

Eisuke Sakakibara worked for Japan's Ministry of Finance for more than 20 years, most notably as vice minister of finance for international affairs. More recently, he served as managing director of the International Monetary Fund.

Here, Sakakibara discusses the evolution of the Japanese economy and the Asian economic crisis that began in 1997.

A Portrait of Japan's Current Dual System Economy

INTERVIEWER: What are the big challenges that globalization poses to Japan?

EISUKE SAKAKIBARA: The Japanese economy right now is what could be called a dual system. One sector of the Japanese economy is an export-oriented sector which is highly competitive, consisting of Toyota and Sony, for example. The other sectors include domestic manufacturing and domestic service industries, like textiles, food processing, and construction, and I include agriculture in that. All of this is very tightly regulated with a lot of subsidies from the government, which makes them extremely uncompetitive. So this duality of the economy has become more and more of a problem for the Japanese economy as globalization proceeds.

INTERVIEWER: Why is it a problem? Why does globalization make it worse?

EISUKE SAKAKIBARA: Globalization makes the export-oriented sector far more competitive, and the difference between the competitive and uncompetitive sector has widened quite significantly. And besides, about 90 percent of Japanese employment is in the uncompetitive sectors, so that without really changing the domestic sector, it has become extremely difficult for the Japanese economy to regain its momentum.

INTERVIEWER: Why is the domestic sector of the Japanese economy so uncompetitive?

EISUKE SAKAKIBARA: Well, it's very highly regulated. It is an interesting system, you know. We have a market-oriented capitalistic system on the one hand, and we have a very socialistic, egalitarian sector on the other hand. Agriculture, for example, is very tightly regulated, and very socialistic in some sense.

INTERVIEWER: That's surprising, because most people from the outside don't think of Japan as having a socialistic economic system.

EISUKE SAKAKIBARA: Well, continental Europe used to have the same kind of system 10 or 20 years ago, but they have structurally changed their economies into more market-oriented economies during the course of the last decade due to the unification of the economy and the currency. Japan hasn't had to go through that process yet, although we have highly international and globally competitive sectors on the one hand in automobiles, electronic appliances, machine tools, and so on.

INTERVIEWER: Disassembling a subsidised domestic economy can be a very painful process to go through.

EISUKE SAKAKIBARA: It is a painful process, but by deregulating the domestic manufacturing sector, you could really invigorate that sector and create new jobs there. You have to go through the process of creative destruction or destructive creation to get there. And times are changing very quickly, so if destruction and the creation proceed simultaneously, the pain may not be as much as some fear it will be.

Japan, Inc.: 1970-1990

INTERVIEWER: Before the slowdown in the early '90s, there was a time we all remember in the U.S. when people looked to Japan as a model of economic success. What had made the economy of Japan so strong? Why did this dual system work so well, this dual system that you talk about now as being a problem?

EISUKE SAKAKIBARA: Well, during the course of the 1970s and the '80s, and starting from the '60s, there was a huge amalgamation from the agricultural sector to the industrial sector, from the rural areas to the urban areas. As a result, agricultural population, or population in the primary sectors, has declined quite dramatically in favor of the industrial and manufacturing sectors. During the course of the last 100 years, we succeeded in transforming our economy from the agricultural economy to the industrial economy particularly after World War II. In that process we established a system which could successfully avoid instability in the economy and the society. We subsidized the rural areas; we subsidized the agricultural

areas in order to avoid a very rapid deterioration of that sector. In that process we created the dual system. It is a somewhat egalitarian system in that there has been an enormous transfer of the income and the wealth from urban to rural areas, from industrial to agricultural areas. It worked in the '60s and '70s and provided the necessary political and social stability to sustain the economy. As a result of migration and these kinds of stabilizing policies, the industrial sector, particularly the manufacturing sector, had thrived.

INTERVIEWER: To what extent was the success of the manufacturing industrial sector due to the direct involvement of the government or government policies?

EISUKE SAKAKIBARA: The government involvement in the industrial manufacturing sector was quite limited. There was attempt in the early '50s, for example, by the government to become involved in the automobile sector, but that effort was in the very early stages. There were abundant manufacturers, so automobile, steel, or, say, machine tools were essentially a free-market-oriented sector. But, as I said, the other 90 percent of the Japanese economy—the domestic manufacturing sector, domestic service, and agriculture—did have lots of government involvement. The success of Japanese manufacturing did not depend upon government intervention. It depended upon entrepreneurship; it depended upon the competition, global competition, competition with both American and European companies. So Japan did have a market-oriented economy at least in one sector: export-oriented manufacturing.

