think that Japan is somehow automatically going to provide the solution. The U.S. will define the problems, and Japan will write the check to solve the problems, which, I think, was the prevailing policy that the U.S. pursued during the 80s.

I think now we're in a situation where a great deal of the problems that come up, a number of the problems that come up, if they're environmental, can be dealt with. Environmental haze in Southeast Asia can be dealt with within that region or with the U.S. dealing with that region. And so I think an element of greater equalization among the powers in Asia is probably a plus in the long run. That's the direction I would go in.

U.S. Savings Rate Increasing

Koo: There's a lot of similarities and differences between the U.S. and Japanese situation. There's no question about it. But I'm also a little concerned about the U.S. in a way that the Japanese never had to worry about. If you look at the last 10 years of Japanese savings rate from the flow of funds data, the flow of funds is the data that I'm referring to my remarks, Japanese consumers really didn't change their behavior at all. They kept on saving at the same amount of money they used to save 10 or 20 years ago. In the United States, you know that the savings rate came down very dramatically, and it's

now going up quite substantially as well. Greenspan is lowering interest rates. The savings rate is going up. This is a very unusual world, even for the U.S. history. You typically see the savings rate come down with a lower interest rate, but that's not what's happening. It's going the other way around.

And on the corporate side, there's a key difference between the U.S. and Japanese situation, and I think this is because Greenspan studied the Japanese situation very carefully. What happened in Japan in 1989, 1990 is that because the land prices increased so much, the Bank of Japan was literally ordered by the public to crush the land price bubble.

So after the stock market crashed, the Bank of Japan kept on raising rates two more times, a year and a half, until the real estate market crashed. Then after the real estate market crashed, the Bank of Japan started easing interest rates. But by then, you have two asset classes already in crash situations, people losing money left and right. They're not going to respond to the lowering of interest rates at that stage at all. And so the key transmission mechanism of monetary policy is through intra-sensitive sectors, which are real estate and construction.

U.S. Replacing Stock Market Bubble With Housing Bubble

But in the Japanese case, this one was the first area that was torpedoed. They could not respond. So the transmission mechanism or monetary policy was logically lost. However, in the U.S., Greenspan, remembering that event in Japan, started cutting interest rates the moment the stock market start collapsing. But at that time, the housing market was still going up. So in the rising housing market, if you bring interest rates down to 1950s level, of course then you ignite a housing bubble. So basically the U.S. policy is replacing the stock market bubble with the housing bubble. And the two are more or less kind of upsetting each other. And that's why the consumption is more or less holding up.

This is a brilliant policy, but whether it will be successful until the end is also questionable because employment is weak, job numbers are weak. And then just the housing number are going higher and higher. So this is obviously a housing bubble. I think that Greenspan's working plan is that while the other corporate accounting mess and all of those problems work itself out, they tried to keep the housing bubble. (End)

About the Panelists

Main Speaker **Dr. T.J. Pempel** is Director of the Institute of East Asian Studies and Professor of Political Science at the University of California, Berkeley. Previously he was on the faculty at Cornell University, the University of Colorado, Boulder, the University of Wisconsin, Madison, and the University of Washington. Professor Pempel has been a member of various professional bodies, including the Social Science Research Council's Committee on Japanese Studies, the Fulbright Commission on Political Science, and the American Political Science Association's Committee on International Exchange. He is currently Chair of the American Advisory Committee to the Japan Foundation and a member of the Pacific Council's Task Force on Japan. Professor Pempel received his B.A., M.A. and Ph.D. degrees from Columbia University in 1966, 1968 and 1972. He is the author of eleven books and several dozen articles, including *Policy and Politics in Japan: Creative Conservatism* (Temple University Press, 1982) and *Uncommon Democracies: The One Party Dominant Regimes* (Cornell University Press, 1991). His most recent single authored book, published by Cornell University Press in 1998, is entitled *Regime Shift: Comparative Dynamics of the Japanese Political Economy*. Currently, Professor Pempel is doing research on the comparative financial liberalization of four major industrial democracies as well as directing two international research projects, one on U.S.-Japan relations, entitled *Beyond Bilateralism*, the other on Asian regionalism and entitled *Remapping Asia*.

