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In this issue:

- **Yen/Dollar --The Strong Wind of Appreciation**
- **Do Economic Statistics Adequately Reflect the Size of the Asian Economies?**
- **Long Live the Asian Bond Market!**
- **India's Role in Central Asia**

Business

- **When Free Trade Went on Siesta: The WTO Cancun Trade Talks**
- **Part II - "Zaibatsu" and "Keiretsu" - Understanding Japanese Enterprise Groups**
- **China: the "New Japan" of Trade Policy?**

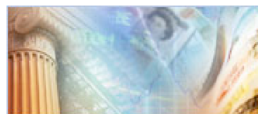
Emerging Market Briefs: Bahamas, Dominican Republic, Indonesia, Mexico, Philippines, Thailand

Book Review: Saving the Sun: A Wall Street Gamble to Rescue Japan from Its Trillion-Dollar Meltdown

Media Highlights

(full-text Advisor below, or click on title for single article window)

(**complete Advisor in PDF format - 1mb**)



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Yen/Dollar --The Strong Wind of Appreciation

By Scott B. MacDonald

A major adjustment is underway in the global economy -- the yen is on track for a gradual appreciation vis-à-vis the US dollar. This is a trend that is likely to continue into next year and has clear implications for helping the United States deal with one of its major problems -- a large current account balance of payments deficit that is expected to come in a little over 5% of GDP in 2003.

Although there are arguments to be made as to why the yen will not be allowed to appreciate, the arguments for such a development loom far larger. Some of the factors for yen appreciation are economic and some are political.

The September 2003 Dubai G-7 summit focused on foreign exchange, with the United States and the European Union looking at China (not part of the G-7) and Japan as well as other Asian countries to appreciate their currencies. The concern is that if global economic recovery is going to take place (and that means having sustainable growth in the U.S. and Europe), a number of Asian countries need to let their currencies adjust to market conditions – i.e. undergo an appreciation due to their relatively strong economic performance, much of it based on export expansion. This in theory should make trade competition fairer for various industrial sectors in the United States and Europe.

Over the last few years, the U.S. economy has been the mainstay of the global economy, willing and able -- though helped by a heavy dose of borrowing -- to buy a tsunami wave of foreign goods from China, Japan, Korea and Taiwan. While helping to keep the global economy afloat during tough times, this support of foreign exporters has come at a cost of employment in the United States (at least this is one of the popular arguments). Job loss in the United States is now a major political issue, in particular, the 2.7 million lost in the manufacturing sector over the last three years. Consequently, the Bush administration prefers a weaker dollar and a stronger yen and yuan due to (1) the pressing need to correct the massive current account deficit; (2) the need to reduce unemployment which could be helped by a potential boost to the export sector; and (3) the need to show that President Bush is tough in dealing with issues central to the common working man as in protecting job losses through currency devaluation (as well as protectionism). Bush increasingly faces potential voter discontent, which

could complicate his bid for re-election in November 2004.

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All of the above puts considerable pressure on the yen to appreciate. We see the natural progression from yen 115/dollar to yen 110 and eventually in 2004, to 100. But economics is not without politics. If the yen goes too quickly to 100 to the dollar, it would be a major negative for Japan's export sector, in particular, autos and heavy machinery. Thus far in 2003, the Bank of Japan has spent over $80 billion to slow any major appreciation of the yen. Y115 was for many months the benchmark around which the Bank of Japan intervened and today it has broken the 110 mark. G-7 pressure at Dubai as well as an improving Japanese economy changed this.

What is significant in Japan is that the domestic economy is now looking stronger and the dependence on the export sector has lessened. Real GDP growth for 2003 is well above last year's torpid pace and possibly could come in around 2%. Consequently, it is easier for Japan to let the yen appreciate – to a point. The last thing Prime Minister Junichiro Koizumi wants to see is a disorderly and volatile appreciation of the yen. This could choke off the economy's recovery and spook investors, especially as he plans on calling an election for the lower house sometime in November of this year. In addition, a rapidly strengthening yen could only give deflationary pressures a further push.