INTERVIEWER: Back in the '80s, many accounts of Japan's success attributed a lot of the credit to bureaucrats, to MITI [Ministry of International Trade and Industry], and the Ministry of Finance. Is that overstated?

EISUKE SAKAKIBARA: I think it's overstated. It's a Chalmers Johnson type of industrial policy argument, but I think it's overstated. [Chalmers Johnson is the author of *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1952-1975*.] MITI had relinquished their control as early as the mid-1970s. Since then, manufacturing industries like machine tools and automobiles have been an essentially market-oriented sector.

Japan in Recession: 1990-2002

INTERVIEWER: Looking at the economy and the government from the inside, as you saw during your career, when did you first have a sense that there was a slowdown coming? And at the time, if you can remember, did you think it would just be a temporary problem? What did you think?

EISUKE SAKAKIBARA: In the early '90s, '92 and '93, we did have a slowdown of the economy, particularly in plant and equipment investment, which had led the economy in the late '80s. In the early '90s, it started to decline quite dramatically. It's the type of thing which is happening in the United States right now. At that time, we thought that the process would be quite short-lived. This kind of boom-and-bust cycle is natural for any market or capitalist economy. We never thought that this process would be so prolonged as it has become in the past decade.

INTERVIEWER: Why has it been so prolonged?

EISUKE SAKAKIBARA: There are various explanations for that. One is with the bursting of the speculative bubble, it has become a balance-sheet problem for the banks. The balance sheets of many of enterprises, of many individuals have deteriorated due to the very rapid decline in real estate prices and equity [stock] prices, and the disposition of those non-performing assets has been delayed because of a feeling that some catastrophic destruction might take place if we accelerated the disposition of those non-performing assets. I think we are wrong in this. Everybody—not only the government, but the business leaders and the neutrals—have been hoping that the equity market and real estate market will turn around within a matter of two to three years, but it has never turned around. It has continued to decline for the last nine to 10 years.

The Clinton Administration's Economic Policy Towards Japan

INTERVIEWER: In that same period when the economic decline began in Japan in '92-93, a new administration took over in Washington. The Clinton team came in, and they started negotiating fairly aggressively with Japan.

EISUKE SAKAKIBARA: That's right, that's right. We had a fairly difficult negotiation in the early part of the Clinton administration. They were very aggressive. At that time the U.S.

economy was just recovering from a decade with all sorts of stagnation, and the Japanese economy had just experienced a very long period of prosperity, so they were very aggressive towards Japan, and they actually intended to structurally change the Japanese economy. Their major intention was to focus on fair competitive pricing, and they thought, at that time, because of those government interventions in our economy, because we structure the whole of the Japanese economy, that Japanese exports had an unfavorably strong competitive edge vis-a-vis the U.S. companies. So their trade negotiations in '93 and '94 were very aggressive and very acrimonious.

INTERVIEWER: How was that policy viewed here in Japan?

EISUKE SAKAKIBARA: Well, I always tell my friends in the U.S. administration that the first part of the negotiations with Japan was quite problematic. For example, they used the currency exchange rate as an instrument for trade policy. The effort was led by Mickey Kantor, and the Robert Rubin and Larry Summers team was behind the scene. Eventually the Rubin-Summers team surfaced in January of 1995. When Rubin became secretary of the Treasury, he declared that he never used the exchange rate as an instrument of trade policy, but that implied that before that time, the U.S. administration had used the currency exchange rate as an instrument of trade policy. I think that was a wrong policy.

INTERVIEWER: To the layman, what does it mean to use an exchange rate as an instrument of policy?

EISUKE SAKAKIBARA: Well, partly because of that policy, the yen had appreciated very significantly to 80 yen per dollar. It even broke 80 yen in March of 1995. That was after Rubin took over, so it was the result of U.S. trade policy, plus the economic trade crisis in Argentina and Mexico, but the yen was unusually strong, Japanese yen vis-à-vis U.S. dollar. The U.S. dollar was weak, and even the U.S. government admitted in April of 1995 that the exchange rate was way below, or above, the fundamentals, depending on which way you look at it. So, in our opinion, the U.S. government had intentionally pushed the U.S. dollar to a very weak level.

INTERVIEWER: Why do you think they were doing that? What was their objective?

