

“Challenges for the US and Japan in the Regional Economy”

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Jane Skanderup

Assistant Director for Programs and Development, Pacific Forum

Center for Strategic and International Studies (CSIS)

My premise is that the US and Japan have domestic economic problems and there are problems in each country's region (Argentina and Singapore are both having difficulties). We are not yet out of the Asian financial crisis. The drop in US demand hurt the Asian technology sector. Asian countries need to move away from the export-led growth strategy, to a more robust domestic demand. Japan is in the middle of this shift.

Japan abdicated this role of economic engine to the US during the crisis. Japan did not promise domestic change. I do have confidence, however, that the new cabinet will at least partially address the non-performing loans issue. But what about growth? The Japanese people need to save their money because returns on investments are so low in Japan. So there needs to be a shift to higher returns on investment. Japan needs to look at its sacred cows. China is willing to play hardball.

I am concerned about the APEC meeting in Shanghai. So far the focus has been on US-China bilateral relations. In my opinion, APEC focuses too much on trade liberalization. The group needs to go back to its roots as a dialogue organization. If steel is hard for the US and agriculture for Japan, we need to talk about the political aspect of our sacred cows. APEC has failed because its goal is too narrow. Mexico is going to host the Fourteenth APEC Ministerial Meeting and the Tenth APEC Economic Leaders Meeting in 2002.

China's challenge for the WTO is to create an authority for implementing the agreement into the provinces. The more China devolves, the more room there is for corruption. Currently, rules and regulations in China are only applied to foreign firms.

Question & Answer

Q: What are the prospects for another WTO round?

They will kick the can down the road. So far we have agreement on e-commerce—that's because there is less vested interest there. Bilateral FTAs have proven more difficult

than expected. Even with a minor FTA between Japan and Singapore, there will be problems on agriculture. South Korea and Chile are experiencing the same problems, with agriculture. The incoming head of the WTO will be more focused on the interests of developing countries.

Q: Can you comment on the negative aspect of trade and investment liberalization? What about an international safety net?

Vietnam has become the world's number two producer of coffee, with the World Bank's support. The Bank has put money into strengthening safety nets. The US approach is to compensate workers who lost their jobs due to the NAFTA, but it is difficult to know who did and who did not lose their job because of the agreement. ASEAN could benefit from pushing an ASEAN FTA, though Malaysia has been dragging its feet.

Q: Can you comment on the economic disparity between China's provinces?

It is an incredible challenge. The ratio of cars to bikes in Beijing has reversed. The Olympics for Beijing may draw resources from the rest of the country. The real opportunity is with China joining the WTO. As China regularizes its rules, you will find areas in China other than the coast that are competitive.

Q: The US has a regional role in Asia. What kind of role should it have?

Bush sees Asia as still evolving, but he has stronger instincts in Latin America. The EP-3 incident showed that Bush needed some tempering. The Treasury Department under Bush will be less supportive of prior IMF programs. So I am not sure how much of a role Bush wants to play. The US would not have a problem with an ASEAN plus three FTA. Japan's priority is to draw the US into a regional forum. The US has domestic challenges: the steel industry needs restructuring but Bush has asked for a dumping investigation on steel imports. The US has to set an example; the global economic powers have failed to restructure. Since the 1997 crisis, there have been many band-aids used instead of real reform.

Q: How can Japan conduct expansionary monetary policy? Should it buy bonds? Might a falling yen worsen the view of the Japanese economy and how would the US respond?

It is a question of degree: if the yen went to 170 to the dollar, it would force China to devalue the yuan. If some monetary expansion led to a rate of 135 yen to the dollar, it

would be manageable. The ASEAN plus three is moving towards a currency swap arrangement. The challenge is not going to come from exchange rates. But my worry is that the enduring strength of the dollar might mitigate Fed interest rate cuts.

Q: On the Japan-China front, could you comment on Japan's safeguard measures against Chinese agricultural products and on the movement offshore of Japanese production?

The safeguards in Japan were timed for the election and I believe this episode may be over. One lesson is that China will not back down. These are Japanese companies in China. Regarding the rise of Japan's investment into China, the same thing is happening from Taiwan into China, as well. It is gutting Taiwan's high tech sector. China wants to use the WTO to lock in reforms, but it is aware of the challenges.

Q: Are Taiwanese beginning to see China as the new land of opportunity?

Yes, Taiwan sees China as the land of opportunity. China seemed to sail right through the financial crisis in 1997 without much difficulty at all. China can win on the economic front if not on security. Taiwan would be smart to embrace and liberalize. Politically, Taiwan may not join China, but economically it will. The argument is on the economic side—for Taiwan to be as useful to China as Shanghai is. It is a politically unstable time in cross-strait relations.

Q: What is China doing these days with its "special economic zones?"

China's meant for those zones to be a test. The challenge now is for China to create linkages, harmonizing regional policies. The current thinking is to create more equality between the zones.

Q: Can you comment on China's agricultural sector?

China is hoping that the WTO will create an opportunity for foreign investment and deregulation to make the agricultural sector more competitive even domestically. The Party's role will shift with China's WTO accession. Their political base will move to the urban areas.

Q: What are US economists saying should be Japan's policy priority—fiscal, monetary, or restructuring?

All of the above. Increasing the money supply is not enough. With restructuring, you need to stimulate the economy. It must be done carefully. The supplemental budget should not go to public works. You have to allow easy exit and entry for firms. And punish firms that are not profitable.

Q: What do you see for the new "strategic partnership" between China and Russia?

CSIS had a recent talk on this topic. China and Russia are interested in being in bed, but they really are not. They will keep one eye open. Russia will be able to revise the ABM agreement. Mutual interest will really be on regional issues like terrorism and energy. Here, the Shanghai Cooperation Organization is the interesting multilateral agreement.

Q: Did you notice a change in the attitude of the Chinese who attended the US-Japan-China meeting?

What was surprising was that there was very little Japan-bashing. The Chinese did not bring up the textbook issue and the Koizumi visit to the shrine. China is more accepting. There is less scripted dialogue; they seem more pragmatic too.

-The RIETI editorial department is responsible for this article.