

September 14, 2009 (Monday) 11:15-12:30

Panel Discussion: Structural change of the global economy and competitive strategy of nations and corporations

Daisuke Kotegawa, Executive Director, International Monetary Fund

Aleksei V. Mozhin, Executive Director, International Monetary Fund

Hiroataka Takeuchi, Dean and Professor, Hitotsubashi University, Graduate School of International Corporate Strategy

Hiro Mizuno (moderator), Partner, Collier Capital Limited

It has been just a year since the Lehman shock. In the time since, there has been a lot of discussion on a global scale about the causes of the financial crisis as well as future challenges. At the G20 Summit that took place the other day, this was the main topic of discussion.

In fact, the world economy is at its most critical state since the end of World War 2. According to 2009 forecasts by the International Monetary Fund (IMF), the annual growth rate of emerging countries is expected to be 1.5% and of advanced economies, minus 3.8%, making for a world average of minus 1.4%. These major economic indicators show that the current financial situation is at its most serious since World War 2 and can be considered on par with the Great Depression of 1929 to 1933.

With this situation in mind, Mr. Kotegawa, executive director of the International Monetary Fund (IMF), based on his own experiences of Japan's financial crisis, warned that delays in implementing policies and other measures would have a grave impact on the real economy. In the past year-and-a-half, estimated losses stemming from amortization of American securitized products increased ten-fold. When this is combined with losses in Europe and other regions of the world, bad assets total 4.540 trillion dollars, according to IMF estimates. To resolve this financial crisis, which grew more serious by the day, last autumn, advanced countries came up with a 3-point approach that comprised of restructuring capital, writing off bad debt, and guaranteeing loan transactions between banks. However, despite the fact that these measures should have been implemented immediately, the injection of public funding and writing off of

nonperforming loans was very behind schedule. In the case of bad debt write-offs, almost nothing has been done yet. As a result, the market remains a potential “zombie” – in other words, anxieties that there are many companies with excessive liabilities still persist. We cannot forget that bad debt write-offs require the support of not just the markets, but the government, as well. The sub-prime loan problem severely damaged both household and corporate balance sheets. If left alone, this problem will create smaller balance sheets of relevant divisions with the servicing of debt and push GDP lower. That is why increased public spending and other government stimulus programs must prevent the shrinkage of GDP to the greatest extent possible.

What is the state of current programs designed to deal with the financial crisis? Mr. Kotegawa noted four measures being undertaken that include the building of a safety net, the disposal of non-performing loans, fiscal stimulus policies and a reevaluation of the financial supervisory system. While newspapers and G20 have covered the reevaluation of the financial supervisory system and the architecture of future global financial systems with much fanfare, these are mid-to-long-term issues and not urgent. Mr. Kotegawa noted that to stop the economic crisis from developing further, fiscal stimulus packages and in particular, the disposal of non-performing loans, are urgently important. He also added that to restore confidence in the market, debt must be evaluated according to strictly defined accounting rules and when necessary, public funds need to be injected.

While many opinions were expressed on the causes and challenges of the financial crisis, all agreed that the economies of the United States and Europe, which served as the locomotive of the world economy up until now, had hit the brakes and that there was much expectation in the BRICs (Brazil, Russia, India and China) to fill the gap. Mr. Mozhin of the IMF pointed out that emerging nations, such as East Europe and Russia, which registered negative growth rates due to the financial crisis, had increasing current account deficits even before the crisis. Some of those countries had good economic fundamentals and well-managed economies, such as the Baltic countries and Iceland. But precisely because of these strong fundamentals, the financial markets were motivated to provide huge capital inflows into these economies, driving up

massive increases in current account deficits. Among the Central and Eastern European countries, the scale of IMF support is greatest in Latvia, Hungary and Romania.

For the world economy to recover from this financial crisis, there is much expectation on the Russian economy as well. However, Russia's economy is suffering from the "Dutch Disease" with its high dependence on oil revenues, as pointed out by Mr. Mozhin. Before the Lehman Shock, profits gained from the rise in oil prices helped fund Russian government spending, delaying diversification of the economy. The rapid rise in currency values also further held back economic diversification. Because of oil resources, currency rates appreciated, which is impeding development of tradable commodities.

Since the Lehman Shock, the financial crisis has brought to light a number of financial issues. First of all is the Bretton Woods system. Some new international financial system must be built to replace it. Mr. Mozhin noted that the current financial crisis has renewed interest in international monitoring systems. For example, Mr. Zhou Xiaochuan, governor of the People's Bank of China (China's central bank), has widely and vocally expressed his opinion that the international monitoring system must change and that IMF's special drawing rights (SDRs) might become the international reserve currency. In addition, Russia believes that its economy has become unstable because the US's Federal Reserve eased monetary policy and because of fluctuating oil prices. The reason behind this thinking in China and Russia is an overall dissatisfaction in the international monitoring system. On the other hand, Mr. Kotegawa pointed out that China's assertions are to soften public criticism of the government's losses in dollar-based investments and that China is in no position to publicly propose a key currency to replace the US dollar.

If we look at all international financial initiatives that have taken place up until now, the Chiang Mai Initiative was revamped and the IMF is providing Mexico, Poland, Columbia and others aid without any conditions. The current situation is very similar to Japan in the 1990s and unless there is a write off of non-performing loans, a second wave of the financial crisis is not out of the question. The US dollar will remain the key currency and short-term recovery will depend on the US economy bouncing back.

The financial crisis after the Lehman Shock had an impact not only in the financial sense, which we have examined here today, but on corporate behavior, including Japanese corporations.

Professor Takeuchi of Hitotsubashi University asserted that macroeconomic indicators, whether they be positive or negative, are not important for a company when determining its competitive strategy. What is important is doing something different from other companies. For example, the Japanese apparel maker Uniqlo, while looking at the current financial crisis through the corner of its eye, has set a goal to beat such world apparel makers as H&M (Sweden), ZARA (Spain), GAP (USA) and others within the next 12 years. In addition, in the US, the largest consumer market in the world, Uniqlo is setting out to be the number one apparel maker.

What must Uniqlo do to achieve this goal? The answer is to move out of Japan, which is suffering from a graying and shrinking population, and make money in overseas markets. To achieve this goal, Uniqlo has diversified its product lineup, such as with tie ups with Jill Sander, and developed its human resources ahead of its overseas business expansion. In regards to human resources development, instead of the usual custom of Japanese companies to nurture Japanese nationals as managers, they have recruited and are nurturing some 200 global managers of many different nationalities. Work should be assigned to people with potential, regardless of nationality.

The deepening financial crisis that was first triggered by the Lehman Shock has influenced all aspects of life, from the macro level of international finance to the micro level of corporate finance. On the macro level, it is important that we first write off bad loans quickly. On the other hand, the source of competitiveness comes from the micro level. Thinking about the causes and results of this financial crisis, as well as the micro and macro challenges ahead, is an important step in finding hints for “Asian innovation” as well.

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