EISUKE SAKAKIBARA: Their objective was to reduce the U.S. trade deficits. At that time the U.S. trade deficit was, I think, around 4 percent of GDP, which is smaller than the current deficit, but they were trying to reduce it to something like 2 percent of GDP. One of the major objectives of the trade negotiation that started in 1993 was to reduce the Japanese trade surplus to 2 percent.

The Asian Boom of the 1990s

INTERVIEWER: In the early 1990s there was an emerging-market boom in Southeast Asia, and a lot of U.S. money and European money and Japanese money was flowing into the region. How did that fit in with the whole equation, with the fact that the Japanese economy was beginning to slow down?

EISUKE SAKAKIBARA: The East Asian manufacturing boom started in the late '80s when the Japanese yen appreciated from 250 to the dollar to 150 to 100 and so on. There was a sizeable Japanese direct investment in Asia. Right now, outright Japanese direct investment is far below that of Europe and the United States, but in the late '80s and the early '90s, Japanese outright investment was more than that of the United States and Europe, and most of that money went into Southeast Asia and East Asia, to Singapore, Malaysia, Indonesia, Thailand, Taiwan, Hong Kong, and so on. As a result, their economies globalized very significantly during that period. Right now, exports, say GDP for Singapore and Malaysia, is more than 100 percent. That number for the United States is only 7 percent, so you can see how globalized those Asian countries are, and that all happened in the late '80s and early '90s. So the economists called this very rapid expansion of manufacturing, export-oriented manufacturing in Asia, the "flying geese from Asia"—flying geese, you know, headed by Japan and then followed by Singapore, Taiwan, Korea, and Hong Kong, and then followed by [the rest of] Asia. The flying geese formed during the course of five to six years in late '80s and early '90s, and one of the reasons for that was the very rapid appreciation of the Japanese yen, which led to outsourcing of production by many of the Japanese manufacturing companies to sites outside of Japan where labor was cheaper.

The Asian Economic Crisis Unfolds

INTERVIEWER: At the time, in the early to mid-'90s, did you feel that the Southeast Asian boom was heating up too quickly? Was the expansion too fast?

EISUKE SAKAKIBARA: We didn't have that sense up until say '95, '96. In 1993, the World Bank came up with a publication entitled "The East Asian Miracle," so everybody was applauding, you know, applauding what had happened in East and Southeast Asia in the late '80s and early '90s. At that time, you know, Latin America was stagnating, and the '80s were said to be the "lost decade." By comparison, Asia was [doing well] from the late '80s up to the middle of 1990s. But along in the 1990s, we sensed some kind of problem forming in Thailand, in Indonesia, in Korea, everywhere.

INTERVIEWER: It began in Thailand. Do you remember what your sense was at the time? Did you think it was likely to be contained there? Did you think that the baht crisis had serious implications for the whole region? Did your thinking about the crisis change as you watched it move from country to country?

EISUKE SAKAKIBARA: Thailand's prices erupted in May of '97. Of course, there was a sense of a bubble bursting in Thailand in late '96 and early '97, but at the time the Thai crisis erupted, nobody, including ourselves, thought that it would proceed to a crisis in Korea, for example. It was unbelievable that the crisis spread as quickly as it did to Indonesia and Korea within a matter of six months or seven months. We realized that the world was much more globalized than we had thought at that time.

INTERVIEWER: What was your own personal worst moment at that time?

EISUKE SAKAKIBARA: Well, I have lots of recollections during that time, but one meeting I remember very clearly was in September 1997. It was the annual meeting of International Monetary Fund, which was held in Hong Kong. That was at the time of the return of Hong Kong to China. I remember meeting with George Soros [the hedge-fund specialist and philanthropist] in Hong Kong. During our meeting Soros said Korean banks owed very heavily to Indonesia, and Indonesia was now entering the crisis, so that the problem will eventually proceed to Korea. So as early as September George Soros was predicting that the crisis would

spread to Korea. After that meeting I checked the numbers and realized it was true. The American and European banks had been withdrawing their money from Korea beginning in the middle of 1997, and in September the Japanese bank, they were the last ones to get out of there. It was a very rapid withdrawal of money by European, American, and Japanese banks which resulted in the Korean crisis in December of 1997.

INTERVIEWER: It must have been nerve-wracking to watch that money that had flowed in in such huge amounts flow out so quickly.

