Symposium on Building the Financial System of the 21st Century:
An Agenda for Japan and the United States
Kyoto, Japan • June 25-27, 1999

Agenda

Friday, June 25, 1999

18:30 - Cocktail Reception in Swan room, B1, at Kyoto International Conference Hall (KICH)

19:00 - Greetings by Amb. Hisashi Owada, JIIA and Prof. Hal Scott and Robin Radin, PIFS
Dinner in Sakura room, BI, at KICH

20:20 - 21:00 **Keynote Address*:* Mr. Eisuke Sakakibara, Vice Minister of Finance for International Affairs, Ministry of Finance**

21:00 – 21:15 Meeting of Facilitators and Reporters in lounge

Saturday, June 26, 1999

7:00 - 8:30 *Breakfast at Takaragaike Prince Hotel*
Optional meeting for Facilitators and Reporters at reserved tables in Hiei room

8:30 - 8:40 **Welcome & Opening Remarks: Mr. Toshiro Ozawa, JIIA and Prof. Hal Scott, HLS**,
Room D, KICH

8:40 - 9:00 **Session 1: Changing Conditions in the Global Financial System**, Room D
Japanese Panelist: Yoshio Okubo, Deputy Vice Minister for International Affairs, Ministry of Finance
U.S. Panelist: Arthur M. Mitchell III, Partner, Coudert Brothers

9:05 - 10:30 Small Group Sessions 1-5

Group 1, Room G	Facilitators:	Masaru Yoshitomi & Arthur Mitchell	Reporter: Hal Scott
Group 2, Room H	Facilitators:	Mikio Wakatsuki & Thierry Porte	Reporter: Robin Radin
Group 3, Room I	Facilitators:	Toyoo Gyohten & David Asher	Reporter: Philip Wellons
Group 4, Room J	Facilitators:	Chikashi Moriguchi & Alicia Ogawa	Reporter: Peter McKillop
Group 5, Room K	Facilitators:	Masaru Tanaka & Henry Laurence	Reporter: Christopher Wells

10:30 - 10:50 *Refreshment Break*

10:50 - 11:10 **Session 2: Financing Retirement in Aging Societies: Japan and the U.S.,** Room D
Japanese Panelist: Noboru Terada, Executive Director, Pension Fund Association
U.S. Panelist: Kathy Matsui, Chief Strategist and Managing Director, Goldman Sachs Japan, Ltd.

11:15 - 12:20 Small Group Sessions 1-5

Group 1, Room G	Facilitators:	Toru Nakakita & William Hunt	Reporter: Hal Scott
Group 2, Room H	Facilitators:	Kunio Hamada & Cliff Shaw	Reporter: Robin Radin
Group 3, Room I	Facilitators:	Takatoshi Ito & Roger Servison	Reporter: Philip Wellons
Group 4, Room J	Facilitators:	Yoshihide Kimura & Ayako Weissman	Reporter: Peter McKillop
Group 5, Room K	Facilitators:	Noriyuki Takayama & Donald Kanak	Reporter: Christopher Wells

12:30 - 14:00 *Lunch in Swan room*
Keynote Address: His Excellency Thomas Foley, Ambassador Extraordinary and Plenipotentiary of the United States of America to Japan
Remarks: Yuji Tsushima, Member of the House of Representatives

14:00 - 14:20 **Session 3: Globalism, Regionalism, Localism: Coexistence, Conflict, Convergence,** Room D
Japanese Panelist: Toyoo Gyohten, Institute for International Monetary Affairs
U.S. Panelist: Hal Scott, Harvard Law School

14:25 - 15:15 Small Group Sessions 1-5

Group 1, Room G	Facilitators: Toru Kusukawa & Kent Calder	Reporter: Hal Scott
Group 2, Room H	Facilitators: Yasuharu Nagashima & Tom Cargill	Reporter: Robin Radin
Group 3, Room I	Facilitators: Naoki Tabata & Nick Kristof	Reporter: Philip Wellons
Group 4, Room J	Facilitators: Koji Ito & Norman Scott	Reporter: Peter McKillop
Group 5, Room K	Facilitators: Akira Kojima &Akira Ariyoshi	Reporter: Christopher Wells

15:45 – 18:45 Kyoto Cultural Excursion, Tour of Nomura Villa and Nanzenji
(Please assemble in the lobby of the Takaragaike Prince Hotel by 15:45)

19:00 - Dinner at Ryotei "Takeshigero"