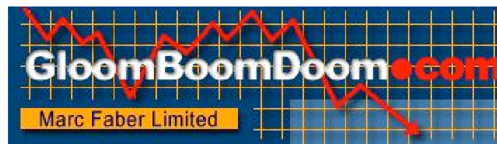
However, for all the efforts of the Bank of Japan to slow appreciation, there is considerable pressure for appreciation. As the perception of a Japanese economic recovery becomes more widespread, we expect that foreign investment will continue to be attracted to the Nikkei. Despite the recent slump the index remains far higher than the lows seen earlier this year. Indeed, according to the Tokyo Stock Exchange, net purchases of Japanese equities by foreign investors in the fiscal first half of the year came to Y6.02 trillion, the largest amount on record for any fiscal half. This was driven by growing expectations of an end to structural problems and hopes for stronger growth.

Another pressure for appreciation is Japan's trade and current account surpluses. As long as Japan's export companies continue to be so competitive, they will continue to suck dollars into the economy. More dollars means more pressure on the yen.

Taking all the various factors into consideration, in the short term we see the Bank of Japan struggling to keep the yen in a 110-112 range to the dollar, with a dose of tough talking, followed by intervention as the trend strengthens below the 110 mark. However, as the Japanese economy is likely to further signal a recovery, we expect that the yen could go to 105-7 by year-end. The bottom line in all of this is that Japan has a little more flexibility in terms of growth to give back a little to help deal with the U.S. current account deficit.

The excesses of the 1990s will require further adjustment in the 2000s. Foreign currencies will play a central role in that process and Japan's appreciation of the yen is part of the picture. An eventual appreciation of China's yuan would be another. By Japan moving first, it can now sit more comfortably in the chorus calling for an appreciation of the yuan. However, we do not see China's jumping on to the appreciation band wagon any time soon nor do we think that it would be smart policy move on the part of Beijing, considering the massive challenges that continue to dog that country's banking sector. These include huge bad loans and troubled state-owned enterprises. Instead, the yen will be further squeezed as the

global economy moves into 2004. Ironically, Washington and Europe's push for Asian currency appreciation has fallen much more on Japan, not China, the country where many of the lost 2.7 million manufacturing jobs have migrated.



Do Economic Statistics Adequately Reflect the Size of the Asian Economies?

By Marc Faber

Officially, the US has a GDP of about US$11 trillion, while China's GDP amounts to US$1.1 trillion and India's to about US$500 billion. Moreover, whereas the world's GDP stands at about US$32 trillion and the advanced economies have a combined GDP of US$25 trillion (G7: US$21 trillion), the emerging Asian economies (including China and India, but excluding Hong Kong, Japan, Singapore, South Korea, and Taiwan - countries that are classified as advanced economies) have a GDP of just US$2.2 trillion. However, if we look at some production figures, it becomes obvious that the US economy is nowhere near ten times as large as the Chinese economy or more than 20 times the size of India's GDP. Neither do the G7 countries have a GDP ten times larger than the emerging Asian countries.

According to The Economist's World in Figures 2003 directory, China ranks as the world's largest producer of cereals, meat, fruits, vegetables, rice, zinc, tin, and cotton. It is the world's second-largest producer of wheat, coarse grains, tea, lead, raw wool, major oil seeds, and coal, the world third-largest producer of aluminum and energy (measured in million tons of coal equivalent), and ranks between fourth and sixth in the production of sugar, copper, precious metals, and rubber. India ranks among the top three producers of cereals, fruits, vegetables, wheat, rice, sugar, tea (number one for the latter two), and cotton. Indonesia ranks among the top four producers of rice, coffee, cocoa, copper, tin, and rubber; while Thailand is the world's largest producer of rubber, and Vietnam the world's second-largest producer of coffee.

"So what?" some readers may think, since these are just commodities and thus are irrelevant in post-industrialized societies! However, if we consider that China is already the world's largest manufacturer of textiles, garments, footwear, steel, refrigerators, TVs, radios, toys, office products, and motorcycles, just to mention a few product lines, and if we then add the industrial production of Japan, Taiwan, South Korea, and India, we get a totally different picture of the size of the Asian economies than is suggested by statistics based purely on nominal GDP figures, which don't take into account the difference in the price level between different countries.

In fact, statisticians, in order to account for the fact that in some countries the price level is far lower than in the Western industrialized countries (such as is the case for most emerging economies), have calculated the GDP level based on purchasing power parities (PPP). And while I have some doubts about the methodology of PPP-adjusted GDP figures, it is nevertheless interesting to see how large the emerging economies are when based on this measurement.

