

Keynote Addresses

Financial Cooperation toward Northeast Asian Economic Integration

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Today I would like to speak on financial cooperation and, putting it in plain words, on how to procure money and in what form the related countries will be able to coordinate.

Asia has now become home to approximately four billion people, and overall has eight problems. For example, in the sense that there can't be any unevenness in the stable energy supply, the putting in place of transportation and logistics, the securing of water and food, the maintenance of supply chains and production networks, as well as growth, and there can't be any disruption in terms of time, it is necessary to continue development with extremely good links.

Moreover, the phrase "inclusive growth" has been used often recently, but it isn't about only certain people benefitting, and as a result the thinking is spreading that it must mean equal shares for all. In the sense of there being extremely wealthy as well as non-wealthy nations within Asia, there are disparities between nations. Other than that, in a given country there are people on the rise and people who will always be disadvantaged. What can be done in order for such a thing, whenever possible, not to occur has become an issue. In addition, mutual cooperation that doesn't come to resemble an assortment of systems or restrictions is difficult.

And lastly, it is crucial that the period of industrial development to date which disregarded the environment has been here for several decades, and also recently, and how to overcome it is an issue. This is an issue for Asia as a whole, and in Northeast Asia also something similar is occurring.

Putting today's global finance simply, from a past situation where money tended to be lacking, money has come to be in surplus. Mirroring the surplus of money, it is a general problem that interest rates have become extremely low. However, within that, what must be taken into consideration is that there is short-term money and long-term money.

Short-term money is that borrowed by tomorrow and paid back within a year, but when undertaking infrastructure development and environmental projects, for example, paying back borrowed money takes 15 or 20 years. It can now be seen that such long-term money is not necessarily circulating plentifully.

At the same time, within the initiative of the Indirect Financing System, where money circulates through banks, the banks have suffered considerable damage, and discussion has arisen that the business operations of banks will have to be restricted a little in order not to damage the banks any further. To date, going to the banks and borrowing money has been the general pattern, but now it is not necessarily the usual case.

In addition, recently trouble has occurred in Japan, and the problem of financing using artificial intelligence (AI) and virtual currency using block chains has also emerged as a turbulent factor in

the world of finance. I think that how to assimilate this skillfully will become an issue in the future.

Finance in the future and finance today are also not necessarily in a clear-cut state. It is generally recognized by finance people that in the future we will plunge into a not clearly understood situation. At the same time, as there is quite a lot of short-term money, when everyone proceeds with work or projects, if reasonable plans are properly made, they won't be unable to borrow. Conversely, increasingly depending on that will lead to amassing debt. In household economics there are education loans and mortgages, for companies there is investment in equipment, and for countries also the situation continues of borrowing money from their own citizens and investors from other countries, issuing government bonds for various reasons, and somewhat excessive debt builds up.

How will this turn out in the future? What can be done so that the accumulation doesn't come clattering down? In our own countries, or in the regions, or in the whole world, we will be thinking about this in the future. It has become necessary to do so.

For the world as a whole there isn't a shortage of money, and analyzing the reason, fundamentally incomes are increasing, amid Asian nations continuing to develop such as China, or India which is chasing it, or Southeast Asia preceding it. Savings aren't possible initially because everything is being used, but when savings become possible, then afterward the growth in savings becomes higher even than the growth in income.

Furthermore, in a given country, the social security system is not always complete. For example, when brought into a hospital, in Japan you are taken straight to a bed, but there are also countries where you are first asked if you have money. In such a country's case, you are forced to save. Including for that, the total savings level is now rising.

On the other hand, even if some development has taken place, as though for example in the middle of watching a marathon, even if the momentum is very good, at a certain point a plateau state will be reached, and the country won't necessarily move forward. If they can overcome that well, they will enter the next world, but the countries which are on the verge of stopping moving forward are increasing. There are places where the demand for funds for the sake of growth is not always large.

Environmental problems are an important matter, and there are costs in order to tackle them. The necessary funds will increase, but at the time when a certain degree of money has to be generated, if the costs increase, the demand for funds will not necessarily increase in order to check them. Such is happening overall, and as a result some amount of money will be left over.

