〔三重野総裁講演〕

World Economy in the 1990s:

A Japanese Central Banker's View

Remarks by

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It is a great pleasure and an honor to be invited to this gathering. Indeed, I am overjoyed with this opportunity, for I have a strong attachment to this great city of New York. I lived here for two years in the late 1950s as a member of the Bank of Japan's New York Office and was privileged to experience American hospitality and courtesies. Although I have not since had a chance to live in the United States, I have frequented here, including two previous visits this year alone. I have always been greatly indebted to you for your continued hospitality.

In addition to having lived here before, I am being a little sentimental for another reason. I am aware that one of my predecessors spoke before the Japan Society three years ago. His name was Haruo Mayekawa. Governor Mayekawa and I spent forty years together at the Bank, and it was him that I worked for in New York three decades ago. Haruo Mayekawa passed away on the morning of September 22nd last year, Japan Standard Time, or about this time exactly a year ago. In this regard, too, this is a memorable occasion for me.

Today I would like to talk about world economy in the 1990s. The 1990s have begun with a number of events. The winding down of East-West tension; democratization in East Europe; and rather despairingly, the Iraqi invasion of Kuwait, to name but a few. Each, to be sure, has implications for the world economy. Oil price increases occasioned by the flare-up in the Persian Gulf could have dire consequences for stability and growth of the world economy. While I am greatly concerned about this prospect, I am by no means pessimistic about resilience of the world economy. In hindsight, the 1980s also began with many sources of concern. Tripling oil prices amid the Iranian revolution were threatening to fuel inflation; major currencies were showing wide swings on exchange markets; and the shadow of recession was looming over the world economy. All this was followed by the international debt crisis. But what might otherwise have been termed a turbulent decade ended with a long period of uninterrupted growth in the world economy with modest inflation. World trade expanded remarkably, and technological innovation gained momentum. Of course, there remain a few dark spots. Economic growth and stability in heavily indebted developing countries have yet to be restored; balance-of-payments imbalances in both Japan and the United States continue, particularly in cumulative terms. Yet, even these dark spots have started to show some signs of improvement or have at least been contained. On balance, the end of the 1980s witnessed more favorable economic developments than may have been anticipated in the beginning.

Having said this, I should perhaps express caution against naive optimism as to future economic developments. The favorable trends as we enter the 1990s did not come about spontaneously. They owed much to policies of major industrial countries. In my opinion, two policies stand out clearly; a commitment to arrest inflation on the macro-economic front, and market-oriented reforms on the micro-economic front.

I probably need not say much about anti-inflation policy. The global economy's performance after the first oil price shock of 1973 and after the second shock of 1979 showed a marked contrast, demonstrating the importance of appropriate policy choices. Among industrial countries, Japan exhibited the most distinct contrast. Those of you who have been members of the Japan Society long enough perhaps remember when Japan's consumer prices shot up by 23 per cent in 1974, and economic growth went from boom to bust. This took place against the background of rapid monetary expansion in the preceding period. In the second episode, however, consumer prices increased by less than 8 per cent in 1980, or 4 percentage points higher than the preceding year, and the economy continued to grow 4 per cent in real terms. This took place when capacity utilization was not as high as in the earlier episode. On top of this, the growth of monetary aggregates had been kept modest in the preceding years and remained so later. I was at the Bank of Japan during both episodes, and one lesson I learned through my own experience is very simple. Once inflation actually flares up, it will take a painful course of action to restore economic soundness.

Currently in Japan, the economy is entering the fifth year of expansion led by strong domestic demand. Markets for both goods and labor are very tight: not as tight as in the period of the first oil price shock, but far tighter than in the second. In spite of this, inflation has been kept low. In my view, this is mainly due to low inflationary expectations, which reflect increased import penetration and more restrained monetary policy to date. In light of the lesson I said I learned in the two periods of oil price increases, monetary policy should be girded when a rise in inflation is still in the offing. It was these considerations that led us to raise our discount rate by 3/4 of a percentage point on August 30th.

