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Change in US stand surprising

THE world economic scenario has changed for the worse. Recession in the short term is a certainty. The world has been dramatically altered after Sept 11 and so has the attitude towards the free and unfettered flow of funds. "It is quite an irony," Eisuke Sakakibara, Japan's former Vice-Minister for International Affairs tells Hardev Kaur in an interview in Langkawi.

Q: The Japanese economy has yet to bottom out. How low will it have to go before it starts to move up?

A: The third quarter, July-September 2001 we will probably have a negative number for GDP growth. The October-December quarter again will be negative - that is almost a certainty at this moment. For 2001 GDP will probably be in the negative number. When the Japanese economy will bottom out, we do not know. All indications are now downward. There is no sign of bottoming out at this moment and we have not really absorbed the shock of the terrorist attack. So there is likely to be a further deterioration of the economy.

There is a limit to the fiscal and monetary policies and we have used both instruments. The fiscal stimulus may be counter-productive in a sense that it will negatively affect the bond market. It may lead to the collapse of the Japanese bond market, which will be disastrous. So fiscal stimulus cannot be used at this moment.

Monetary easing is fine. But its immediate impact will be very limited, because banks will not increase loans, they will simply increase their demand deposits with the Bank of Japan and they will probably increase their holding of Japanese government papers (JGP).

Not much money will be spent on productive sectors. So on both monetary and fiscal fronts it is very difficult to stop the deterioration of the economy in any significant way.

But I think easing the monetary policy should be continued although it does not have any direct impact as there is no negative impact.

If we have disinflation there is no fear of inflation. So, monetary easing needs to be continued. It is important to try to accelerate structural reforms. Probably short term structural reforms may be negative - we experienced one case - collapse of one distribution company.

The bankruptcy resulted in the rise of the Nikkei. Once there is some kind of bottoming out in various sectors, the market will probably react favourably so that over the short term the impact will be negative but through the improvement of the market sentiment the result will probably be a quick bottoming out of the Japanese economy.

I have said the best policy at this time is the acceleration of structural reforms (in Japan). But there is a need to be vigilant. The Japanese recession will probably prolong for at least a year.

There is also a likelihood that the US economy may not turn around in the April-June quarter of next year and the US recession may also prolong as well. Europe is also declining very quickly.

The current growth rate in Germany is almost zero, France and Italy are coming down very quickly. There is a simultaneous recession in Japan, Europe and the United States. Asia is quickly deteriorating as well.

One result of this simultaneous recession in the developed countries is that there will be a significant decrease in the flow of funds to emerging countries.

So what happens to Argentina, Brazil, Turkey is something we do not know. They may result in some kind of financial crisis. What we are experiencing is a recession which only takes place once in 50 to 100 years and we have got to recognise that. We could talk and offer a more optimistic scenario - there are various scenarios.

I try to give as optimistic a scenario as possible. But in down-grading the forecast from fine to cloudy to rainy, the electrical storm ahead is very big. This is a very difficult period in the world economy.

Q: There is currently no economic leader in the world. What should the region (East Asia and Southeast Asia) do to help itself?

A: First of all, Asia has benefited, both Japan, Southeast Asia and East Asia, from globalisation. We have been one of the major beneficiaries of globalisation. But globalisation as we experienced during the course of the late 1980s and early 1990s came to an end with the East Asian crisis. When there was a V-shaped recovery, we thought that the crisis was over. But this new crisis indicates that the period of an American-led world wide globalisation is over.

What kind of world we are heading towards? I am not 100 per cent certain. But it is a new 21st century economy which is different from the 20th century. They say this war against terrorism is a new type of war, a war without national borders. If we go back some 100 years there was a new type of war, in 1914 World War 1, that involved the entire world. Before that there was a regional war - the French-German war. Now in the 21st century we have a new war.

The capital and the world economy of the 21st century will be different from the capital and economy of the 20th century. We have to recognise that once a century we encounter and are confronted with a major transition of the world system and economy.

One scenario is for some kind of regional cooperation, some kind of regional unit that binds with each other. Some call it empire of the 21st century - the European Empire, Asian Empire and the American Empire. They are building the European Empire (European Union). But the Asian Empire is not here yet. "Empire" may not be the right word but some kind of regional cooperation within Asia is extremely important.

Q: Should regional co-operative efforts including the Asian Monetary Fund (AMF) and EAEC be pursued even more aggressively now?