Within that, the Lehman Brothers shock occurred in September

2008, and in 2009 most developed countries and a fair proportion of developing countries fell into minus growth. Subsequently, fiscal and monetary policies were carried out in order to support this, but as each country already had considerable debt, the leeway for undertaking fiscal policies was not always great and placed a considerable weight on monetary policies.

Even now the US Federal Reserve Committee, the European Central Bank, the Bank of Japan, etc., have considerable liquidity, make it easy to circulate money by injecting cash into the market, and have been supporting the economy by lowering interest rates. However, the previously mentioned short-term money has emerged, but long-term money hasn't. As a result, the money which the Central Bank has released has been for short-term operation, and with one of its targets being the stock market and another the real estate market, as we originally thought a situation where money doesn't circulate smoothly has arisen.

How long will they continue such low interest rates and plentiful financial policies? When the target changes, it is possible for the demand for funds of developed nations to fall, and trade-offs will occur between bond interest rates and stock market prices resulting from the monetary policies.

Based on this general situation, in what form will money be held in the future? And what must be done in order to procure money? Certainly, when entering into the main issue, project design of what to do will become highly important. According to the Asian Development Bank, for Asia as a whole there is annual infrastructure demand of US\$1.7 trillion. Up until several years ago they were saying US\$0.8 trillion, and this has more than doubled in one go. Within that, the necessity of design has heightened, in the sense of whether it involves the borrowing of the necessary money and its proper repayment.

As for things desired for good design, one is whether what should be done is clear. Giving road networks as an example, whether it is better to place them here or there is a fact, but it is important to make a priority ranking and make clear the aims for what is most necessary among, for example, lowering the total transportation costs by connecting ports, or being able to shorten the time for people living in the mountains to travel to hospital through going to hospital crossing the mountains. With that in mind, there will be discussion of whether to spend that money only on making ports closer or shortening the time to get to hospital. There will be an exchange of various opinions with the local people shouldering the projects. For a plan stating "it would be good to have it", procuring the money will be quite difficult.

The word bankability sums that up in its entirety, and closely undertaking discussion on not only whether banks are able to lend, but also on whether they are able to get repaid properly, is required. As the procurement method for money and how many years of borrowing vary by project, it is also necessary to discuss that in tandem.

Within that, how nations or local public bodies should take responsibility has become the next issue. It is relatively simple if factories are to be built in private-sector projects, but when it comes to infrastructure projects building roads, ports and high-speed railways, the ability to move that large an amount of money is at the

national level at any rate. The most important thing for investors and suppliers of finance thinking of putting money into that, is whether what nations and local public bodies are doing is predictable and whether it is stable.

When money is given out, it is meant to be given out on the premise of current conditions, but when it frequently happens that every year laws change, and the direction changes toward a form such as recently in the United States where Trump often issues executive orders, then even if it is possible to respond to short-term money of approximately one year, for people giving out money for long periods it acts as a drag. In that sense, how governments are able to guarantee predictability and stability and even if changes in systems are inevitable, it is necessary for governments to commit to having to make matters retroactive for what has already commenced.

Investors also are grateful that nations and local public bodies are in the end taking care of problems in the form of insurance and guarantees when nations and local public bodies implementing projects initially hope for money from them or when conditions are bad, but with strong nations and local public bodies gradually on the decrease, finally, in having to reckon their own money, the stability and predictability of systems become necessary.

In Northeast Asia, there are still socialist and communist regimes, but those countries, rather than maintaining laws for a long time, are altering their systems in different ways as necessary. These changes make improvements as intended, but as they take place occasionally they all the same become a drag, and it is necessary to examine how to consider that.

Furthermore, while they are important points today, projects only within certain nations are ending, and are gradually growing fewer. Projects will become necessary which straddle borders, and not just one border, but two or three. In inclusive growth, it is not just that certain places only become prosperous, but that all become prosperous. To that end, as it is necessary to forge mutual connectivity skillfully, cross-border projects will become necessary.