Sunday, June 27, 1999

7:00 - 9:00 Breakfast at Takaragaike Hotel
7:30 - 9:00 Breakfast Meeting of Discussion Chairmen and Steering Committee (Reserved Table at Beaux Sejours)

9:00 - 9:40 **Presentation and Discussion of Session 1: Changing Conditions in the Global Financial System**, Room D, KICH
Japanese Chairman: Mitsuhiro Fukao, Professor, Keio University
U.S. Chairman: Thierry Porté, President, Morgan Stanley Japan, Ltd.
Reporter: Robin Radin, Harvard Law School

9:40 - 9:55 Refreshment Break

9:55 - 10:35 **Presentation and Discussion of Session 2: Financing Retirement in Aging Societies: Japan and the U.S.**
Japanese Chairman: Noriyuki Takayama, Professor, Hitotsubashi University
U.S. Chairman: Marshall Carter, Chairman and Chief Executive Officer, State Street Corporation
Reporter: Christopher Wells, White and Case

10:35 - 10:50 Refreshment Break

10:50 - 11:30 **Presentation and Discussion of Session 3: Globalism, Regionalism, Localism: Coexistence, Conflict, Convergence**
Japanese Chairman: Mikio Wakatsuki, Chairman of the Board of Counselors, The Japan Research Institute, Limited
U.S. Chairman: David Hale, Chief Economist, Zurich Financial Services
Reporter: Hal Scott, Harvard Law School

12:00 - 13:30 Lunch in Swan room

REPORT: 1999 Symposium on Building the Financial System of the 21st Century: An Agenda for Japan and the United States, Kyoto, Japan

The second Symposium was held from the evening of Friday, June 25 to noon on June 27, 1999 at the Kyoto International Conference Hall in Kyoto, Japan. It was organized by the Harvard Law School Program on International Financial Systems and the Japan Institute of International Affairs. The Japanese financial system had begun to emerge from its crisis with the recapitalization of the Japanese banks and continued reform of the regulatory system. There was hope that Japan had begun to turn the corner toward more general economic recovery combined with concern over the increased role of the Japanese government in the economy. The international financial system was in the process of responding to the lessons of the 1998 Asian financial crisis through the spawning of the new International Financial Architecture.

The Symposium brought together more than 80 senior government policy makers, academics, legal experts and bankers to discuss three issues: (1) Changing Conditions in the Global Financial System which focused on Recovery and Reform in Japan; (2) Financing Retirement in Aging Societies: Japan and the U.S.; and (3) Globalism, Regionalism, Localism: Coexistence, Conflict, Convergence which focused on the International Financial Architecture. The complete list of participants is in Annex I. There were two off the record keynote addresses, one by the United States Ambassador to Japan, Thomas Foley, and the other by Eisuke Sakakibara, Japan's Vice Minister of Finance for International Affairs.

On Saturday, the three issues were discussed in five small group sessions after agenda setting introductions by one panelist from each country. Each small group session was led by a U.S. and a Japanese facilitator, and one of the participants served as a reporter. The results of these discussions were presented to the Plenary Session on Sunday. The results were commented on by panelists and then considered by the group as a whole. We have included in Annex I written versions of presentations made by some of the speakers: (1) Mitsuhiro Fukao, *Recapitalizing Japan's Banks: The Functions and Problems of Financial Revitalization Act and Bank Recapitalization Act*; (2) Arthur M. Mitchell, *Remarks*; (3) Kathy Matsui, *Demographic Tsunami: Catalyst for Shareholder Capitalism*; and (4) Yoshio Okubo, *Changing Conditions in the Global Financial System*. In addition, a number of concept papers were prepared by participants. See Annex II.

This Report combines a discussion of conclusions reached in the small group sessions on Saturday and the discussion of those issues in the Plenary Session on Sunday.

I. Recovery and Reform in Japan

Notwithstanding the planned agenda to survey the changing conditions of the global financial system in this session, actual discussion came to focus almost exclusively on a critical assessment of the remaining challenges of Big Bang and banking system reforms in Japan and the arguably positive or negative linkage between completing these reforms and stimulating macro economic recovery. This shift from global concerns to those relating to Japan, it was noted, reflected the recognition that the globalization of financial markets now means that the entire risk structure of the global economy is potentially tied to the conditions of one regional or even local economy, and particularly one of such great importance as Japan's.