Asia (including China, Japan, India, South Korea, Indonesia, Taiwan, Thailand, the Philippines, Pakistan, Bangladesh, Malaysia, Hong Kong, and Vietnam) has a PPP-adjusted GDP of US$14 trillion, which is 50% larger than the US's PPP-adjusted GDP of US$9.6 trillion. In fact, by this measurement, Asia, in which we should probably also include Central Asia, Australia and New

Zealand, as well as parts of Far East Russia, would be by far the world's largest economic bloc. And while, as just mentioned, I have some reservations about PPP adjustments, in general I think that it is fair to say that the PPP-adjusted figures reflect a far more realistic picture of the size and importance of the Asian economic bloc with its 3.6 billion people (61% of the world's population) than do the nominal GDP figures, which suggest that the US has a GDP ten times that of China.

One of the reasons why I have chosen to discuss the size of the Asian economies, their impact on commodity prices and on resource-based countries and basic companies aside is that if we compare the true size of Asia with the extremely low weighting some Asian countries have within the MSCI World Free Index, it becomes obvious that some big changes are likely to take place in future. The combined weighting of the entire Asian region with 3.6 billion people and the world's largest economic bloc is just 3.4% excluding Japan and 12.1% including Japan!

This low weighting of Asia compared to the US raises two important questions. Is Asia ex-Japan really worth around 5% of the world's entire market capitalization (5% would include shares, which at present cannot be bought by foreigners), and is the US worth 11 times the Asian market capitalization ex-Japan? I, for one, doubt it! This particularly because of the low price level in Asia compared to the US and also because of Asia's bulging foreign exchange reserves, which are approaching $ 2 trillion. Should the day come when Asians have more confidence in their own economic bloc (which I think will happen in the next few years), we could see a massive shift of assets from the US to Asia, with Asian financial assets and Asian currencies rising very strongly relative to US financial assets and the dollar. In other words, I think it is only a matter of time before Asian currencies and Asian assets, including real estate and stocks - will appreciate relative to US financial assets and US properties.

There is one further point worth mentioning. If an individual or a financial institution asked a traditional fund manager (who inevitably follows the index weighting quite closely) to invest their funds that have been allocated to equities, they would end up having more than 50% of their money in the US and just 11% in Asia including Japan, a region which, as I have explained above, is already the world's largest economic bloc with 3.6 billion people and the world's most favorable growth prospects (moreover, they would have a maximum of 5% of their money in Asia ex-Japan, with 3.5 billion people and which includes the world's fastest-growing economies - China India, and Vietnam). He would also end up with less than 1% of his assets in combined China, India, Indonesia (the latter a country with the world's fourth-largest population), Bangladesh (eighth-largest country), Pakistan (sixth-largest country), Thailand, and the Philippines. Somehow, I think that such an asset allocation, which implies that the index-benchmarked investor would own just 1% of a region that is inhabited by half the world's population, simply doesn't make any sense at all and exposes the absurdity of indexing as it is practiced today.

In fact, I believe that investors should allocate at least 50% of the money they invest in equities to Asia where valuations are far lower and growth prospects more favorable than in the US.

But, while I am very positive about Asia from a number of points of view (the size of the economy, growth potential, low valuations, and low weighting within the MSCI Index), I also have to admit that near term I am far less optimistic. I simply feel very uncomfortable about the US economy and the entire financial system, and feel that the US stock market has at best entered a sharp correction phase or may at worst, experience a crash - if not now, then following another brief bout of strength. And since the recent strength in the Asian markets has been driven largely by foreign buyers, a US stock market correction or, in the worst case, a crash would almost certainly spill over into Asia and lead to some pronounced weakness but not likely to new lows.

It is for this reason that I have turned more cautious on Asia from a near term point of view. In the US, I am particularly concerned that rising interest rates will have a negative impact on the housing market and on financial stocks, which make up more than 20% of the S&P 500. Housing stocks, which have been formidable performers since 2000 (up fivefold), should from now on under-perform, as the decline in refinancing activity will slow down the industry. Moreover, the Philadelphia Bank Indexappears to be tracing out a head and shoulders formation and financial shares such as Fannie Mae look poised to decline sharply. I may add that while financial stocks look likely to weaken in the US, in Asia financial shares appear to be strengthening.

In sum, I like Asian assets including real estate and equities and I remain of the view that investors should avoid the US. Thus, you might consider hedging your Asian bets by shorting the US!.

Long Live the Asian Bond Market!