For example, two countries with one border are being targeted, but it is necessary to discuss properly the division of the burden for repaying money at the time money is supposedly drawn from outside. If building a bridge across a river, it is usual that the nations on the two banks go fifty-fifty, but if there is a great difference in what effects the existence of the bridge brings, then the amount that should actually be paid ought to reflect that same difference. To date, it is the case that splitting the cost fifty-fifty remains undiscussed, but by so doing, for weak countries and in the example of a bridge, if the country with relatively little advantage from the building of the bridge does not join in the burden, then in the end it won't proceed as a whole. In that sense, if simple rules are not made regarding the burden, then they will have to pursue discussions beforehand.

There are six nations in the target range for Northeast Asia, but in what form will they divide the burden among themselves? If all the countries had the same strength, it would be OK to decide simply on the degree of benefit received alone, but when there is a difference in the economic strengths of countries, it is necessary to consider at the same time that the prosperous country has a lot. It is difficult to make such a rule among the 190 countries in the world, but if there are six nations then wouldn't it be necessary for such discussion to be pursued?

Regarding the provenance of the money, there are both public- and private-sector sources. In the case of countries lagging behind in economic development, there are many areas being supported by official development assistance (ODA) from developed nations, but in Northeast Asia such countries are few, and to some extent private-sector finance is provided. Either that or, via devoting capital to the region with private-sector finance taking a measure of risk, a situation is arising of being able to make the judgement that it is good for both the recipient and the donor country. First it is necessary for our region to acknowledge matters in that way. Even within that, however, there are disparities in the strength of countries, and how to integrate that will be the next step, and I think that, looking at the total picture, for the time being we are in a region where private-sector capital is being provided.

ODA has had a considerable influence to date, but the developed nations providing it are suffering fiscally. In particular, in Europe after the Lehman Brothers shock, with the creative accounting of Greece there were various kinds of trouble and strength fell considerably, and it has become difficult for the respective countries to provide funds to overseas development aid. Amid the weight of public funds gradually falling and the weight of private-sector funds growing large, it is necessary to consider how we can draw out private-sector funds as something attractive. A future issue is building strength to draw out private-sector funds for the sake of our development and the execution of various projects.

In bilateral ODA, at times of difficulty there is also a supplementary portion from multilateral institutions, such as the Asian Development Bank and the World Bank, but the source of funds for those international institutions and the backup for guarantees are also undertaken by the governments of developed nations, and hasn't grown that much. Within this, private-sector funds are circulating relatively copiously, but it is not the case that they are circulating as well as thought. Due to a variety of reasons which will be mentioned later, short-term money is circulating well, but the long-term money necessary for infrastructure and environmental projects is not in easy supply.

One problem is that banks suffered considerable damage from 2009 on. To date, the banks put together deposits and lent them to projects which they thought OK in their own judgement, but whether they didn't have that judgement capacity or were a little sloppy in their processes, various defaults occurred, and there were 22 banks in operation nationwide several decades ago in Japan, but they have now decreased to 5 with mergers and failures occurring. In Europe, and actually in the United States also, similar things occurred.

When banks looked like they were going to go out of business, the government aided the banks, giving support and injecting money in the form of stocks. However, as the source of that money is taxes, and there is pressure because, in the people's view, "using our money, the banks are surviving somehow and continuing business; first we want you to use it for business that will give direct reductions to us, and because you're using it in other countries there ought to be money spare." When such a thing happens in affluent nations, money not being provided by affluent nations, as with ODA, can also occur in the private sector.

In the case of private-sector money, taking a degree of risk is permissible, but if the pressure increases from the people, saying

"you can't take risks because it is supported by our taxes," as expected business becomes difficult to do. If financial patriotism in this form grows strong, money will stay in the country and not leave. Conversely, when there aren't people borrowing money within the country, the banks themselves are also in trouble, with no borrowers for their money. It is necessary to consider the public consciousness and at the same time whether theirs is a rational judgement.

Summarizing the current market conditions, speaking of the relationship in the supply and demand of finance, the supply side has grown excessive. Via central banks injecting a large amount of money in order to support the economic situation, in general terms low interest rates have continued for a long time. Now, even when everyone deposits 1 million yen, if you withdraw it in one go from an ATM, then the interest it earns will disappear through the charges for using the ATM. This is occurring globally and not only in Japan. At the same time, as mentioned previously, due to various restrictions imposed on the banks themselves, there is little long-term money. On the other hand, as the central banks are increasingly distributing money, short-term money has come to abound.

