

## **Keynote Addresses**

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I would like to give you a brief explanation of the world economic situation as well as the direction Japan should take to achieve its sustainable growth in the post-crisis era.

### Slide 1

First, I would like to look back briefly on the world economy in the past 10 to 20 years. In the 20 years before the crisis, the volume of the trade in world economy grew rapidly. The world's dependence on exports increased significantly from around 20% in the 1980s to over 30% in 2007. The movement of goods and capital across the border greatly intensified in these 20 years. This has been called globalization. Formation of a single common market across the European countries is one of the main elements.

In 2008, the ratio of exports to GDP in Germany accounted for 47.9%; the UK, 28.4%; France, 27%; in Asia: Korea, 54.8%; China, 36.6% and Japan 17.4%. And for the United States, the ratio was 12.6%.

When you look at the numbers with Japan, the ratio dropped from 15% in early 1980s to 10% in the late 1980s. This may be explained by the effort made by the Government of Japan to change the structure of its economy towards a one more oriented to domestic consumption as proposed in Maekawa Report in 1986. The level of the ratio continued to remain at 10% level until the year 2000. Then, the number increased sharply towards the year 2008 to over 17%. This change shows that very slow, but steady recovery of the Japanese economy from so-called the lost decades after the burst of the bubble was driven by exports.

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Indeed, in these 10 years, Japan shifted its exports to goods with high-added value, particularly high-end intermediate goods such as electronics parts and materials, which were exported to China, Korea and Southeastern Asian countries. Those parts and the materials were assembled there and then exported to Europe and the United States.

In these 10 years, the so-called Asia-wide production network was formulated. After the financial crisis, depressed markets in the US and Europe dramatically reduced the demand for high value-added products, some of which contained high value-added intermediate goods and materials produced in Japan. That was one of the main reasons for the large, adverse impact the Japan economy suffered at this crisis.

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The second major change in these 10 to 20 years in the world economy has been the rapid growth of

newly emerging countries, including China, India, Brazil, and Russia. Before the crisis, there was a rapid and a steady expansion of the size of the economies of newly emerging countries. After the crisis, the structure of the world economy has changed dramatically. While the developed countries are lagging behind in their recovery, China and other emerging countries are recovering rapidly. Economic growth of newly emerging countries will account for 56% of the world economic growth in 2014. The financial crisis accelerated this change in a discontinuous way.

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This does not mean, however, that the Chinese and Indian economies substitutes for those of developed countries.

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The world was affected by the financial crisis. Here, we can divide affected countries into three types. The first type includes countries that experienced a financial bubble or a housing bubble, such as United States, the UK, Iceland and Spain. As these bubbles burst, financial institutions were burdened with nonperforming loans. Individuals, whose collateral value had disappeared, were left with debt. And corporate balance sheets deteriorated. With a lack of liquidity, the debt repayment of various entities was prolonged and companies continued to have weak balance sheets. This situation makes many economic entities very cautious in spending or making new investments. This behavior will slow the pace of recovery.

The second type includes those that have the high dependence on exports. Germany, Japan, Korea and coastal provinces in China are representative cases. These economies faced a sharp decrease of exports, apart from Korea, whose exports quickly recovered owing to the weak Won. There still remained excess supply capacities in these countries.

The third type is emerging countries that have been supported by a strong domestic demand such as Inland China, Vietnam, India and Brazil. China saw all the economic recovery by promptly increasing public spending to boost domestic demand. China's economy grew 8.7% in 2009. Last week, I visited the central and western regions in China, and I found that their economies grew more than 13% in some provinces.

The first two types of nations need to continue to take financial stimulus measures amid an accumulation of fiscal deficit; however, it is necessary for these countries to take a very fine-tuned economic policy to manage risks such as exchange rates and interest rate risks. In particular, the recent issue, which Greece debt has highlighted the issue of sovereign risk in the Eurozone. With a large amount of fiscal debt, the Government of Japan too has to take very cautious approaches in its fiscal and monetary policies.

