

The 25<sup>th</sup> JEF-AEI Meeting  
February 22<sup>nd</sup>-23<sup>rd</sup>, 2011  
CONFERENCE SUMMARY

**Session I: Political Outlook in Japan and the United States**

- While Mr. Ozawa has been persecuted and lost party membership but still yields a sufficient amount of influence in the party through his faction. He has been able to maintain his influence and power because no one stops talking about him, though he has lost his party membership the media continues to focus on him.
- Though the DPJ has shifted Japan to a more conservative ideology, the LDP has characterized the DPJ agenda as a socialist agenda. An example is the DPJ reallocation of the budget to focus more on education and social security; but with an increasingly aging population this is an inevitable shift in reallocation.
- There are a couple of concerning issues regarding Japan's increasing debt. Over 90% of Japanese bonds are owned by Japanese people and while this fact makes their budget issue less of a problem than the budget in the US, regardless the government must communicate that it is serious about addressing this concern.
- The DPJ must establish a platform, as opposed to maintaining their oppositionist attitude. They must be willing to work with the bureaucracy as opposed to sidelining them. Within the domain of diplomacy and national security national interest must serve as the policy driver.
- In the US the near term problem facing the Republicans, is that they promised to cut \$100 billion out of this year's budget, but Treasury Secretary Geithner has said they are planning on cutting too much.
- In Japan, the DPJ party is heading towards an agreement on the Trans-Pacific Partnership (TPP). Opposition to TPP will arise if Prime Minister Kan is removed and someone from the Ozawa faction is elected as prime minister.

**Session 2: Coping with Changing Security Environment in Asia**

- There are a couple actions the US and Japan can take working together with the European Union (EU). The first is to continue putting pressure on China under international rules like the World Trade Organization. Second, by creating a cooperative front with developing countries, vis-a-vis China it will allow us to put pressure on China from the perspective of other developing countries. Third, we must exploit the minerals outside of China (other than coal).
- Regarding speculation as serious cause of concern for energy security. Japan's futures market doesn't operate as well as the US, and requires more transparency in

transactions. The role of the government should be to make sure that markets are orderly.

- Speculators that are wrong disappear very quickly, on average speculators are correct about the fundamental prices. It is too easy for governments to blame markets and price movements on speculators, to control speculators with regulation is unsustainable. Futures markets have been around a very long time.
- The current turmoil in the Middle East is of concern, 10-15% of the world oil production comes from countries that are currently experiencing unrest. If the supply of oil is disrupted enough to a point where prices rise then we must be concerned about what will happen to the Japanese economy.
- If China were to control the first island chain in the East China Sea, then how would that impact Japan? Is Taiwan the key to not allowing China to control that island chain? Though this is not the case right now, it will be a question raised by 2020, and Japan should be wary of Chinese presence in that area because they have greatly increased their activity over the past couple years. The US military base in Okinawa will play a very important role in maintaining stability in that area.
- The August statement by the Chinese government has left economic aid information to the DPRK opaque. But they have made it clear that keeping the DPRK a stable state as a buffer from the ROK alliance is important.
- The South Korean Sunshine policy has prohibited the ROK government from participating in reunification policy planning. The problems facing a united Korea are much greater than those that faced a united Germany. The income divergence between the two have greatly increased over the past couple years. There are two things facing Korea that Germany didn't have to deal with, post famine divergence in education and nutritional standards. In regards to education, North Korea cannot read South Korean materials because they have been trained in the phonetic alphabet.
- Maintaining cohesion amongst allies is important when dealing with the DPRK because they have a habit of splitting apart allies though talks. During talks the DPRK has suggested that they would like to see the US military move out of both South Korea and Japan.
- China has become more interested in the arctic routes up through the Sea of Japan; it is only a matter of time until we see Chinese ships moving into that area since they already dominate trade in East Russia.
- The increased Chinese interest in the Sea of Japan presents a threat to Russia. As a result, Russia has begun laying claims to the disputed Kuril Islands. They have increase their military spending in this area by investing \$175 billion into the East Sea fleet. This should not as an aggressive move against Japan but as a response to China's increased interest and activity in the Sea of Japan.
- The growth of the Chinese military in particular is shaping the operational strategies of the smaller countries that are now increasing the number of submarines they maintain.
- All rising powers need to find a way to assert their power; as a result a call for China to be more transparent with the reason for their action will not work. The US has a responsibility to try and understand what they are doing and what their intentions will



be in the future. We must show both China and the region that we are creatively resolute in maintaining the stability of the region.

### **Session 3: Trade Issues**

- The TPP has the potential to serve as a building block for Free Trade Area of Asia-Pacific. Member nations in the TPP negotiations are willing to accept every nation in APEC.
- US is much more forward looking in regards to existing FTAs. The US is pushing towards regulatory coherence, trying to get other nations to agree to what the US has here as one central office of regulation. The reaction of the other 8 countries is committed and not acting negatively to US positions. There is a strategic divide in what trade agreements ought to look like and where developing countries should fall.
- Unresolved issues, within the US say bilateral agreements will not be changed, which means new comers who come in will not have a set standards that other countries have agreed to. There are differences in tariffs on the EU side between Japan and Korea.
- To negotiate EPAs with China and Australia, Japan must have leverage, because of that Japan's participation in TPP is important. It's time for Japan to make up its mind, there are too many things floating around.
- This is a solid set of agreements that fulfill the American goal of being involved in a pacific agreement. Part of what has happened in the US is that other countries are doing things we don't like, so the administration has gone out and enforced certain things by pushing for enforcement actions. With the change of power in Japan many new initiatives have been taken and implemented to move forward on a decision regarding TPP.
- As the TPP is the only negotiation going on right now, it is in Japan's best interest to join soon so that they are able to join in discussion. However, CEPEA has made a complement function to protect those members in CEPEA that are not involved in TPP discussions.