After the 2008 Lehman Brothers shock, the United States overcame it in approximately two years, but overcoming it in Europe took a long time, and in addition trouble occurred due to Greece's national creative accounting, and the strength of European banks fell considerably. The European Central Bank has been rapidly circulating money, but as to whether it is provided in a form used as long-term money, it has come to be provided only quite limitedly.

The above was the situation to date, but the direction of financial policies is changing little by little. From around 2014, the United States first, with the crisis situation having ended, began changing direction extremely slowly. Recently, the European Central Bank has also begun to follow it, and from around 2019 will be oriented in the direction of changing the policy to date. As Japan is lagging a little behind in comparison with Europe, although I think it will be later, we are now seeing the basic direction changing.

At the time, the US moves were the largest. The United States is the center of the finance markets, and the US dollar has that much strength. In what form the United States will change its direction for finance not only impacts the US economic climate, but also impacts other developed nations, emerging economies and developing economies. However, amid the dark clouds which the Federal Reserve Board—the US central bank—is plunging into, there may be a lack of leadership, the prediction of inflation has grown difficult, and Janet Yellen, Chair of the Federal Reserve, has also said that the movement of inflation is a mystery.

At the same time, as factors restricting the moves of banks, for the reason that everyone is making deposits in banks which have been considerably damaged, there is discussion that for those banks to retain their health, it is better for them to impose a variety of restrictions. From the first a bank is taken as having an enviable amount of money, but now in both Japan and the world, in a sense the business line most exposed to a crisis has become financial business, and within that what banks maintain has become important.

People in manufacturing and distribution going bankrupt is never a good thing, but in the case of financing, there are also other healthy

firms borrowing from those financial institutions and there are also well-meaning depositors putting money into those banks, and bankruptcy must be avoided if possible. In order for banks to become healthy, it is better not to exaggerate, and moves to restrict activities will emerge anyway. President Trump, who talks of excessive restrictions, has proposed easing up a little on financial regulations, but points that specifically say what best to do have not yet come into view.

Regarding the banks themselves as they are now, in a situation of not being able to do business, if the systems for maintaining the financial systems of the six nations of Northeast Asia and the health of banks differ, it will not be easy for them to do business together. Even if the money provider is the United States only, there has to be some degree of agreement on in what form the implementer of the project receiving the money will allocate the capital, and in what form they recoup the money. If one country is in receipt, then that country's system will be OK, but when cross-border business is being done, when it comes to allocating the money in some form and fulfilling responsibilities, then differences will emerge in the method of fulfilling responsibilities, and it will be rather awkward.

The six nations of Northeast Asia also differ in social systems, and there are considerable differences regarding financial mechanisms, and it is obvious that they cannot immediately be completely the same. However, via discussion of what will cause the biggest problem, harmonization so as to seek gradual coordination will be the greatest issue for Northeast Asia in the future.

At the same time as that, for the banks themselves in the future, if their strength goes, it is necessary to consider whether it would be necessary to seek funding sources from places other than banks. Already in the United States, when firms do certain business they don't rely on the banks, but issue stocks themselves and procure funding, or issue bonds themselves and take on loans, and this style of direct finance has grown big. In the case of Europe and Japan, the weight of banks in industry and other finance has grown high, but if the banks' strength looks to be going, direct finance will become necessary.

In that sense, first the activation of bond markets is conceivable. Up to the present money was deposited in banks or the post office and was put together there and business done, but when a given company says it wants to borrow money because it wants to do some business, it will be necessary to create a bond market in the form of direct lending of money to the company.

At the same time, among people with money there are some with long-term money. Typically, they are people who manage pensions, and it is necessary to manage the capital for a long time for those who don't need the money right now, but in 20 or 30 years' time, and reaching out directly to such people must be considered.