From Financial to Debt Crisis

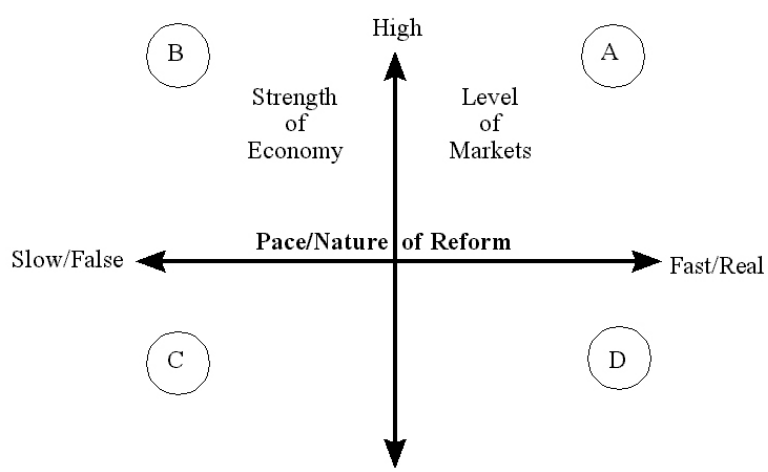
The overarching theme of discussion on Japan in this session concerned the implications of how a private sector financial crisis, which had dominated attention at the time of the last Symposium in June 1998, had been replaced by an equally serious public sector debt crisis one year later. Earlier fears of a banking sector meltdown had been substantially resolved through a program of large capital infusions and outright bank takeovers by the government. However, the accumulation of public debt through these and other extraordinary expenditures, including, massive fiscal stimulus initiatives, unprofitable Fiscal Investment Loan Program (FILP) investments, small business loan and loan guarantee programs, as well as the escalating burden of servicing government bonds, created new concerns about the soundness of economic management and about the potential abandonment or slowdown of needed reforms. While fiscal stimulus and costly safety net measures were recognized as important for economic recovery, the expanding role of government in the banking system, the labor market, the small and medium size business credit markets, among other areas of increasing government intrusion, raised questions about whether the government had a plan of how and when to phase out its increasing role in the economy, once the economy began to recover.

Financial Reform versus Macro Recovery: The Sequence and Pace of Pursuing Policy Imperatives

The apparent policy conflict between pushing macro-economic recovery on the one hand and pushing structural reform on the other was the focus of much discussion. Some participants cautioned that Japan avoid pursuing American style reform, when the US has produced a bubble that could burst at any time with disastrous consequences. Others strongly rejected this view, arguing that this was not a philosophical battle between Japanese and American styles or models. The proposed reforms involve increased transparency, disclosure, management accountability for ROE, all of which are becoming global standards, not just American. In this view, to neglect such standards would sap Japan's economic vitality and foster a decline in Japan's standard of living. While reform might be costly to economic performance and social stability in the short term, the long-term benefits would more than justify the trouble, it was also argued.

The causal interplay between the pace and nature of financial reform and the strength and weakness of the economy returned as a topic of discussion taken up at the previous Symposium. The reintroduction of the matrix (set forth below)

JAPAN IN CRISIS
Big Bang Scenario Matrix



gave participants an opportunity to compare Japan's position in mid-1999 with its position in mid-1998. Most participants saw constructive movement, but debated the direction of change: from lower left (quadrant C) up (towards quadrant B), across (to quadrant D) or diagonally up (to quadrant A). No consensus emerged. In one view, the sequence of reform should no longer be an issue for discussion this late in the game. That it still is may be a matter of concern.

Participants also discussed the appropriate speed of reform. One view was that Japan could not afford to wait, since slowing down now would undermine the effectiveness of reforms already undertaken. Another view was more qualified. Japan, it was argued, was not structured for speedy reform. For example, the cross-shareholding system continued to function in a way that eliminated or at least moderated pressure on corporate management to raise earnings as a priority. The emergence of a full-fledged disclosure-based system of securities regulation also had to wait for the completion of expected reforms in the accounting system. Fixing such problems would inevitably take time. But, as many stressed, it was essential to move quickly to change practices, policies and institutions that continued to damage efficiency and frustrate the operation of market mechanisms.