EISUKE SAKAKIBARA: That's right, that's right. Within a matter of two to three months, Korean foreign reserves were very quickly depleted also. The beginning of December in 1997, the U.S. government, the Japanese government, myself, and the European governments knew that the Korean foreign reserves might be depleted any day. We were watching day by day what was happening in the Korean short-term capital market. This was the time when Kim Dae-jung had just won the election. It was a transition period, but it was a very difficult time. We were being sent information on daily basis.

In Washington, Frankfurt, and Paris, the Europeans were watching at the European banks, Americans were watching the American banks, and we were watching the Japanese banks. The central banks of all the G7 countries [Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States] got together and compiled the daily data on the withdrawal of money from Korea.

INTERVIEWER: At the time you were talking to Secretary Rubin and Larry Summers in the U.S. What do you remember from those conversations?

EISUKE SAKAKIBARA: There are a lot of things taking place during that period. As early as late August and early September of 1997, the Japanese government proposed the establishment of an Asian Monetary Fund. Larry Summers was furious. He was very strongly opposed to the idea, so we had heated discussions over the phone and at various meetings about whether we should proceed to establish an Asian Monetary Fund. That kind of heated debate continued for two months, and in the end Larry prevailed, but it was an interesting period. We remained friends, but we had very different views of the world at that time. I was

saying from the outset that this was a crisis of global capitalism. But in 1997, Larry's view and Bob Rubin's view was that it was an Asian crisis, and, essentially, Asian policy management was the problem—Asian governments and Asian corruptions and collusions, the Asian structured economic system, which is quite close to the structure of the Japanese. I admitted that was a part of the problem, but I said that the problems had arisen both on the part of the borrowers and lenders, and the lenders were mostly Wall Street, so it was a problem created by both the borrowers and lenders; it was a problem of global economy.

I think I was right. Rubin recognized that later, when the crisis spread through Russia to Brazil and eventually to Wall Street itself. Wall Street was in crisis in September and October of 1998, so what started as an Asian crisis in 1996-97 and what started as an Argentinean and a Mexican crisis in 1994-95 eventually spread to Wall Street in '98. And so, in September and October of 1998, the Rubin-Summers team was very tense. They then initiated a very aggressive policy to intervene when the American hedge fund Long Term Capital Management [LTCM] collapsed. They succeeded in staving off the crisis in the U.S. Their sense of urgency, their sense of crisis was very strong by then, but they didn't have that urgency in '97. They thought it was simply a regional crisis.

INTERVIEWER: Lee Kuan Yew, the senior prime minister of Singapore, holds the opinion that the U.S. simply didn't understand Asia and didn't give Asia as much importance as it deserved at during that time. What's your sense of that?

EISUKE SAKAKIBARA: That turned out to be true, of course. The Rubin-Summers team was quite involved in the Asian crisis. I think they did their best, but in the end, the United States did not pour any bilateral money into any of the Asian countries. They promised bilateral money to Indonesia and Korea, but they never dispersed it. That is a reflection of U.S. national interests, perceived U.S. national interests. I think Rubin and Summers wanted to disperse bilateral money at least to Korea, but the American Congress wouldn't let them. You know, Asian countries, including Singapore, are pro-West. Lee Kuan Yew is one leader who is very pro-American, but even here, like in the West, there's such a thing as a regional interest.

INTERVIEWER: When you proposed an Asian monetary fund, what was the argument coming back from Larry Summers against it?

EISUKE SAKAKIBARA: His main objection was that it would undermine the International Monetary Fund; it would undermine the global efforts to ride out of the crisis. Of course our position was that it wouldn't. It would probably supplement the global institutions. There's such a thing as Asian Development Bank as against World Bank. Why not an Asian Monetary Fund? But Larry Summers in particular thought that it was an Asian challenge or a Japanese challenge to the USA generally. He felt I should have approached it a little bit more discreetly, not to generate that sense of threat to the USA and Germany.

Global Consequences of the Asian Economic Crisis

INTERVIEWER: What do you take as the most important lessons to come out of the Asian crisis and its global consequences?

EISUKE SAKAKIBARA: Well, one thing is that the global capitalism we now have is inherently unstable, and we need to be prepared for the recurrence of this kind of global crisis. We don't have the international mechanism to really prevent a crisis or to manage them when they occur. Although we have tried to create it as much as possible after a crisis, it is not here. We have global markets; we don't have a world central bank. It's very simple. If you have a global market, you've got to have a world central bank which can be a lender of last resort. In the domestic markets we have that; in internal markets we have a central bank which is a lender of last resort. So theoretically you have only two choices: One is to create a global lender of last resort; the other is to control, to limit the flows of capital in and out of individual countries. The latter turns out to be extremely difficult. And the creation of a world central bank is politically very difficult, so we have to tread a very difficult middle way, which is full of risks and problems.