A: Those ideas were good ideas. The name is not important. As various names generate various kinds of reactions. But trade and financial co-operation within Asia and Southeast Asia is important together with cooperation in East Asia - China, Japan South Korea - and possibly involving India in future. There is a need for this close economic financial and economic co-operation as otherwise we will continue to be divided and ruled.

The time is right (for cooperation), with the crisis and it is a time of great transition. But even so we must expect a difficult but challenging time with new cooperation.

Japan has to change, Japan has been very closed. We have to open up our agriculture, we have to open up our manufacturing to the rest of Asia. That is very crucial and it is a very daunting task for Japan. Japan has to go through a structural change. When the Japanese talk of deregulation and liberalisation, it is always in terms of (responding to) US pressure. Now we have to do it for Asia. That is our task.

The development model that depended on external private finance may have become somewhat obsolete. You have to mobilise your own savings, have to mobilise your own inter-regional savings. Relying on American investment banks and foreign investment banks may be patterns of the past. Now we have to come up with new schemes.

Q: A lot of the American funding for growth came from this region. Should not those funds be mobilised for this region? With the recent attacks on the US do you see the funds and savings, that went from Asia to the US, coming back to Asia?

A: Not immediately as there is no area that is thriving at this moment. Many people want to place their funds out of the US. But where? Japan is worse than the US, Europe is quickly deteriorating, Singapore has negative growth, Taiwan is going into negative territory. There is no place to put the money.

But if we come up with some regional mechanism that is viable and which is credible, funds would flow into this region. This is extremely important. To do that you need to have some kind of cooperative scheme. And Asia is a place where most of the savings are generated. It is our money. I have always joked with my American counterparts that when they come up with some kind of grand initiative that the definition of the American initiative is "American initiative with Japanese money". Japanese savings ratio is high, your (Malaysia's) savings ratio is very high. We have to keep it for ourselves and think of some kind of mechanism to effectively use the savings within the region. The time has come to jointly come up with some kind of scheme.

Q: Post Sept 11, do you see some decentralisation, diversification of financial centres away from New York to other parts of the world?

A: Not yet, not yet, not yet! Too quick a diversification may not be that desirable. Eventually as each region strengthens its foothold that might happen. But now there is a worldwide recession. Every part of the (global) economy is falling apart. The issue right now is which region could restore its energy and vitality quicker than other regions, quicker than other countries. Short term recession is a given factor for everybody. We cannot avoid it. We have got to be realistic.

Q: Even if, as you say, short-term recession is given, there must be something that countries like Japan, Malaysia can do to soften the impact of a recession or even of the world going into depression. We have the money.

A: Some kind of social security network is absolutely necessary. But trying to prop up the economy by orthodox monetary policy will not work. We have to change the structure of the economy. The situation for a developing country like Malaysia and for a developed country like Japan, may be different. We are much more affluent. We could persevere with some serious downturn of the economy. But with some poverty existing in the developing world, the pain may be severe and in that case there is a need to have some sort of safety net to try to ease that pain.

Q: US has been reducing interest rates and yet there is no impact on the economy. Why, and what else can be done?

A: Three things - in the fall of 1998, the interest rate reduction was extremely effective. Alan Greenspan, Federal Treasury Secretary, had cut interest rate three months in a row - 50 basis points each in September, October and November and quickly the crisis was over. But that crisis was a financial crisis and an interest rate reduction is a very effective cure for a financial crisis. This time the crisis is in the real sector - the IT sector and the manufacturing sector - and interest rate cuts are less effective on the real sector than on the financial sector.

Secondly, the American consumer has been accumulating debt both in mortgages and in consumer credits. Given the accumulation of those debts, interest rate cuts may not stimulate housing expenditures or consumption as much as it does otherwise.

Thirdly, there is a lag between monetary policy and its impact on the real sector. If you combine the three factors the impact of interest rate

reductions may not be as effective as people think or may be slower than people think.

The same can be said of fiscal policy. Fiscal policy and tax cuts may be effective when the consumer is still quite confident about the economy. But right now, with all those risks, all the fears that have crept into the consumer sentiment, consumer confidence is quickly deteriorating and tax cuts take time and at a time like this it may only result in an increase in savings.