### **Session 4: Global Economy and Finance**

#### *Part I: Global Economic and Financial Outlook*

- The debt problem facing Japan is more sustainable than that of the US, because the Japanese people own most of the country's debt. Going forward, Japan will face an issue as the demographics change and the savings rate starts falling, then the government will have to find a way to sustain the debt.
- In the US, the second round of Quantitative Easing made it more likely for there to be a run on the dollar by Asian countries, like China who hold large sums of American Treasuries, by buying long term treasuries and allowing Asian countries to buy short term treasuries which allows them to minimize their losses.

- The current issue in the US regarding the solvency of a couple large states is that there is no bankruptcy law for states. There is currently a proposal to potentially allow states to declare bankruptcy. This is less a question regarding the debt to bondholders but more an issue of unfunded pension liabilities. The federal government cannot force a state to go bankrupt. But, because the US dollar is the world reserve currency it buys the dollar some time to figure things out.
- With the Japanese economy, the currently negative growth rate in total capital investment might start to pick up as the Chinese economy begins to experience loosens in capital investment.
- Simpson-Bowles plan proposed in 2010, in the US, would have reduced US debt and dealt with pressing short term issues as well as dealing with long term problems like social security. The biggest drawback with the Simpson-Bowles plan is that it doesn't deal with medical spending, the biggest long term problem.
- In the coming years if the Euro and Japan both experience fiscal crises foreign investors will need to put their money somewhere, this may help the US to recover.
- Today's deficit is the byproduct of future mistakes and the debt is a product of past mistakes and commitments.
- Going forward, globalization will change its model for several reasons. One example is that we are beginning to see China as center of the market and no longer just for production; this factor will put a damper on growth.
- Government debt is more of a political issue than economic problem. If we don't restructure debt we can end up with a very serious economic problem.

#### **Session 4: Global Economy and Finance**

##### *Part II: Emerging Shape of the World Economy and Financial Systems after the Crisis*

- A problem facing US regulators as a result of regulation like the Dodd-Frank Act is that many of the agencies mandated to pass rules and studies don't have the staff to comply. Therefore the financial sector is unlikely to see the regulations mandated in the Dodd-Frank Act implemented.
- Equity and commodity prices tend to rise when bank credit isn't expanding. In the over-the-counter market you have to be able to assess the credit worthiness of the seller of the securities.
- The Dodd-Frank Act was passed so as not to waste a crisis, it was an opportunity to pass more regulation. Consequently, it has taken banks out of fixed income securities trading. The Consumer Financial Protection Bureau will also impose tremendous regulatory costs on the economy.
- In the financial sector when there are losses you can easily move them around from agency to agency, but you cannot make them disappear. The losses will eventually have to be realized, losses will be transferred to either lenders or taxpayers.



- The big problem in the housing sector is the number of bad assets being held by the banks. The banks thought they could wait it out and sell off the assets before the bubble burst. In the US, we allowed homeowners to use their houses as ATM's by taking out lines of credit off their house. But, we didn't implement a process of recourse should the homeowner not be able to pay their mortgage. There was very little incentive for the homeowner to stay with the house because they had more to lose by staying with it than walking away. As a result, when homeowners ran into financial trouble many walked away from their financial commitments.
- If you have a country like Greece that seems to be falling apart, credibility is affected because if the government is unwilling to tackle the transfer problem then they will face problems in the coming years.
- When a government decides to cut transfers it relays a message to both domestic and international community that the government is serious about creating a sustainable path to dealing with the deficit issue. Transfers will become the long term problem that serve as a structural impediment to a sound government.
- In 1992 the Community Reinvestment Act imposed affordable housing goals on Fannie Mae and Freddie Mac. It allowed them to gain access to a significantly large fund and now hold about \$5.5 trillion in credit. Prior to 1992, Fannie and Freddie had very conservative credit standards and requirements for underwriting mortgages that protected our markets. The Community Reinvestment Act began the process of deteriorating mortgage standards. The decrease in mortgage standards and increase in lending led to an unprecedented number of weak mortgages fueling an ever growing housing bubble.
- Had Bear Sterns been allowed to fail, steps would have been taken by the market in order to prevent the future failure of other institutions. However, the market responded to the government's actions and assumed that in the future other institutions that were considered systemically important would also be saved should financial trouble happen. When the government did not bail out Lehman Brothers the market reacted in panic when they realized the government did not have a set plan for dealing with failing financial institutions. We cannot allow people to believe that the government is going to rescue financial institutions if they fail.
- A big question facing the global economic recovery is will the nature of capitalism change? Historically we have seen the economic nature change after significant crises. After the great depression the economic landscape in the US and even Japan was drastically altered.