INTERVIEWER: If that middle-way path is followed, does that mean there will be more and more crises?

EISUKE SAKAKIBARA: I think so. One crisis which we may be heading towards is a crisis generated by the [recession] in the USA. If the U.S. economy really goes down, it will have an impact in Asia; it will have an impact in Latin America; and Europe probably will not be able to sustain the world economy with its demand. When the East Asian crisis ended, I said that the

next crisis will probably come either from the United States or Japan or Japan and the U.S. together. The course we're heading on right now does seem to imply that that is a possibility, a real possibility.

Circumventing the "Iron Triangle": The Need for Structural Reform

INTERVIEWER: You mentioned that during the Asian crisis when you talked to Rubin and Summers, they said that there was a problem, a political and structural problem within Asia itself. After the crisis, there was some pressure put on Japan from the Clinton administration to reform. How was that pressure from Washington felt within the Japanese government?

EISUKE SAKAKIBARA: I really didn't feel any specific pressure from Rubin and Summers in terms of structurally changing the Japanese economy. The United States has pressured Japan for the last 40 to 50 years. We're used to that. We are used to listening to their lectures. Of course when Larry Lindsey of the Bush administration took over, he said, "Well, I'm different from that Larry Summers; I'm not going to lecture you." But we are accustomed to hearing the lectures from the U.S. government all the time. Rightly or wrongly, they lecture us.

But I have always recognized that there is a need for a structural reform in Japan. We need to adapt our system to the globalized system, and that need has probably become much greater during the course of the last decade. The discrepancy between the domestic sector of our economy and the international sector has widened quite significantly as globalization has proceeded, and the "iron triangle" between politics and bureaucracy and vested interests has become tighter and tighter, so we now have a wage-structure problem, and many Japanese people, voters included, are now feeling the need for reform. That is the reason for the victory of Mr. [Junichiro] Koizumi [in his election as prime minister] a couple of months ago.

INTERVIEWER: When you were at the ministry arguing for reforms inside the power structure, how were they received?

EISUKE SAKAKIBARA: I was able to implement a major structural reform that was called "financial big bang." We deregulated the Japanese financial system between November 1996 and 1999. If you look at the Japanese financial system, it's an entirely different sort of system from four or five years ago. Ninety banks have finally merged into four groups. Foreign banks

have come in, and companies like Sony in the manufacturing sector are now entering the financial system. These structural reforms were initiated by the Japanese government, not necessarily because of pressure from the U.S. government. Of course, the U.S. has advised for a long time to do this, and to some extent we have followed their advice, but we did it on our own. It was a difficult process. During the course of the last three or four years, we have had a major financial problem, a crisis, partly because of the deregulation. But I thought—we thought—it was inevitable that we must open the Japanese financial system to the foreign markets.

INTERVIEWER: You talked about an "iron triangle" that you see when you are when inside the government. Can you give us an example of how you run up against that iron triangle? Was there anything you wanted to do but couldn't do because of those vested interests?

EISUKE SAKAKIBARA: Well, there were lots of things that you couldn't do. I mean, this kind of iron triangle exists not only in Japan, but everywhere, to some extent. Democracy creates this, and you need to be very skillful to circumvent the various channels of pressure. Take, for example, deregulating foreign exchange control completely. When I was the director general of the international financial bureau, banks were against it, so we needed to find a way to suppress the bank opinion through some kind of public opinion. At the time of the banking crisis, banks did not have enough time to ponder over the implications of a wholesale revision of the foreign exchange control act. And at the same time, it was a surprise move on our part. Banks never thought that we would dare to do that, because that meant relinquishing the vested interest of the Ministry of Finance as well. We are interconnected. Banks had the vested interest, and to some extent the bureaucracy has shared that, but the bureaucracy at that time initiated the change, so banks never dreamed that we would relinquish our authority over the financial institutions. It was a surprise move, and we tried to maneuver through a very narrow path as skillfully as possible. It can be done, but you have to have a strategy; you have to be Machiavellian; you have to have luck. But with luck and with strategy you can do it, and eventually you'll have the public opinion behind you. But it is always a difficult process in any country.