By Michael R. Preiss

Asians tend to save for the future while Americans borrow from the future. The irony of the situation is that America, the only superpower left in the world, is financing its standard of living with excessive borrowing from the world, in particular Asia. This is due to the status of the US dollar as the world's reserve currency and the lack of alternatives in the existence of a deep, liquid and well governed and functioning Asian Bond Market.

If Asian countries were to substantially reduce their holdings of US Treasury bonds, they would remove a key source of finance for the US investment and the war on terror spending. President Bush is recklessly turning the United States more heavily into debt and the need for a local alternative to the US bond market is suddenly becoming an issue again.

China is under intense US political pressure to revalue its currency and in order to pave the way for the inevitable full convertibility of the Renminbi, China is hosting the 1st Annual Asian Bond Market Forum in Beijing this coming November.

President Bush and the Us Federal Reserve is making clear the degree to which they are willing to bet the integrity of the global financial system in its determination to keep the game going. Spend and not save, consumption vs. production and borrowing from the future. The US Federal Reserve Bank controls its own balance sheet. It can print as much money as it likes but if it is liquidated by the American commercial banking system and credit contracts then deflation will surely follow. This is not just theory.

Like gold or any commodity, US dollars have value only to the extent that they are strictly limited in supply. But the US government has a printing press that allows it to produce as many US dollars as it wishes at essentially no cost. By increasing the number of US dollars in circulation, or even by credibly threatening to do so, the US government can also reduce the value of a dollar in terms of goods and services which is equivalent to raising the prices in dollars of those goods and services.

Under a paper money system, a determined government can always generate higher spending and hence positive inflation. Domestic monetization and deliberate depreciation of the dollar are major policy alternatives available to the American government to fight deflation. This is obviously a real issue for

America, the world's largest debtor nation and its foreign creditors many of which are in Asia.

It is quite realistic to assume that the US dollar standard will become obsolete by the end of this decade, while at the same time I expect the Renminbi to become fully convertible and Asia to have its own fully developed bond market. All of this will have huge implications for Asia, financial and geopolitical, given the massive foreign exchange reserves accumulated by the region and the huge percentage of them held in US dollars.

Renewed efforts are now under way to set up an Asian bond market whose purpose it is to lessen the dependence on the United States and to better circulate local money within the region and funnel it into a variety of Asian public and private sector bonds.

The Asian bond market initiative is led by member countries of the Association of South Asian Nations (ASEAN) plus Japan, China and South Korea. These countries hope that by establishing the market, the pool of savings will be used to buy new bonds issued by private firms and governments within Asia. The plan is to establish a system to enable institutional investors in the region to purchase local currency-denominated bonds issued by Asian governments and private sector firms.

If the Asian Bond Market becomes a reality, many fear that Asian investors, who are the largest foreign owners of US Treasuries, may cut their holdings of US government debt, withdrawing a key source for America's large current account deficit.

Continued weakness in the US dollar could make Asian investors even less willing buyers of American debt. However, for the time being many Asian central banks, institutional and private investors do not have a choice. The US has captive buyers for its debt due to the lack of an Asian bond market.

One of the key motivating factors behind the creation of the Asian Bond Market was the 1997 Asian financial and currency crisis that hit the region. The establishment of deep financial and capital markets is one of the best measures to prevent a repeat of the financial collapse that spread among the region.

A deep and well functioning bond market lessens a company's dependence on the often volatile equity market and improves a companies capital structure. This is turn will make it easier to withstand any financial storms. However the IMF spearheaded by the United States strongly resisted any efforts to establish an Asian Bond Market then.

At that time, the United States had a president who was more global and farsighted in his thinking and the Clinton administration favored a strong dollar. Now under President Bush, the focus is more narrow and domestic in nature and the US has adopted a weak dollar policy.

President Bush's strategy seems to be to run the US even more into debt and let the dollar fall. As a result of this, foreigners who still buy US debt are net losers, and the US can continue to live beyond its means.

The last time such an aggressive policy was attempted was not the Reagan "star wars" program, as some commentators have suggested, but the "guns and butter" policies of another populist president, Lyndon Johnson, in the mid 1960s. The exporting of the resulting US inflation lead to two Sterling crises, the shattering of the gold standard and the explosive growth of the eurobond markets, which attempted to recycle the massive "petro-dollar" surpluses.