Now, let me move on to the Japanese economy. First, let me point out the challenges Japan's

economy is now facing. The first challenge is its ageing society with fewer children. Japan has the world's lowest birth rate of 1.34 children per woman. In 2030, the working population will have shrunk by approximately 18%. Japan will have a structure in which each elderly person aged 65 or more will be supported by 1.8 workers.

The second challenge is that of employment. While competitive industries may earn their incomes both from domestic market and abroad, those industries may not necessarily create enough numbers of high-paying jobs in Japan.

The third challenge is the goal of achieving a low carbon society. Japan announced its policy of reducing its carbon dioxide emissions by 25% by 2020, compared with 1990 level, assuming that all major countries will unite in one framework and commit to this goal. Another big issue is Japan's budget deficit.

In the current difficult economic situation, every country in the world should take responsible policy measures. That will enable each of our countries to head towards recovery. Every government should put an emphasis on creating more domestic demand, which leads us to economic recovery. At the same time, every government should pay sufficient attention to the size of its budget deficit.

As the world leaders declared at the G20 Summit meeting in Washington DC, every government should promote free trade and take decisive actions against protectionist measures. All of us know that protectionist measures will only lead us to a further shrinkage of world trade. Now is the time for us to revitalize the WTO Doha Round Negotiations.

#### Slide 6

Late last year, the Japanese government announced the basic policy of its new growth strategy. It puts forward the policy of aiming for an economy that works for the people and focusing on improving people's lives by achieving the growth by demand. The keywords are environment and energy, health, Asia, tourism and local revitalization, science and technology, and employment and human resources.

In Japan, economic growth is achieved with much less input of energy than any other country in the world. Japan intends to cooperate with other countries, particularly with the newly emerging countries in Asia, to share these energy efficiency technologies to make Asian economies' growth more energy efficient and environmentally friendly.

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To this end, Japan has already set up various frameworks under which Japan cooperates with other nations to transfer its green technologies. For example, the Japan-China Energy Conservation Environment Forum has been held four times so far, with the participation of some 4000 people. Hundreds of joint projects related to environment protection between the two countries have been

formed already. Japan is also expanding its hand to East Asian countries to help them build necessary infrastructures, which covers broad areas in order for East Asian countries to meet the demand of their rapidly increasing middle class populations.

#### Slide 8

Japan is currently cooperating with organizations such as Economic Research Institute for ASEAN and East Asia or ERIA, the Asian Development Bank and ASEAN for drawing up blueprints of development plans for Asian infrastructures. Japan is ready to grow with East Asian countries. This year, Japan is the host country of APEC meetings. Japan is taking initiatives to promote further regional economic integration and to draw a plan of APEC growth strategy for the 21 member economies.

#### Slide 9

In East Asia, cross-regional economic integrations have been formulated through the creation of various EPA and FTA. Among Asian countries, Japan, China, Korea, India, and Australia and New Zealand, have already concluded EPAs with ASEAN-10 countries, separately. Now, 10 plus 6 countries have started a study to form a single EPA, which covers 16 member countries.

Last Friday, Prime Minister Hatoyama instructed his cabinet members to prepare a strategy for his campaign promise of building the East Asia Economic Community. This 10 plus 6 EPA will become one of the important vehicles toward this goal.

Last but not least, I would like to point out the current developments of the Free Trade Arrangement between Japan and European countries. The Government of Japan is working hard to promote Economic Integration Agreement or EIA with European countries. This assumes we will go beyond the traditional FTA and EPA network or framework not only in terms of trade in goods and services, but also for a higher order model of comprehensive economic partnerships incorporating a wide range of areas such as harmonization of systems and standards, investment, innovation, the environment and cooperation in third countries.

Japan and European countries share a lot of values and interests. Through an EIA, I believe we can build a win-win relationship, and EIA will be recognized as an important tool for Japan to fulfill its role as a bridge between Europe and emerging Asian countries.

(Benoît Coeuré Deputy-Director General and Chief Economist of the Treasury and Economic Policy at the French Ministry of Economy, Industry and Employment)

The world economy has experienced the worst crisis since 1929, and the first global crisis in a globalized economy. Millions of workers have lost their jobs in developed economies, and years of efforts to curb poverty in the developing world have been at threat.