When confronted with a supply shock like an oil price increase which threatens to give rise to inflation, the public may be tempted to call for government intervention in business activities through micro-economic measures. But such measures are unlikely to ensure success of a durable anti-inflation policy. Inflation is a macro-economic development just like aggregate economic growth or the balance of payments. Price controls or similar government intervention tend to distort markets and resource allocation. It may conceal the underlying inflation for a while, but by hindering the efficiency of the economic system, it builds potentials for future inflation and reduces opportunities for growth. There are abundant examples of this, recent experiences in the communist countries being some of the most salient.

A few minutes ago I said that two policies of major countries have contributed to non-inflationary growth in the world economy: commitment to anti-inflation and micro-economic reform. While discussing the first issue, I have already started taking up the second. During the 1980s, industrial countries took several bold steps toward making their markets freer and they continue to do so. "Deregulation" and "privatization" are the buzz words. In Japan, "market opening" can be added to this glossary. Such market-oriented reforms enhanced competition, not only in domestic markets, but internationally. It was under these circumstances that goods, services and technology travelled more frequently across borders. Increasingly competitive global markets seem to have accelerated technological innovation, which in turn contributed to non-inflationary growth.

A salient feature in this regard was that not only industrial countries but also a number of developing countries followed suit and thus reaped the benefits of expanding free markets. East Asian NIEs are prime examples of expanding market economies, and more recently, so are the ASEAN countries. In fact, the economic prosperity of market economies -- both developed and developing -- is one of the important factors that forced communist countries to face the need for change. When I recall the events in Eastern Europe last year, the exodus of East German vacationers to the West clearly marked a watershed. They sought many freedoms, not least of which appears to have been a free and more prosperous economy. This pressure eventually brought down the Berlin Wall.

As far as deregulation is concerned, finance has not been an exception. In the United States virtually all interest rate ceilings were lifted and the business scope of financial institutions expanded. In Europe securities markets were reformed, as was seen in London's Big Bang, and international capital flows were liberalized. Also in Japan, significant steps were taken to free cross-border transactions and relax interest rate ceilings, while a number of new financial instruments were introduced. In addition to financial deregulation, the 1980s witnessed rapid progress in telecommunication. Actually, financial innovation and deregulation were, at least in part, spurred by technological progress. Against this background international financial transactions have expanded considerably, and financial markets in individual countries have truly become a single "global market." The degree of this integration was demonstrated on

Black Monday in October 1987 in a most dramatic way. Now I know everyone in financial circles in every corner of the world is paying attention to the coming G-7 and IMF meetings. I hope myself or my fellow central bankers won't make the news headlines since that usually happens when there is bad news.

Thus, increased mobility of capital, goods and services has brought with it increased interaction between national economies, or if I may use another buzz word here, "interdependence." The interdependence between Japan and the United States is now particularly pronounced. As you are probably aware, the United States is Japan's largest export market, and Japan the second largest next to Canada for the United States. These trade volumes are growing rapidly. Japanese capital is important in financing the U.S. balance-of-payments deficit, and the stability of U.S. financial markets is of direct concern for Japanese investors. Macro-economic performance of the two countries is also interdependent. In the United States, continued expansion of exports and related business investments are a prerequisite for balance-of-payments adjustment under sustained economic growth. In Japan, continued growth of manufactured goods imports will contribute to both balance-of-payments adjustment and stable price conditions at home.

Economic interdependence obviously calls for policy coordination across national boundaries. Indeed, the Plaza Agreement of 1985 and the Louvre Accord of 1987 set a precedent for policy coordination in line with this economic reality. Moreover, monetary authorities acted jointly during global emergencies: the Mexican debt problem in 1982; the collapse of a major U.S. bank in 1984; the stock market crash in 1987. In each case when the world economy was on the verge of a crisis, coordinated actions were successful in avoiding havoc and preserving the stability of financial systems.