Discussants **Mr. Richard C. Koo** is Chief Economist of the Nomura Research Institute, the research arm of Nomura Securities, Tokyo. Before joining Nomura in 1984, Mr. Koo, a U.S. citizen, was an economist with the Federal Reserve Bank of New York (1981-84). In addition to conducting financial market research, he has been appointed by several Japanese prime ministers to a number of key committee positions to study the future designs for the Japanese economy. He has also spearheaded the national debate on how best to save Japan's ailing banking system through his frequent TV and parliamentary appearances. Since 1998, Mr. Koo has been a visiting professor at Waseda University in Tokyo. In addition to being one of the first non-Japanese to participate in the making of Japan's 5-year economic plan, he is also the only non-Japanese member of the Defense Strategy Conference of the Japan Defense Agency. Author of four books on the Japanese economy, Mr. Koo writes regularly for various publications, which include the *Los Angeles Times*. Mr. Koo holds a B.A. in Political Science and Economics from the University of California at Berkeley, an M.A. in Economics from the Johns Hopkins University, and was a Doctoral Fellow of the Board of Governors of the Federal Reserve System. In financial circles, Mr. Koo was ranked 1st among over 100 economists covering Japan in the *Nikkei* Financial Ranking for 1995, 1996 and 1997, and by the *Institutional Investor Magazine* for 1998. He was also ranked 1st by *Nikkei Newsletter on Bond and Money* for 1998, 1999, and 2000.

Dr. Jia Qingguo is Professor and Associate Dean of the School of International Studies, Peking University. Previously he was a Visiting Fellow at the Brookings Institution, a Research Fellow at the Institute of Global Conflict and Cooperation, University of California, and a Guest Research Fellow for the Institute of World Development at the State Council of China. Professor Jia has taught at the University of Vermont, Cornell University, University of California at San Diego, and the University of Sydney. Professor Jia is vice president of the China Association for Asia-Pacific Studies, board member of the China Association of American Studies, and board member of the National Taiwan Studies Associations. He also is a member of the editorial board of the *Journal of Contemporary China* (USA), *Political Science* (New Zealand), *International Relations of the Asia-Pacific* (Japan) and *Hong Kong Review* (Hong Kong). Professor Jia received his Ph.D. from Cornell University. He has published extensively on U.S.-China relations, relations between the Chinese mainland and Taiwan, Chinese foreign policy and Chinese politics. His book *Unrealized Rapprochement: Sino-American Relations* (1997) was published in Chinese.

Mr. Shigemitsu Sugisaki became the Deputy Managing Director of the International Monetary Fund in February 1997. He began his career in Japan's Ministry of Finance in 1964 as a member of the Minister's Secretariat. He had held various positions in the International Finance Bureau and the Tax Bureau, and was appointed Personal Assistant to the President of the Asian Development Bank in 1976. Mr. Sugisaki rejoined the Ministry of Finance in 1979, holding a number of positions, including Deputy Vice Minister of Finance for International Affairs in 1990-91, Deputy Director General of the International Finance Bureau in 1991-92, and Commissioner of the Tokyo Regional Taxation Bureau in 1992-93. From mid-1993 until July 1994, Mr. Sugisaki held the position of Secretary-General of the Executive Bureau, the Securities and Exchange Surveillance Commission. He was appointed Special Advisor to the IMF Managing Director in 1994. Mr. Sugisaki has a B.A. from the University of Tokyo and a Masters of International Affairs from Columbia University.

Moderator

Dr. G. John Ikenberry is the Peter F. Krogh Professor of Geopolitics and Global Justice at Georgetown University. In addition, he was a Senior Associate at the Carnegie Endowment for International Peace and a Fellow at the Woodrow Wilson Center for International Scholars. He received his Ph.D. from the University of Chicago. Dr. Ikenberry is the author of numerous publications, including, *State Power and World Markets: The International Political Economy* (2002), *After Victory: Institutions, Strategic Restraint and the Rebuilding of Order after Major Wars* (2001), and *Reasons of State: Oil Politics and the Capacities of American Government* (1988).