Growth is now back on track both in developing and in developed economies. This has not happened by chance but as a result of an unprecedented effort coordinated by G20 leaders and implemented at national and at a regional level. Of course, as an example of a regional level implementation, Europe is a case in point and the stimulus effort has been coordinated by the European Commission and implemented by national governments.

Not only has the G20 put together an unprecedented package of fiscal and monetary stimulus, and also a financial rescue, even more importantly, the G20 has forced an historical change on international financial institutions by mandating them to assist developing economies in their counter cyclical action. For all us who have lived the previous crises in Asian economies, this is a major step towards understanding the needs of Asian countries.

Growth is recovering now at different paces in different economies. The first challenge for us is not to recreate the imbalances that have led to the crisis. As the former Italian Finance Minister Tommaso Padoa-Schioppa once remarked in a conference, "it seems as if everybody is looking forward to returning to the pre-crisis growth path, but they have not noted that this is the very path that has led to the crisis."

It is well accepted now that reducing global imbalances will require an upward adjustment of savings in the US and an upward adjustment of consumption in China and in other excess saving countries. This will not be forced upon the US or upon the Chinese corporations and people. This should come as the outcome of structural and behavioral change, and it will take place only if it can be proven to be in the own interest of the Chinese and the US corporations and people. The newly established G20 Framework for a Strong, Sustainable and Balanced Growth will be the key forum to establish dialogue on these issues, and we look forward very much to cooperating with our G20 colleagues, including of course our Japanese colleagues to reach this outcome.

Global rebalancing will also require some amount of nominal exchange rate adjustment. It is important that this nominal exchange rate adjustment does not only weight on currencies with flexible exchange rates, vis-à-vis the US dollar, such as the yen and such as the euro. This supports us at some point to enhance the flexibility of currencies, which are currently pegged to the US dollar, including the Chinese renminbi.

I have talked a lot about the US and China. As a European, I am not suggesting here that Europe does not have a role to play in global adjustment. Surely, Europe as a whole does not contribute to global imbalances. But it has its own work to do. Let me mention three challenges we are facing currently in Europe.

The first challenge is for Europe to fix its public finances. We are entering uncharted waters where accumulated liabilities, both on-balance and off-balance and thinking in particular of ageing liabilities, may feedback onto our financing costs and depress animal spirits in our economies. This is an instance where the precautionary principle advises us to act sooner rather than to act later. This

sounds like climbing a mountain. But actually, there are three mountains to climb, and they are put on top of each other. The first mountain is for us to adjust the unsustainable pre-crisis path of public expenditure. The second mountain or the second challenge is to absorb the fiscal cost generated by the crisis which includes both the fiscal cost directly and the other cost of rescuing the financial sector. The third challenge is to prepare for the fiscal cost of an ageing population.

France has committed to bring its general government deficit back from 8.2% of GDP in 2010 to 3% of GDP in 2013. This is a daunting challenge, but we do not have a choice. It will require a thorough reexamination of public choices, reengineering of the way public services are being delivered. It may also require tougher fiscal rules as a complement and including maybe rules at the constitutional level.

Former IMF Managing Director Michel Camdessus has been tasked by President Sarkozy to reflect on these issues, and to put forward proposals before summer in France. In addition, a pension reform will be proposed in June with an aim to extend the retirement age and to improve the employment rate of the senior workers. These reforms will be painful, but I trust they will support confidence and eventually they will support consumption.

The second challenge is for Europe to raise its long-term growth rate. There is a risk that reducing global imbalances, which is the objective we are pursuing in the G20 framework, would result in a lower, not in a higher growth rate of the global economy. Demand arising from emerging market economies will not be enough to drive global growth. There is also a risk, although it is difficult to quantify in a precise manner that the crisis may have dented the growth potential of developed economies. This is a risk we cannot afford to take. We now need urgently to invest into higher education, research and development.

France is doing its part by investing 35 billion Euros amounting to 1.75% of the French GDP in universities and new technologies, with a new dedicated governance and delivery scheme. Let me add that this will create many cooperation opportunities between France and Japan in the field of new technologies, new processes and new products and I knew that France and Japanese companies are looking forward to it.

