

KOREA: CHALLENGES AND OPPORTUNITY FOR JAPAN

INTRODUCTION

Japan and Korea are co-hosting the World Cup. Rightfully seen as significant progress in a troubled relationship.

Korea experienced a terrible financial crisis in 1997-1998 when GDP growth swung from +7 to -7 in a single year.

Korea has since exhibited a remarkable recovery. As difficult as this may be for Japan, my presentation will be organized around the question of whether there are lessons for Japan in the Korean experience?

Japan – faces four challenges:

- A weak banking system,
- Deflation,
- Fiscal imbalances
- The need for structural change

Banks

Estimates of non-performing loans:

- In past decade Japanese banks have provisioned for ¥60 trillion of non-performing loans – a figure greater than the size of the South Korean, Canadian, or Dutch and Belgian economies combined, yet NPLs continue to grow.
- FSA estimates that bad loans net of collectible collateral are ¥34 trillion yen; non-official estimates are in ¥40-170 trillion.

Problematic policy-response:

- Admitting failure of 1999 recapitalization is loss of face =>
- Must pretend that everything is fine/undercontrol =>
- Shooting the messenger (ING-Barings, Goldman Sachs, the IMF, ratings agencies) =>
- Undermines market confidence, exacerbates problem.

It could take another decade to eliminate the NPLs through a continuation of the just-provisioning approach.

Japanese banks exhibit the most extreme divergence between intrinsic financial strength and actual ratings due to implicit guarantee.

Monetary Policy

Japan is first country since the Great Depression to experience deflation (though admittedly, Japan's is on a smaller scale).

BOJ policies have been incompetent and now threaten its attainment of legal and political independence.

The answer is inflation targeting. Hayami, Shiokawa, and Koizumi have made ludicrous public statements on this topic, and Shiokawa and Takenaka have engaged in a public slugging match over it.

Fiscal Policy

Japanese fiscal policy is fundamentally opaque, and the MOF bears responsibility for this.

Numbers are bad:

- IMF estimates that gross debt/GDP ratio will reach 150% by 2005 – worst of the G7.
- Sovereign debt downgraded to below Botswana level.

Now face a nasty squeeze: in the long-run need to get the deficit down, though fiscal contraction will worsen situation in the short-run.

Final thought: Much has been made of the fact that Japan's sovereign debt now carries a lower rating than Botswana, an African country with an HIV infection rate of roughly 25%.

But this is a bit misleading – Botswana is a stable, well-governed country, with enormous natural resource wealth – sort of a sub-Saharan Saudi Arabia, but with better politics.

More to the point is that on current trends, by next year, Japan and South Korea, which experienced its own financial crisis in 1997, will have the same rating. Perhaps this prospect may be the shock to the system that Japan needs to spur it to action. (SLIDE)

HOW DID THIS COME TO BE?

South Korea experienced serious financial crisis in 1997-98 – how as it apparently recovered relatively quickly while Japan has remained mired in stagnation?

Three South Korean advantages:

- Poorer country, bigger problems (GDP GROWTH SLIDE)
South Koreans experienced obvious decline in incomes
Japanese have merely stagnated
- Luck of the political calendar
Koreans had election at the beginning of their crisis
Japanese have experienced relative continuity of LDP governments
- Small country blessing – greater openness, greater influence of outside ideas (TOEFFL SLIDE)

The result has been much greater policy response

- Cleaning up the banks more quickly through provisioning, ABS, changes in management (SLIDE)
- Inflation targeting (SLIDE)
- Fiscal rectitude (SLIDE)
- Faster recovery

Should Korea and Japan pursue FTA? Skeptical –

- Credibility problem with WTO obligations to cover “substantially all products.”

Key issue is whether it is credible to consider any real NE-SE Asia agreements given agriculture – problem of even Singapore-Japan agreement suggests “no.”

- Normative issue: if so is it a good thing?

Modeling work suggests that Japan-Korea and Japan-China-Korea would disadvantage both US and ASEAN due to trade diversion – they could be expected to oppose.

- Rules of origin, lack of transparency etc. – “the spaghetti bowl” all would be better off reinvigorating the WTO.

IS THIS THE END OF JAPAN?

No.

STRONG SOCIETY

Comparison of Social Indicators with US and Korea – let's follow the life-cycle

Birth:

- Share of births to women under 20 more than 9x higher in US than Japan
- Incidence of pre-natal disease/death more than 3x higher in US than Japan
- Result: infant mortality lower in Japan (4/1000) v. US (7/1000), as are
- Deaths to children under the age of five.

Once born,

- Educated at similar rates, similar rates of basic literacy and numeracy
- However, US youths show higher rates of delinquency,
- And Japan has slightly higher rates of participation in higher education; statistically, this is because the rate of participation in higher educations is significantly higher for Japanese males in comparison to US males, where ethnic minorities have significantly lower educational attainment rates.

As adults

- Americans both marry and divorce at higher rates than Japanese.
- Americans are also 10x more likely to be incarcerated than Japanese.
- Crime is hard to standardize, but on the one crime that would appear relatively standard – homicide – is more than 6x as high in the US.

Japan still has work to do:

- Smoking and suicide rates are significantly higher in Japan than in the US, and
- Japan scores badly on any measure related to gender or female equality

But at the end of the day, despite higher rates of suicide or cancer, Japanese outlive Americans by around 3 years.

CONCLUSIONS

Japan continues to maintain strong society, though how long that is possible on the base of a weak economy is an open question.

However, the lessons that Japan can learn from foreign experiences are largely technocratic in nature and perhaps more easily transferable than the broader societal lessons that Japan might have for the rest of the world.