Promoting Market Mechanisms

Although concern was expressed about the need to pursue reform without abusing essential Japanese traditions, history and culture, participants seemed to agree that the restoration of economic dynamism in Japan would require the further promotion of market mechanisms in ways that would involve significant change to existing institutions and practices. Particular focus was given to the following areas:

Postal Savings System. Substantial concern was raised about the damaging impact of the postal savings system on the development of a free, fair and global financial system in Japan. Together with the FILP program, in this view, the postal savings regime crowds out the private sector, hinders development of the capital markets and distorts price formation. Despite the Big Bang liberalization program, or perhaps because of it, postal savings (and the FILP) have reported high growth in their assets. This misallocates savings and complicates the government's guarantee system. Reform of the postal savings leviathan is problematic, because it is (metaphorically) the "third rail" of Japan's financial system, so sensitive politically that if you touch it, you may die. For that reason, the government had so far made only modest adjustments to the system, such as closing off FILP access to postal saving life insurance funds. Meanwhile, consideration of system privatization has been delayed. As one participant noted, perhaps this delay is wise, since a private system would be an even more terrifying competitor for other financial institutions. As long as the government owns this monster, it is in a position to control it. In this light, restructuring the system, rather than privatizing it, may be a better course, it was suggested.

Banking System Reforms. Some participants questioned why the market mechanism had been avoided in the process of rehabilitating the banking system. Banks had been recapitalized with virtually no conditions, except to relend to small business with government guarantees; the RCC has chosen collection, rather than bulk sales or securitizations, as the means of bad asset disposition. The message was that the government should move fast to privatize banks it holds to ensure that no zombie banks remain. And it should handle the disposition of LTCB and NCB in a fair and open manner. "The world is watching how the government deals with these cases," said one participant, suggesting that the cases are a litmus test of the government's commitment to market principles. Others suggested that the real test would be the government's adherence to the April 1, 2001 date for lifting the unlimited guarantee on bank deposits. Any postponement would be highly adverse to both the substance and spirit of Big Bang, it was argued.

Stimulating Equity Markets. Achieving the economic benefits of a liquid, transparent and accessible equity market would require important changes in current market institutions and behavior. Participants highlighted the following:

- to bring alienated consumers back to the market will require a display of strict regulatory discipline to support new confidence in a fair market environment.
- both consumers and intermediaries need reeducation to equip them to handle the opportunities and risks of a newly diversified product and service market.
- corporate management needs to be reoriented to prioritize shareholder value by activating the corporate governance mechanisms of accountability.
- cross-shareholdings need to be substantially reduced to provide the liquidity, depth and transparency that a robust equity market requires.

Fostering Entrepreneurship. Japan has a strikingly weak infrastructure for encouraging entrepreneurship, participants noted. Bank credit standards, exchange listing and IPO standards, as well as the prevailing merit based regulatory regime, have all reflected a traditional bias against supporting start-up and early stage companies. Alternative channels for risk capital have also been extremely inadequate, discouraged by, among other things, the lack of exit mechanisms for investors. Participants urged that these deficiencies, perhaps starting with improvement of over-the-counter IPO facilities, be promptly overcome in order to promote new sources of economic growth. In this light, the NASDAQ-Sofbank initiative seems to be very encouraging, some remarked.

M&A and the Acceptance of Foreign Capital. The removal of remaining legal, institutional and cultural impediments to M&A will make a strong contribution to vitalizing Japan's economy, it was argued. Some encouraging developments can be found, including a new bankruptcy law for small and medium sized companies, the introduction of clear debt-for-equity swap mechanisms, new legislation to facilitate minority buy-outs, and flexible enforcement of anti-monopoly laws in mergers. But more needs to be done to stimulate the kind of active market for corporate control that will attract significant foreign direct investment, and promote an internal economic dynamic to strengthen management culture and raise equity returns.

Managing the Social Consequences of Change

Financial system reforms and related economic structural changes have brought about rising unemployment and other strains on the Japanese social fabric that expose the inadequacies of the existing social safety net, it was noted. While triggering some negative political reaction hostile to the pace and direction of reform, these developments have also led to new government initiatives designed to fortify social welfare provisions and anticipate the requirements of a changing economic environment. Government programs have begun to shift from traditional subsidies for job security to retraining programs of displaced workers in sunset industries. But the cost of these programs, which are likely to expand as unemployment rises, will place additional burdens on an already heavily indebted government and increase its scope of economic intervention. Again, questions were raised about how the government will be able to withdraw from the private economy, when its intervention is no longer justified by crisis.