The Prospects for Recovery: Act One Begins

INTERVIEWER: What about the prospects for recovery in Japan?

EISUKE SAKAKIBARA: I think it will take two, three, four, five years to really structure a change to take place. We are now in act one of the Japanese change. There are maybe four or five acts to follow, but Japan has finally decided to change, and change may gain momentum and accelerate or may generate some confusion, some kind of backlash. We cannot predict at this moment, but it is in a very interesting point. There will be a lot of business opportunities; there will be a lot of challenging tasks, both in the public and private sector, so I really look forward to the next two, three, four to five years. It will be a very interesting and challenging period for the Japanese economy and Japanese society.

INTERVIEWER: If this is act one, do you think that the government and the Japanese people are prepared for the political and the social costs of going to act two, three, and four?

EISUKE SAKAKIBARA: Yes, I think so. I think we are prepared. The important thing is to form a good strategy and to generate the public opinion to support this kind of structural change. After all, Japan is quite an affluent society in terms of per capita income. We are above the United States and above most of the European countries, and if you walk through the city of Tokyo you will see citizens dressed well; they eat well. Their housing is a little small, but this is a typical urban problem. So I think that we have the room to persevere through the structural change, as long as there is light at end of the tunnel that everybody can see.

INTERVIEWER: What are the costs that might come along the way? Are we talking about unemployment? What do you expect?

EISUKE SAKAKIBARA: Stability of the society... I think the lifelong employment system has to go, and the labor market has to become much more flexible. This is psychologically a very difficult burden for those who are accustomed to the situation, but if you talk to the young generation who are entering the big companies or the government, they do not expect to stay there for more than 10 or 15 years. So generationally, changes are already taking place. For those people who are in their 40s, 50s, and 60s, it may be a very difficult transition, but I think it's inevitable, and now people feel that this is inevitable. You've got to be prepared for that, and changes are very quick, you know, because of all the technological innovation that is taking place so quickly. If the leadership is well established both in the public and private

sector, I think we could go through this transition process fairly skillfully. After all, in the late 19th century, we went through a very dramatic structural change. In the 17th century, we went through a dramatic structural change, so to say that the Japanese are culturally not well suited for changing the structure of their society is wrong. We have absorbed the unfolding of civilization throughout our history, first Chinese and Korean then Western, mostly European, and then American. So I think it's not a cultural inertia; it's an institutional inertia which is the problem, and I think you can change this institutional inertia with a strong leadership.

Re-enter China and India: How Japan and the U.S. Will Approach Changes in Asia

INTERVIEWER: Let me ask you about the Bush administration. Do you hope for a different tone from Washington, a different approach towards U.S.-Japanese relations, both economic and political, particularly factoring in China as well?

EISUKE SAKAKIBARA: I do see a change in Bush administration from the previous Clinton administration. First of all, they are more market-oriented, leaning more towards market fundamentalism. The Rubin-Summers team respected the markets, but they were little bit more interventionists than [Secretary of the Treasury, 2001-2002 Paul] O'Neill and Lindsey, so there are two sides to it. One is that, as Larry Lindsey told me when he visited us before he took the position, they will lecture the Japanese less. But when a crisis comes, what I am afraid is that their crisis-resolving measures may not be aggressive enough.

You know, the Rubin-Summers rescue plan was very aggressive, maybe too aggressive, but the Bush approach may be too moderate, because sure, we have a globalized market economy, but the globalized market economy is, as I said, inherently unstable, so in a time of crisis, to what extent the new administration recognizes the role of the government is something I don't know at this point. Second, we do not know what kind of China policy they are pursuing, but one major event in the 21st century will be the re-emergence of China and India into the world economy. China and India has have woken from the sleep of last 200 years. Now the world is going to become like 70 or 80 or even 400, 500 years ago, when China and India were the major powers. China is a major issue that both the United States and Japan need to tackle. Of course Cold War-type containment won't work, but the accommodative sort of policy of the Clinton administration may not be liked by the Bush administration, so we will need to cooperate.

It's a different Asia now for Japan. Over the last two or three decades, Japan was able to form the flying-geese formation, and we took some leadership at least in the economic sphere, but that may not be possible now. We need to cope with China. Hopefully we need to be able to cope with India as well. So this is a different world, and China will probably change dramatically the production patterns within this region. It is already happening. Many of our production sites are now moving from Japan and the other Asian countries to China, dramatically reducing the costs of manufacturing in many areas. So China is a new factor, both politically and economically, and this is a major policy challenge for both United States and Japan.