What is more, amid the development of AI and the Internet, we have arrived at a situation where money can be borrowed without going to a bank. Already in the Midwestern United States and China, if you want to borrow say 1 million yen, the willing-to-lend responses come via the net, and matching occurs. The banks have made no mediation in that. It is necessary to consider that a peer-to-peer movement will gradually gain in size.

If money circulates without going through banks, should trouble occur the damage will be lessened. We deposit money in banks,

banks put that together and if the borrowers fold it is the case that the banks themselves will break, but if the projects to which various people have lent individually don't go well and the money cannot be recovered, then the respective investors each suffer a little pain, and in the sense that they don't end up collapsing and dying, the risks are spread. Whether they will permit that in the financial world, particularly in countries where the government has a degree of control over the economic system, whether to accept that or not will be one resulting decision.

In Asia, in comparison with Europe and the United States, the development of the bond market is lagging behind, but through skillfully activating this, people with money can not only have the narrow choice of bank deposits, but also be able to have a little longer operation. In a long operation, as a higher rate of return is usually offered, the fact is that a situation aiming toward that will be possible.

In order to create a variety of bond markets, different procedures are necessary. For example, supposing bonds are defaulted on, procedures must be considered as to who will compensate for that, and it is also necessary to consider whether that be done by existing or new institutions. In the future, once they issue bonds, an OK-rating for the project the company is attempting to do or the strength of the company will be necessary, and must be considered alongside who is going to do it. As overall institutional development, there will have to be examination of the bankruptcy and taxation laws, etc.

This has already happened in Southeast Asia, and this will probably be possible in Northeast Asia also, making use of the experience of China, the ROK, and Japan. Within that, in order to acquire capital which is as long-term as possible, in the future we must ask for money to be provided, with an interest in pensions in particular. In the current situation, pension funds give out money in developed countries to water and electricity projects, for example, but countries where this has not been done to date are not very willing to do so. While this will come as no surprise, it will be important to do something to overcome that.

In infrastructure also, it will be necessary to create anew, and somehow continue maintaining already existing infrastructure during long use. The funds for that are also large, and within the previously mentioned US\$1.7 trillion, they must use money not only for new construction, but also how to deal with holes appearing in already built roads and bridges that are unstable. Already existing infrastructure is called "brown field," and that to be newly built "green field", and it is necessary to consult with the providers of funds on putting money into the brown field also.

In the world of politics, while a great many politicians are wholeheartedly working on the creation of new infrastructure, they do not show much enthusiasm for maintaining and repairing that already built. I think that there is a need to consider drawing pension funds toward the brown field, but it is not that easy. Moves have arisen where they will provide money to the existing infrastructure of developed nations, but cannot easily lend for new infrastructure. I think it is necessary to consider how to make that attractive for Northeast Asia as a whole.

Lastly, in receiving money from outside, or receiving it from places already having a lot of capital such as China and Japan, when countries appear which would seem to become unable to repay

easily, it will be necessary to somehow protect against and support that. Already in Southeast Asia, with the Chiang Mai Initiative, they have created a system of 13 countries in total from the 10 ASEAN members together with Japan, China and the ROK, and when various kinds of trouble occur they take remedial action.

Fortunately, after the 1997 Asian financial crisis such a crisis has not occurred, and the system has not yet been invoked. In Europe's case, the problems arose in Greece, and the three parties of the International Monetary Fund (IMF) in Washington DC, the European Union in Brussels, and the European Central Bank in Frankfurt forged an initiative to lend money at the same time.

At a time when the strength of banks is gradually lessening, it is necessary for us to discuss in what form to make such a system stable. If that can't be done, not only will it interfere with

development, but because money must be repaid for the debt, that proportion of imports of food and energy will not be possible, and it will be necessary to create cooperation mechanisms regarding that.

When undertaking cooperation in that form, if they were to create some shape of system in the six nations of Northeast Asia, it is necessary to continuing making a structure to enable proper mutual checking with one another. Via the imparting of accurate information as quickly as possible to the partners working together on a project, mutual cooperation mechanisms will be possible.

From this time, various problems will probably occur, but I think there is strength for Northeast Asia as a whole. I would like to think that, via the pursuing of financial cooperation in the forms mentioned today, the development of the entire region will be possible.

[Translated by ERINA]