Robin Radin

II. Financing Retirement in Aging Societies

The initial panel presentations stressed that the challenge of financing retirement in aging societies is greater in Japan than the United States because of (a) the far more rapid rate at which the Japanese population is aging, (b) the lower level of investment income growth resulting from Japan's poor domestic economic performance, and (c) other demographic considerations. Discussion generally concentrated on the issue in Japan, reflecting perhaps the general view that the scope of the challenge there was on a greater scale than in the United States.

As for Japan, six themes were considered: (1) the existence of a crisis; (2) how to balance between public and private pension schemes in addressing the problem; (3) the desired source of retirement benefits; (4) the selection between equity and fixed income sources for funding retirement benefits; (5) social phenomena which are creating challenges to the Japanese pension system; and (6) the general question of pension management reform. Each of these themes is summarized in the discussion below.

The plenary discussion revealed little basic disagreement among the participants about the challenge to Japan, although participants differed regarding the urgency and scope of the challenge. In general, Japanese participants stressed that there was still plenty of time to address the relevant issues, noting that the high savings rate in Japan allowed for a variety of approaches and solutions. U.S. participants, on the other hand, stressed the need for Japanese political and bureaucratic groups to address the issues more forcefully in the near term.

Is There A Crisis?

On the question of whether a crisis in fact exists, many Japanese participants felt that “crisis” was probably too strong a depiction of the challenge to Japan. These participants noted that Japan had an extraordinarily high rate of savings and that many Japanese had several “pots of monetary savings” from which they could draw to meet any retirement need. Others noted that most Japanese in retirement could reasonably expect assistance from family members and that such assistance could predictably be expected given the strong family bond and reciprocal sense of obligation between parents and children in Japanese society.

Other participants noted that Japanese in retirement consume considerably less than during their working years (when children’s education, acquisition of a home, etc. are priorities). Others were confident that a recovery in the economic growth rate would more than assure a stable level of retirement savings. Most noted that few Japanese families expect that they can rely entirely on the social security system (<u>kosei</u> <u>nenkin</u> <u>seido</u>) to fund their retirement, and that most have made some alternative provision for these eventualities.

United States participants expressed concern that unless the “macro growth rate” increased substantially in Japan during the next several years, the size of the hole in public and private pensions systems would grow beyond the ability of the government and private sectors to provide a remedy without extraordinary social and economic disruption. They noted that both public (<u>kosei</u> <u>nenkin</u> and <u>kokumin</u> <u>nenkin</u> <u>kikin</u>) and private (<u>tekikaku</u> <u>nenkin</u> and balance sheet reserve) pension systems were considerably underfunded and that considerable social dislocation could be expected when the scope of these problems becomes public due to anticipated accounting changes. They also noted that many Japanese employees and self-employed persons in fact were not participating in mandatory social pension systems such as <u>kosei</u> <u>nenkin</u> and <u>kokumin</u> <u>nenkin</u> <u>kikin</u> (for the self-employed).

Both Japanese and United States participants agreed that the scope of the underfunding challenge could be met by thoughtful governmental policies so long as they were promptly implemented. It was noted that the anticipated trend towards "disintermediation" whereby existing bank savings (for which risk is highly concentrated and systemic in character) would be channeled into collective investment products in the form of pension and mutual funds would be one approach to solving this problem.

Restructuring the Balance Between Public and Private Pension Schemes

Concerning the issue of adjusting the balance between public and private pension schemes, it was observed by both Japanese and United States participants that without exceptional economic performance in the Japanese economy or in Yen adjusted returns from outside Japan, public sector pension plans will be unable to meet their promised benefit payments as Japan's "baby boomers" (born during the 1950s) mature. It was observed that the scope of this underfunding problem would become clear in greater detail during the first decade of the 21st Century.

Among the possible solutions to the underfunding challenge noted by participants was the possibility of the reduction of benefits in programs such as kosei nenkin, Japan's social security system. Several participants indicated that while such adjustments might help address the overall government plan funding challenge, such programs, even where not reduced, are clearly insufficient to meet the daily needs of Japanese pensioners. All participants in such programs will need other means to address their retirement needs.

Another alternative suggested by several participants, and widely discussed in the Japanese press in recent years, is the possibility of providing for later retirement by Japanese workers. Many participants noted that this was, in fact, consistent not only with pension funding needs, but also with the desires of the pensioners themselves who often feel that they are being retired just when they can be most productive. However, others noted that lengthening the tenure of senior workers could result in perpetuating the existing approach to economic development, an approach that has clearly become outmoded.