In sum, the 1990s have begun with two underlying forces at work: expansion of market economies and interdependence of national economies. I believe these trends will strengthen further and can form a basis for continued progress of the world economy. Of course, degrees of interdependence differ among countries, and a particular group of economies are more closely linked within the group than *vis-à-vis* other countries. EC 1992 and the U.S.-Canada Free Trade Agreement may encourage increased economic interdependence between member countries. Among Asian and Pacific countries, too, there is a movement towards enhancing regional economic co-operation. I consider these developments to be part of a process of geographical expansion of market economies, rather than heralding closed regional blocks. I hope that my expectation will be proved correct by policies among the countries concerned that will ensure non-member countries open access and equal treatment in these regional arrangements. In view of the economic prosperity at the outset of this decade, which is founded on expansion of free economies, the task in front of us is to consolidate these successes rather than allowing the trend to reverse.

Despite successes, frictions have emerged in recent years between major countries, Japan-U.S. relations being a conspicuous example. There is a long list of areas where opinion varies between the two countries: trade, foreign investment, finance, intellectual property, etc. It should be noted that disagreement is as pronounced within each country. In my opinion, some frictions between countries as well as disagreement within each are inevitable consequences of economic interdependence. As countries expand the scope of exchange, the growing complexity of relationships leads to intense debate over mutual interest versus national interest. Also, as tariffs and other visible barriers to international transactions subside, structural aspects of economies have drawn attention, which may also be a natural development. In fact, the recent exercise of the Structural Impediments Initiative, as its name suggests, focused attention on structural aspects of both economies. Such policy dialogue will help deepen mutual understanding of problems that are of domestic origin but nonetheless have significant implications for other countries, and the world at large.

Keener attention has also been paid to financial structures, in which I have direct interests. For example, since 1984 serious discussions have been undertaken with respect to financial regulations and market practices at the U.S.-Japan Working Group on Yen/Dollar Exchange Rate Issues. These discussions have in fact contributed to enhancing both the efficiency and international compatibility of Japanese financial markets, although further improvements may have to come particularly as regards the functioning of capital markets. The financial structures of major countries are taking center stage in the ongoing discussions of financial reform in the United States as well as in Japan. Indeed, President Corrigan says, in his excellent insight, that the banking and financial structures of major foreign industrial countries, including Japan, are of importance to the United States. In Japan, too, financial reform is now discussed with reference to the past and current experience of the United States. Today I won't bother you by discussing technical aspects of these ongoing discussions. I know these issues are a rather tedious topic for those outside the financial community.

Here I would like to conclude with a few rather general remarks about issues of economic structure, keeping the financial structures in mind. First of all, economic and financial systems must ensure the efficient functioning of markets, which I have already mentioned in connection with micro-economic reforms. My second point of emphasis concerns the international implications of an individual country's system. Where there is a defect or simply a nuisance in a country's system, transactions will go around it as far as finance and other highly mobile activities are concerned. As a result, not only does the system fail to function appropriately at home, but this circumvention can also distort resource allocation internationally. In this regard, international compatibility and consistency are highly desired. Finally, such efficiency and international compatibility must accompany the soundness of the system. This is particularly true of finance. In view of the international repercussions of the 1987 stock market crash and other financial disruptions, international co-operation should be in place not only in terms of fire brigade operations, as I described a few minutes ago, but also in constructing sound systems.

Ladies and gentlemen, as economic interdependence and globalization have reached their present level, we are truly cast into the same boat, whether we like it or not. It is our joint responsibility to guide the world economy in the right direction and construct systems in accordance with this economic reality. Thus, co-operation between the United States and Japan, whose economies are the largest and the second largest in the world, is now more important than ever. At the crux of such co-operation, it is hoped that there will be an exchange of views -- candid yet constructive -- that will minimize frictions arising from misguided perceptions. Without doubt, the Japan Society will make a valuable contribution towards this end. I wish the Japan Society continued success in its many respectable efforts, and thank you for your kind attention.