The third challenge is for Europe to address its internal imbalances. In a way, Europe resembles those Japanese gardens, which have been constructed as small-scale images of a larger landscape. Europe is a microcosm of the world economy with countries where saving is in excess and countries where savings is insufficient. We have not paid enough attention to reviewing the growth model and reviewing the competitiveness of European countries, particularly inside the Eurozone. This will change, and European leaders are now committed to oversee closely this process.

You may have, of course, heard that yesterday night in Brussels, European leaders have decided on a last resort rescue package for Greece, but also on strengthening economic policy coordination at the leaders' level within the euro group, which is an important step for Eurozone integration.

Finally, let me say a few words on international trade. In Washington and in London and again in Pittsburgh, G20 leaders have committed to fight protectionism and they have committed to avoid repeating the destructive trade wars that have been experienced since the 1930s, after the Great Depression. This has been very successful so far, and WTO monitoring of trade measures has evidenced that protectionist measures have been limited so far. This is not enough, however, we need the Doha Development Agenda to come to an agreement as a signal that major economies remain committed to free trade. Bilateral agreements such as the EPAs or EIAs are useful complements as long as they are not used as a substitute to reaching a multilateral agreement and as long as they are not a substitute to a proper enforcement of existing WTO rules.

Let me conclude by saying that Europe and France are committed to doing their part in raising world growth and in strengthening international cooperation. We are looking forward to the forthcoming G8 and G20 presidency, which will be exercised by France in 2011 to achieve these objectives, and in particular, we are looking forward to working very closely with our Japanese colleagues in strengthening international cooperation on economic matters.

#### **Q&A**

(Q1) We have both heard the obligatory references to the Doha Round. I think we have been hearing those for many years. We hear the talk about trade agreements and I think we agree that they can be complementary, at the same time there are probably no substitutes. We worry about the exchange rate pressures. I wonder if you could say a few words about the realistic prospects for global trade. Are you particularly worried about developments that are taking place with regards to exchange rates and the potential for that to lead to additional protectionist pressures?

(Okada) Talking about the future of the DDA, now people are working very hard to make stocktaking procedures to prepare the further steps, which will be taken by the trade ministers to show the directions towards achieving our common goal for concluding DDA by the end of this year, which was announced by the G20 leaders about a year and a half ago.

It is really difficult to achieve that goal. If several countries become more active and decisive to take their actions toward the agreement, I think it is still a small room for us, for the possibility of closing the agreement towards the end of this year or maybe at the beginning of next year.

Secondly, I think there are no substitutes for DDA. But at the same time, it seems to me that there are some kinds of competition of concluding EPAs among various regions. I do not believe that the expansion of regional EPA would substitute the multilateral agreement, but the kind of competition between the effort of concluding EPAs and negotiating a multilateral agreement will make the world a little bit changed towards a better scenario.

Thirdly, on exchange rates, instead of answering to your question directly, I would like to say that I also welcome yesterday's European leaders' decision to set up a very good framework for the difficult issues they are now facing in European communities. And the world market responded quite favorably. The stock market in New York responded favorably, and also the exchange rate of euro vis-à-vis yen became stronger this morning, and I am sure that that will bring lots of benefit for, at least the participants of this symposium from European countries, which may have to pay hotel rate during your stay in Japan.

(Coeuré) Let me just add a few words. On trade, I really have nothing to add to what Mr. Okada has said. I fully share his views.

On exchange rates, stable exchange rates are very important for trade and for investment. There are structural features in the international monetary system that may have to evolve over time to induce more stability, and this will be part of the working program of the forthcoming French presidency of the G20 to try to work on these structural features. But it is a long-term issue.

In the short run, what is important is to fix global imbalances. There may be some nominal exchange rate adjustments coming along this current account adjustment, but exchange rates alone cannot change the shape of the world economy. This would be the tail that wags the dog. So, the important is the dog, which are current imbalances. So, we have to work on economic policies, growth models and domestic reforms to adjust saving rates and exchange rate stability will be the outcome of this agreement.