China and Asean's favorable response to the Asian Bond Market is therefore significant because it reaffirms the effort to design and build financial protection for Asia with a more balanced financial infrastructure, thereby diversifying risk of intermediation across a large number of institutions and

market players.

It would also offer an additional source of funds, instead of being tied solely to borrowing from international financial institutions and would help China to pave the way for full convertibility of the Renminbi.

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To develop a bond market, three essential components are needed. Firstly, there must be a deep and liquid government bond market to serve as benchmark yield curve against which corporate paper can be priced. Secondly, there must be an adequate infrastructure, both legal and operational, to support trade and transfer of instruments and funds. Operational infrastructure includes efficient clearing and settlement systems, short and long-term foreign exchange hedging instruments, risk management for investors and bond rating agencies establishment, and development of secondary bond market and repurchasing market. Thirdly, there must be collaboration among players in the bond market, namely, the intermediaries, the end-users and the private sector.

Because it is an important far reaching initiative, many areas will be addressed in Beijing: pension investors need better and more choices; banks need a disciplining competitor; both investors and issuers need a live, market-priced benchmark – i.e. an Asian yield curve – to price long-term investment risk; infrastructure finance needs local currency finance and local watchdogs; the local markets need proper credit-rating agencies. The potential list is long.

The Asian Development Bank (ADB) has shown its willingness to promote the supply side of the Asian Bond Market in APEC economies in Asia and so far the mood toward materializing the Asian Bond Market has never been better.

This is true especially now as Asian nations feel that they need to lessen their dependence on the United States, especially after US Treasury Secretary Snow is pushing for Asian currencies to appreciate.

For some time, a happy equilibrium has existed between the US and Asia. The US buys Asian exports, and Asian countries use income from the sale of their exports to buy US assets to help prevent their currencies from rising against the dollar, and it keep exports competitively priced.

However, this equilibrium now seems to be breaking down as the Bush administration (for domestic political purposes) is putting pressure on Asian countries to revalue their currencies.

Traditionally, economic growth in many Asian countries hinges on exports and generating foreign currency, but trade is largely based on the US dollar. As the US dollar has entered a secular bear market, more Asian countries feel the need to shift to domestic demand as one of the key drivers of economic growth and lessen their dependence on exports to the US.

What's becoming more apparent now is the way Asia has been strengthening its financial infrastructures by combining market-based rules with ingenuity to instigate economic and financial dynamism for the region and to encourage

better utilization of regional resources.

The regional bond market development is tied into market-based rules and a stable financial infrastructure, such as rating agency standards, settlement systems and sound governance. Central Banks in Asia alone buy more than 40 per cent of all international purchases of US government debt.

Asian nations – foremost China - do more than Washington appreciates to finance the growing US current deficit. More than 90 per cent of the current account surpluses earned by Asian nations through trading with the US, Europe and Japan are put on reserves in US Treasuries.

If Asia, led by China un-pegs its currencies and moves toward floating ones, US bond yields will surge. Rising bond yields would put a lot of pressure on the US economy and might derail the recovery.

Seen from this perspective, it makes you wonder if Secretary Snow truly understands the risks involved in demanding that China and other Asian countries scrap their pegs to the US dollar or whether it is pushing local politics too far. But with a US election on the way, it's much easier to pick on the currency policies of China and other Asian economies, instead of dealing with structural problems at home for which there is no easy solution.

If the White House isn't careful, though, its actions could cause much bigger problems with far reaching consequences. The Asian Bond Market gathering could set in motion momentous changes with unpleasant outcomes for an America that has grown used to relying on Asian buyers at its treasury auctions.

If the Asian Bond Market does find attention of the media and regulators, it could become a regular event. It is in the interest of the global community to have a deep and liquid Asian bond market with lots of participants – it does not matter whether it will work from the beginning, what's important is that it is started and the right direction is taken.

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India's Role in Central Asia

By Kumar Amitav Chaliha

India has launched a number of new policy initiatives in the Central Asian states and their vicinity. The economic and strategic initiatives now being implemented are shaped by several factors, including India's vision of playing a broader Asian role commensurate with its rising economic and military power. The strategies are also meant to extirpate Islamic terrorism from South Asia, Afghanistan and Central Asia; to checkmate Pakistan and restrain China's growing power and influence; to prevent India from falling into energy dependency on any one source; and to have access to new trading opportunities.