Finally, there was also considerable discussion about the relatively radical idea of shifting "cross-holding" of corporate shares among industrial groups to corporate pension plans in order to increase pension fund assets and preserve existing relationships among individual members of these industrial groups. The views on the efficacy of this approach were widely divided. A number of participants noted that the evils of "cross-shareholding" were widely evident in Japan's economy and that shifting such shareholding to pensions would only further the decline in Japan's economic competitiveness. Others argued that it might be beneficial if Japanese companies, under the pressure of having to divest cross-shareholdings because of contingent liabilities associated with pension obligations, transferred such interests to "group" pension plans. This might result in a higher public float for Japanese companies (desirable in its own right) if the pension plans did not blindly hold the stock but managed their investments according to principles of fiduciary duty. There were also a few participants who argued that "cross-shareholdings" were not a problem, and thus their transfer to pension plans was not a meaningful solution to Japan's social and retirement challenges.

Sources of Retirement Benefits

On the issue of the anticipated sources for the funding of retirement benefits, a detailed discussion of the alternative funding paradigms was carried on in the small group sessions. One key question was the mix of public and private sector programs in generating sufficient returns to maintain existing programs.

Government sector Japanese participants noted that it was unclear that reinvesting through private sector vehicles would ensure the required levels of return. Moreover, because of exchange rate volatility, public sector investment abroad to achieve desired returns could result in an increased exposure to risk without sufficient levels of return to justify such exposures. These participants, together with some United States participants, argued in favor of transferring responsibilities for pensions increasingly to the private sector.

With respect to private sector pension possibilities, several Japanese and United States participants noted that the Big Bang placed increasing emphasis on the concept of "self-responsibility" on the part of employees for private pension returns, and that this concept appeared to be a cornerstone of the proposed "defined contribution" pension system. However, many participants expressed uncertainty as to whether the Japanese workforce was ready for a "self-responsibility" system in the retirement pension area. A number of participants pointed to the overriding issues with respect to the underfunding of corporate pensions, noting that if the relevant contingent liabilities were fully disclosed and accounted for many of Japan's major companies would be rendered insolvent on a balance sheet basis.

It was noted by many participants that shifting responsibility for investing in retirement savings would help ensure a sufficient retirement would merely take the problem out of the hands of professional asset managers and place it in the hands of relative novices (Japanese workers). Some more cynical participants commented that the only real point of the Japanese "401-K" system was to be sure that Japanese corporate and public sector asset managers would not lose their jobs on the basis of almost complete incompetence.

Finally, with respect to the question of how to fund public pension benefits, a number of participants commented on the "dark secret" of the grossly inadequate funding for Japan's kosei nenkin "social security" system. These participants insisted that increasingly policy-makers would have no choice but to either: (i) materially reduce the promised level of benefits; or (ii) increase taxes or required contributions to pay for the benefits. Several participants noted that the issue of contributions was particularly difficult because, in view of the rapidly aging workforce, in future years the tax/contribution burden on younger workers would be particularly heavy and socially unacceptable. They noted that these issues were at the center of the massive legislative controversy brewing in the Diet over Japan's pension reform bill.

Equity Versus Fixed Income Alternatives

There was general agreement among United States and Japanese participants that investors remained cautious about investment in the Japanese stock market. It was noted that this market remained predominantly an institutional market and that individual participation in the market remained at historic lows. It was also recognized that a major paradigm shift and public investor education effort was required in order to turn Japan from a nation of savers to a nation of investors.

With respect to whether equity or fixed income investments would be the most appropriate for retirement savings by investors in Japan, there was no consensus. A number of participants stressed the immaturity of Japan's equity capital markets and their tendency to follow speculative rather than value oriented trends. Japanese participants reflected the strong conservatism of the general Japanese population in emphasizing the desirability of investing retirement savings in national, prefectural and corporate fixed income securities.

A number of commentators suggested that the success of the U.S. model in recent years, predominant investment in equities, was a passing phenomenon and that the U.S.'s "equity bubble" would, in bursting, bring disillusionment (or loss of faith in equity securities) similar to that which followed the collapse of Japan's bubble economy. These commentators pointed to the irrationality of the sky-high pricing for internet securities and suggested that such prices reflected "return fantasies" among investors in the United States equity markets. There was a strong sentiment that United States policymakers were being unrealistic in believing that United States equity valuations could continue at current levels. Consequently, it was suggested that many United States participants were inappropriately biased in favor of an equity side investment model for retirement savings. Certain Japanese participants were confident that they would be able in future years to point to the naiveté of their United States counterparts and that a predominantly fixed income oriented security model for retirement savings would be found to be the best and safest for retirement savings.