As a matter of fact before Sept 11, in August, when the Americans had the first round of tax cuts their saving rate increased by three per cent. They have saved all. After Sept 11 they may save more. If they save then tax cuts will be affected. I hope that fiscal and monetary policies will be effective and if these policies are effective than the US economy will turn around in April or June next year, if they are not, then the American recession will be prolonged. That is a real possibility. The US has enjoyed prosperity for the last 10 years, two to three years of recession is unsurprising.

Q: Malaysia is pump priming the economy. Recently the government unveiled a RM4.3 billion stimulus package and in August a RM3 billion package was announced. Are such measures effective for a country like Malaysia?

A: As long as consumer confidence is somewhat sustained it works, and as long as the fiscal debt issue is not a major issue it would have no negative effect on the markets. In the Malaysian case, particularly public investments could be an effective cure to the decline of the economy.

The Malaysian situation is different from the Japanese situation. We have done that for the last 10 years. It did work, at least it stopped Japan from going into deep recession. Japan has grown at 1 per cent, a very low rate but we are still growing. That was at least partly due to the fiscal stimulus. After doing it for 10 years, after accumulating as much debt as we have done, additional fiscal stimulus action is quite risky. But that is quite different from Malaysia's situation. There is a genuine infrastructure demand in your country. In rural Japan, we don't need anymore roads. You need them.

Q: Singapore registered negative growth of 5.6 per cent in the third quarter and is in real recession and no longer just in a technical recession. Do you foresee the region being further affected as a result of slow growth and recession in both Japan and Singapore?

A: Singapore has export/GDP ratio of more than 150 per cent and as other economies shrink, naturally they have a very big impact on Singapore. I am not that pessimistic about Malaysia. But Malaysia's exports/GDP ratio is very big as well, so you will be affected quite significantly.

Asian countries have benefited from globalisation and during this period of globalisation Malaysia's export/GDP ratio has increased quit dramatically. That trend would probably reverse in the 21st century. At least global diversification and the near term impact could be quite significant. Malaysia should be prepared for that. Invest in infrastructure - generate do mestic demand and try to substitute some of the decline in the external demand with domestic demand.

Q: What impact will the move by the US to freeze terrorist funds and assets have on economies and the world financial system? The free flow of funds was championed as part and parcel of globalisation and liberalisation in 1997-1998.

A: It is quite an irony that the US which has been pursuing liberalisation of international finance - it pushed for the opening up of off-shore markets and even after the East Asian crisis when we urged for some monitoring of some short term funds, off-shore markets and so on, the

US adamantly refused to do that. Now because of the terrorist attacks, they are urging a monitoring of those financial flows and flow of terrorist funds. They want the funds out of the system. It is quite a change!

But if you become extremely legalistic and in trying to "smoke out the terrorist funds " as President George W. Bush said, you certainly will shrink the size of the international financial system.

The international financial system has had some kind of anonymity. The Swiss Banks have numbered accounts and these numbered accounts, (by individuals, organisations and associations) are for various reasons and part of that may be terrorist funds or tax evasion. That is the international financial system, it has been the system for the past 50-60 years. Are the Americans going to change that? Are they trying to change it? I do not have the answer to that. At least those people in the Pentagon want to change that. But do the people in Wall Street want to change it? I do not know.

But this will probably have an impact on changing the nature of capital flows in the world. The free wheeling global market is now denied by the Americans themselves. At least they do not want the terrorist funds. In the markets one cannot be too moral. Money is money. It is a very ironical aspect of US policy that at this moment they are pushing for controls. The defence people and those in the Pentagon want a change to the free wheeling markets and this will mean a change in globalisation as we have come to experience during the course of the last decade or so.

Q: Do you also see a change in the thinking in World Bank and IMF?

A: They have not changed. Look at what has happened. Joseph Stiglitz received the Nobel Prize for economics and there is a vehement attack on Paul Wolfenson (World Bank President) in the American media. The tide seems to have changed a little bit. Whether that will result in a change in the IMF or World Bank. I do not know, that has not happened yet. But the mood of the world has definitely changed.

If you replace your Prime Minister's attack on hedge funds by the American attack on terrorist funds, it is the same thing. Not only your Prime Minister Datuk Seri Dr Mahathir Mohamad but Colin Powell is calling for the same thing.

Because hedge funds' financial resources are not disclosed, they don't have any disclosure requirements (but) I am sure some of the hedge funds have terrorist funds.

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