India has joined the "New Great Game" being played in the Central Asian region where competition for economic and strategic positioning is intensifying. The ensuing conflict of interest in the area between India's longtime ally, Russia, its newfound strategic partner, America, nuclear rival China, and Iran, is fuelling New Delhi's "forward" Central Asian policy. Since

India is unable to insulate Central Asia from such power politics, it has decided to become a part of it. Its size, military and nuclear capability makes it a significant part of the complex jigsaw.

Pakistan, as part of its ongoing challenge to India in Kashmir and South Asia generally, has consistently tried to establish strategic depth in Central Asia. It tried to implement its agenda from the 1990s by supporting the Taliban, and through them the myriad extremist and terrorist groups that have destabilized Kashmir and Central Asia. The events of September 11 and especially the attack on India's Parliament in December, 2001, has awoken India to the urgent need of devising a comprehensive strategy to stabilize Central Asia and prevent it from becoming a haven for terrorism and a strategic platform from which Pakistan could threaten Indian interests.

As a strategic measure, India in May,2002 established its first military facility outside its territory at Farkhor in Tajikistan. A bilateral agreement was also signed in April to train Tajik defense personnel, and service and retrofit their Soviet and Russian military equipment similar to that of the Indian armed forces. A similar pact between India and Kazakhstan is expected to be signed soon.

Tajikistan, Kazakhstan, Uzbekistan and Kyrgyzstan, besides Russia, have supported India's case for entry into the Shanghai Cooperation Organization. The six-nation organization, which also includes China, was set up six years ago to deal with border issues, combat ethnic and religious tensions in member countries and to safeguard against the spread of Islamic terrorism. While Beijing has been silent on the issue of India's entry and encouraging Pakistan's membership, security officials feel China would not oppose India's case as part of its long-term policy of "keeping its friends close, but its enemies closer."

Indian officials and entrepreneurs have been looking to explore the immense possibilities that lie with increased interaction with the five Central Asian republics. Most of these countries have enormous oil and natural gas deposits. Indian which has so far been over-dependent on oil from the Persian Gulf states, is keen to tap into the Central Asian energy reserves. There is also a huge market in this region for Indian pharmaceuticals, heavy machinery, tea, and information technology.

To achieve these objectives, India has launched a regional "people-to-people" initiative by inviting diplomats, parliamentarians and opinion makers from Central Asia to visit its industrial and technological centers and also to interact with politicians, officials and businessmen.

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New Delhi's efforts are already paying dividends. Its supply of pharmaceuticals to Central Asia has increased to 30 percent of the region's requirements. During an industrial meet at Almaty recently, Indian companies got orders for consumer goods worth $28 million. And, Kazakhstan has sought India's IT expertise to develop software parks and start joint ventures.

The shortest route from India to Central Asia is by land through Pakistan and Afghanistan. But, New Delhi cannot use this route given its troubled relations with Islamabad. So, India has joined Russia and Iran to build a North-South corridor, which will not only strengthen Iran and Russia, but also enhance access to energy and trade from these countries and Central Asia. Linking India's commercial capital, Mumbai, with the Iranian port of Bandar Abbas by

maritime transport, the North-South corridor will subsequently rely on existing road and rail networks that are being upgraded, to link with Central Asia, as also with Russia and western Europe.

This corridor holds promise for New Delhi for it will "enable India to bypass Pakistan while reaching out to Central Asia, " says an Indian External Affairs Ministry official. "We do not have to wait for India-Pakistan relations to normalize to tap into Central Asia, " he said.

But, there are obstacles in the implementation of this corridor. The potential of the transport corridor will be determined by the funds available to upgrade the rail and road networks and other related infrastructure. ""None of the signatories to the North-South Corridor Agreement -- Russia, Iran and India -- have that kind of money," says the Confederation of Indian Industry.

There is also the question of security. The corridor runs through the unstable Caucasus region. Few will be willing to send cargo through conflict-ridden Chechnya or Dageshstan.

Finding a route bypassing Pakistan is also important for India due to its increasing involvement with another country in the region -- Afghanistan. Since a land route via Pakistan is not possible in the immediate future because of hostile India-Pakistan relations, links like the North-South corridor are vital.

India has already opened a front by setting up the military base at Farkhor in Tajikistan. The base is being used to provide relief assistance that India pledged to Afghanistan after the Taliban's ouster.