Finally, several commentators stressed the importance of efforts on all fronts, by government policymakers, regulators, financial intermediaries and individual investor groups, to promote individual investor education in the emerging investor self-responsibility investment system. If was noted that basic education as to investment including valuation, portfolio theory, and risk diversification would be required if the new approach to retirement savings would succeed. A variety of views were expressed as to how this might be accomplished from use of the internet to grass-roots investments clubs. Nevertheless, there was an overall consensus that the challenge would be great, but that the longer term benefits justified the proposed effort.

Challenges to the Pension System: Social Phenomenon

One significant undercurrent throughout the conference was the emerging social independence of Japanese women in 21st Century Japan and their pivotal role in addressing the problem of financing retirement in aging societies. The issues discussed in this connection were:

- the inclusion generally of women in the workforce;
- the timing and regularity of the re-entry of women into the workforce following their child-bearing years;
- the general low level of fertility among Japanese women;
- social perceptions regarding motherhood and its importance to Japanese society;
- the delay in having children evident among Japanese women during the past two decades;
- the perceived inequality of opportunity for Japanese women in corporate Japan and the resulting disincentives to re-entry into the workforce in later years.

An additional consideration mentioned by several participants was the question of Japanese immigration policy as it relates to the question of social change, fertility and supplementing the workforce. Unfortunately, because of time and other constraints, insufficient attention was given to this difficult question. However, most Japanese participants acknowledged that it was an extremely sensitive social and political issue.

Pension Management Reform

On the final theme of pension management reform, several sub-themes were developed, among which were (1) the question of measuring portfolio performance to ensure transparency in the consideration by investors of management capability; (2) the general question of corporate governance as it affects performance measurement for Japanese enterprises in which public and private sector participants invest; and (3) the general issue of regulatory enforcement to ensure transparency and management accountability.

It was observed by several participants that significant advances had been made in the past several years in the objective performance evaluation of public sector pension management and that the destruction of public sector pension participant value through MOF ill-inspired "price keeping operations" was largely a phenomenon of the past. It was accepted that public sector investment sacrifices for policy purposes had, with the reform of MOF, become more limited. However, it was also noted that in the private sector considerable non-transparency remained and that efforts were needed to enable individual investors to compare "apples with apples" in the selection of collective investment pension products.

Another theme developed on this topic was the question of reforming corporate governance in Japanese corporations and ensuring that the financial information which companies provide to public investors appropriately reflects material factors affecting share values. From this question also emerged the issue of whether the entire corporate regulatory system was adequate to discipline corporate management and to promote Japanese corporate performance.

Finally, the overall role of Japanese regulators in evaluating and disciplining financial intermediaries and corporate Board of Directors was raised. Unfortunately, there was by and large insufficient time to delve deeply into this question. It was noted, however, that compliance review by Japanese regulators had been strongly enhanced with the advent of the Big

Bang and that this would likely continue. It was suggested that after cleaning up the problems with financial intermediaries, attention might be turned to the broader question of corporate governance, shareholder value and corporate performance and, eventually, to the reform of public sector institutions such as the postal savings system.

Conclusions

In summary, Japanese participants appeared somewhat more optimistic that their United States counterparts about the ability of the Japanese government, Japanese industry and Japanese society to address the challenges posed by financing retirement in its aging society. These participants felt that Japan was well on the way to addressing the relevant concerns and that the combination of (1) the resilience of Japanese industry and the Japanese people; (2) the massive pools of savings built up by Japanese workers, and (3) the anticipated recovery in the Japanese economy and general economic reform would help ensure that the Japanese retirement system would meet citizen expectations. United States participants continued to express doubts about these sanguine predictions and continued to express concern about the fragility of the overall financial and economic system in Japan. On balance, both groups agreed to the need for a continued dialog and attention to the overall retirement funding problem.

Christopher Wells

III. International Financial Architecture (IFA)

This session focused on various proposals and plans for reforming the international financial system (IFA) put forward in the wake of the 1998 Asian Crisis. There seemed to be a general recognition that the subject of IFA was now important since the G7 proposals were becoming more concrete and moving beyond the talking stage to implementation.