INTERVIEWER: Did you feel during the Clinton administration that they were ignoring Japan to form a strategic partnership with China?

EISUKE SAKAKIBARA: I didn't think so, but that's sort of a Japanese complex, I'd say. I never felt that way. We were very close to the Treasury, and we talked constantly with the Rubin-Summers team. I don't think they neglected me in any sense of the word. So the view of some of the Japanese conservatives that the Clinton administration bypassed us to form their relationship with China I think is just wrong. Sure, China is a big market; the United States was interested in that, but so was Europe. You know, it's only natural. We should have been more like them; we should have approached China more aggressively. As I said, the world is changing. Japan is not the only important developed country in Asia. China is a developing country, so it's only natural for the U.S. government or the European governments to put an emphasis on China. That's not neglecting Japan.

INTERVIEWER: As China becomes more and more developed, as production patterns shift, do you fear Japan being left behind?

EISUKE SAKAKIBARA: Oh, there's that possibility. I always say the Japanese position in Asia is like Great Britain's position in Europe. China and India are our France and Germany, and we are at the periphery of the continent, a small island at the periphery of the continent, an island which is well developed, which is ahead of other countries, which is close to the United States but which is not at the heart of Asia. So we should have that kind of attitude. We could

never take a genuine leadership position in Asia. We could supplement those in leadership like the UK does. So I think that the Japan-centered perception and sentiment of many Japanese is simply wrong. They are not global enough; they are not international enough; they are very parochial. They always think that Japan is the center of things. We're not. We have to believe we are at the periphery.

Is There a Financial Panic Ahead for Japan?

INTERVIEWER: In very plain language, could you tell us what the crisis is in the Japanese banking system? Is there a risk of financial panic or a meltdown?

EISUKE SAKAKIBARA: We have had a banking problem, but if you look at the bank balances, most of their borrowers are the domestic manufacturers and domestic services. It is my opinion that the banking restructuring has to go along simultaneously with a corporate restructuring, but the restructuring of domestic corporations and domestic manufacturing companies has not proceeded, so despite the infusion of a huge amount of public money, bank balances have not improved, because the distribution and construction companies who are the major borrowers from the banks have not restructured their operation. The financial sector itself has restructured, but its borrowers have not restructured their operations. And the Sonys and Toyotas do not borrow from the banks; they borrow from the global markets, so our banks' health will only be restored when their borrowers' restructuring is complete. That is where we are heading at this moment: direct disposal of non-performing assets by the banks. Who will force those borrowers to restructure, to declare bankruptcy? And that is what we need. In the process of this restructuring of the borrowers, we may have some mini-financial crisis again. We may need another round of infusion of public money.

INTERVIEWER: But you don't see financial panic?

EISUKE SAKAKIBARA: Aha! Well, a financial crisis is possible, but we have ways to avoid that through an infusion of public money.

The Globalization of Japan, Again

INTERVIEWER: You talked about how Japan has changed before. Is globalization like the arrival of Admiral Perry [Admiral Matthew C. Perry, sent to Japan by American president

Millard Fillmore in 1853 to demand the end of isolation and opening of trade to the West in Japan]? What is the impact of globalization on Japan? I mean, clearly you see it differently from most Japanese.

EISUKE SAKAKIBARA: This is going to be the third or fourth opening of the Japanese economy and society to the world. Japan is a very parochial and a very closed economy. There's no question about it; it's a very closed society. Walk around the Japanese cities, you don't see many foreigners. It's quite different from New York, London, or Kuala Lumpur or Singapore. We are mono-culture, mono-racial. We need to change. We need to change our immigration laws, for example; we need to change our nationalization laws. We need to become global. This is absolutely necessary for Japan. We need to open our economy and our society as well. We need to open our educational system. This is an absolute must for Japan in the coming decade or two.

INTERVIEWER: What do you say to the Japanese who say, "We have a great society; why do we need a change?"

EISUKE SAKAKIBARA: We have built a great society, but success breeds failure, so unless you constantly change your society and your economy, you are doomed to fail, eventually. We have created a very successful modern economy. We had a major success in the early 20th century, too, but because of that success, we had a miserable defeat in World War II. We succeeded quite dramatically after the war during the high growth period, but now that success is a problem. That success is now breeding failure, so we've got to change. You've got to change to create another success.