India's relations with Afghanistan had been much circumscribed so long as a Soviet-style regime ruled Kabul and had been non-existent during Taliban rule. The Pakistan-backed Taliban's staunch anti-India position prompted India to fully back the Northern Alliance. With the Taliban's ouster by the Northern Alliance and American forces, India was given the chance to establish itself firmly in Afghanistan. This time, it appears focused on not missing the opportunities -- both strategic and economic -- that Kabul offers.

The setting up of the Farkhor base is a step in this direction. India has also reopened its embassy in Kabul and has decided to establish consulates in Heart, Jalalabad, Kandahar and Mazar-e-Sharif. Again, it has given an immediate assistance of $100 million, resumed the India-Afghanistan air link, and revived the Indira Gandhi Hospital in Kabul where Indian doctors are fitting artificial limbs to the large number of war-disabled Afghans.

Besides, India is also seeking to be a major player in the reconstruction of Afghanistan for which $20-$30 billion is expected to be spent by international donors in the next decade. Unless the political situation in Afghanistan prevents implementing such a long-term plan, India expects to get a substantial share of the reconstruction contracts ranging from road construction to restoration of health care facilities.

Visits by Afghan President Hamid Karzai, Defense Minister Mohammed Fahim and Foreign Minister Abdullah Abdullah to India have helped foster this growing relationship with Afghanistan. In the process, India is seeking to establish itself as a major stakeholder in Afghan affairs.

There is no doubt that India will continue to support the Northern Alliance leaders in the Afghan administration. These leaders are locked in a power struggle with President Karzai and it is no secret that they are now calling the shots. While the linkages between India and the Tajik-dominated Northern Alliance have been beneficial to both, New Delhi cannot ignore the opportunities that are now available to revive the centuries-old relations with the Pashtuns who oppose the Alliance. The Pashtuns formed the Taliban with Islamabad's help and have been anti-India since the 1980s. Strategists say New Delhi should be careful of Pakistan's efforts to foment Pashtun

discontent by propagating the view that they have been inadequately represented in the Kabul power structure. Recent Indian gains in Afghanistan would be stymied if Pakistan and remnants of the Taliban foist a new Pashtun leadership in Kabul.

India's new policy initiatives in Afghanistan and Central Asia have involved improving relations with America, Russia, China and Iran, mainly due to mutuality of economic and strategic interests. The question is how are these relationships going to develop?

Despite the current bonhomie, there still exists a lot of mistrust between India and Iran. The Iranian leadership is still wary of a strong Hindu-dominated India, while New Delhi views an influential Islamic Iran as a potential adversary in the long run.

India's growing strategic relations with the United States are also likely to put New Delhi in an awkward situation if it did join the Shanghai Cooperation Organization or is heavily involved in the North-South corridor process. Moscow and Beijing anticipate an eventual clash with Washington in the region awash with oil and gas deposits. And, India is not anxious to convey to America that it is willing even to consider a Moscow-Delhi-Beijing triangle to ensure a multi-polar world, while simultaneously enhancing relations with Russia and China.

New Delhi does not want to jeopardize its long friendship with Russia. And with China, it is finding ways to cooperate despite officially unstated but visible goals on the part of both countries to restrain and rival each other's growth of power and influence in Asia. India's eagerness to keep its options open has been prompted by fears that despite warming India-U.S. relations, Washington is going to depend more on Islamabad to safeguard American interests in Central Asia and would not change its policy on Pakistan in the foreseeable future to accommodate India.

Since this is the beginning of the implementation process of India's economic and strategic initiatives, it is difficult to forecast the ramifications. But, what is certain is that they will be profound and long-lasting and have great significance for the future.

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BUSINESS

When Free Trade Went on Siesta: The WTO Cancun Trade Talks

By Jean-Marc F. Blanchard, Ph.D.
Senior Consultant, KWR International

On September 15, global trade talks in Cancun, Mexico ended without an agreement. The breakdown of talks does not bode well for the future of the Doha Round, the latest series of World Trade Organization (WTO) talks designed to produce a greater liberalization of the global economy. Many worry that the lack of a trade deal is hindering economic growth and reducing confidence. In a pique, U.S. Trade Representative Robert Zoellick opined "some countries will now need to decide whether they want to make a point or whether they want to make progress."