Given the close connection between the Asian financial crisis and the development of IFA, there was discussion of the extent to which poorly managed financial systems played a role in the crisis. No real conclusions were reached. Some believed international markets and institutions were more important than domestic government policy in the financial sector. In the course of this discussion, many participants expressed a concern with the volatility of prices in the financial system. For example, the Emperor's palace in Tokyo was worth more than the state of California in the 1980s, then fell to the value of Indiana in the early 1990s, and had since declined to the value of Arkansas.

Discussion of IFA generally focused on three areas: (1) whether the IFA should recognize the validity of an Asian Way; (2) the difficulties of formulating and enforcing banking standards; and (3) the role of market discipline.

The Asian Way

The Asian Way discussion raised the possibility that financial systems should be dealt with differently in Asia than elsewhere. Some argued that supervisory officials should rely more on guidance than regulation, following the Japanese model. Others contended that the Japanese model was outmoded and being superseded in Japan and elsewhere because guidance had not worked. Some believed that transparency, a pillar of IFA, would not work in Asia due to the lack of a disclosure culture. Others contended that this culture, to the extent it really existed, should be changed by encouraging the adoption of international accounting standards and the adoption of rigorous disclosure standards for public companies. Without transparency, market discipline would be ineffective.

There was substantial discussion about the desirability of capital controls in light of the experience of the Asian crisis. Some argued that inward capital controls might have avoided excessive reliance on short-term funding in foreign currencies, for example, possibly in South Korea, and might avoid outward flows once a crisis appears, as may have been the case in Malaysia. Others argued that optimal short-term capital flows could be better achieved by making lenders hold adequate capital against the risk of default and by minimizing IMF bailouts. Many questioned whether capital controls of any kind could be effective—citing a history of avoidance—and worried about the future costs, capital flight and lending premiums.

Many believed that the IFA had made insufficient provision for the role of regional organizations like APEC. While there might not be an Asian Way, they contended that IFA standards might have to be adopted to regional conditions, and that regional organizations were in the best position to understand these conditions. Others were concerned that regional organizations might dilute standards, and that the real differences among countries which might necessitate different treatment were related more to stages of development than to geographical placement.

International Banking Standards

The second major topic of discussion was banking standards as exemplified by the Basle Committee's Core Principles. It was generally agreed by all that effective banking supervision is a key to avoiding regional and global crisis. As in the Asian Way discussion, there was significant disagreement as to whether there should be just global standards or multi-tiered standards based on stage of development or geography. Some commented that banking regulation requirements could be easily avoided as demonstrated by the CS First Boston case in Japan where CS First Boston allegedly aided Japanese financial institutions in covering up the extent of their bad loans.

In the plenary session, there seemed to be general agreement that the global financial system generally required global standards and global monitoring of standards by an international institution, most likely the IMF. There was also agreement on the proposition that any enforcement of global standards should be by sovereigns and not by multilateral institutions like the IMF and that countries should be given time to adjust to the new global standards.

There was disagreement over whether there should be different standards for developed and developing countries, although this would be less of a problem if global standards themselves took into account the views of all countries, as may have been the case with the IOSCO disclosure standards. There was significant opposition to regional approaches. It was not likely, for example, that Japanese taxpayers would fund Japanese surveillance and enforcement of Asia standards.

Market Discipline

Finally, there was discussion of the role of market discipline. Discussants recognized that transparency was a key requirement for market discipline to work and that the moral hazard created by IMF and national bailouts would have to be minimized. For most participants, market discipline was not an alternative to regulation. Most believed that strong markets, the agents of discipline, could only exist with strong regulation.

Participants agreed that markets needed effective regulation. Some argued that a global system requires strong supervision of financial conglomerates and highly leverage institutions. Some proposed that all supervisors should conduct on-site examinations of financial institutions.

Hal S. Scott

Lead Sponsors

JAPANESE BANKERS ASSOCIATION

•

STATE STREET CORPORATION

Sponsors

AMERICAN INTERNATIONAL GROUP COMPANIES

•

THE CHASE MANHATTAN FOUNDATION

•

FIDELITY INVESTMENTS

•

LEHMAN BROTHERS JAPAN INC.

•

MERRILL LYNCH JAPAN SECURITIES COMPANY, LIMITED

•

MORGAN STANLEY DEAN WITTER JAPAN LTD.

•

THE NOMURA SECURITIES COMPANY, LIMITED

•

THE TOKIO MARINE AND FIRE INSURANCE COMPANY, LIMITED

•

THE YASUDA FIRE AND MARINE INSURANCE COMPANY, LIMITED