According to various news reports, two issues sank the negotiations. First, the developed world, particularly European Union countries, would not compromise on the issue of agricultural subsidies. They simply could not bring themselves to make significant reductions in subsidies now running an incredible $300 billion per year. Second, the developed world called for a liberalization of foreign investment rules to improve transparency, reduce red tape, and open government procurement. Developing countries, led by Brazil, China, and India, were unwilling to move forward without meaningful cuts in agricultural subsidies. Moreover, they never warmed to the idea of new foreign investment rules because of the potential adverse consequences of such rules for their domestic industries.

For cynics, the talks produced one agreement, a concurrence on the merits of protectionism! In truth, the meeting had one noteworthy accomplishment. Specifically, there was an agreement authorizing developing countries to import generic versions of vital drugs—e.g., those needed to deal with epidemics like HIV/AIDS—without contravening WTO intellectual property protections, provided that importers meet certain conditions and sellers take measures to prevent exports to developed countries.

WTO delegates will be meeting again in Geneva in December, but it is hard to imagine how they will achieve the goal of a new global trade deal by the end of 2004. In fact, it is possible that free trade has gone on an enduring siesta. One reason is that the U.S. seems to have abandoned the leadership role it has played in the past. Another reason is that the democratization of foreign economic policy has made it more and more difficult to advance the agenda of an open international economy. A third reason is the changed geopolitical environment. This makes economic tradeoffs in the name of national security less likely.

Ever since the establishment of an open international economic order in 1945, the United States has played a lead role in promoting it. It has cajoled, threatened, and bribed other states to get them to reduce tariffs, to eliminate non-tariff trade barriers, and to accept new items on the global free trade agenda. The U.S., however, no longer seems willing to assume such a role. The weakness of the last three American Presidents has made them wary of alienating constituencies that might provide the crucial margin of victory in close Presidential elections. This dynamic is shown vividly in President George W. Bush's decision in March 2002 to dramatically increase tariffs on foreign steel. Moreover, the U.S. continues its heavy subsidization of large farms.

Frustrated by the lack of progress at the global level, U.S. policymakers have increasingly turned to bilateral and regional negotiations, arenas where the consensus of 146 WTO members is not required and the U.S. can use its political and economic power to strike favorable deals. The evidence indicates the U.S. will maintain such a strategy. Such arrangements, though, are not as beneficial for world trade as global deals and have the potential to produce a series of closed trade blocs.

Compounding the problem, global trade negotiations have become much more democratic. The democratization of globe trade has occurred because of internal changes within countries, the activism of non-governmental organizations, and the structure of WTO negotiations whereby a complete consensus is required for the conclusion of trade deals. This development increases the number of players who can veto trade deals, injects time, organizational, and material burdens into the trade negotiation process, and restricts secret side-payments. The democratization of global trade clearly is positive from a procedural standpoint, but not necessarily for the future of free trade and investment.

The last factor that bodes poorly for an open international economy is the changed geopolitical situation. Many forget the Bretton Woods system came into being not only because the U.S. and its allies wanted to promote capitalism, but also because they wanted to avoid the protectionist mistakes

of the 1930s, mistakes they believed fueled the Great Depression and World War II. Beyond this, open trade benefited from the willingness of the U.S. to tolerate European and Japanese protectionism if it facilitated the containment of the Soviet Union. Such geopolitical imperatives no longer exist. Hence, there is a reduced inclination on the part of the U.S. and others to accept disadvantageous trade structures.

In total, the prospects do not look good for a further opening of the international economic system. How might companies respond to this changed setting? Clearly, it will be critical to exploit whatever leverage one's home government has to gain access to other markets. Furthermore, it will be essential to draw upon knowledgeable individuals who can facilitate access to foreign markets. Finally, it will be advisable to direct attention to those countries that actively embrace the liberal trading order.

Part II - "Zaibatsu" and "Keiretsu" - Understanding Japanese Enterprise Groups

By Andrew H. Thorson

This Article is Part II of a series that explains the origins of the Japanese corporate complexes that have characterized Japan's modern economy. Part I explained the origins of pre-WWII zaibatsu. This part discusses the dissolution of the *zaibatsu* and origins of the current company groups known as the *keiretsu*.

***Zaibatsu* Dissolution:** As explained in the previous article, by 1945 the zaibatsu had grown to control a significant portion of Japanese trade and industry. During the Allied occupation, the zaibatsu were liquidated in order to "democratize" Japan's economy. In addition, for the purpose of controlling concentrations of economic power, special provisions were included in Japan's Antimonopoly Act for the specific purpose of forbidding holding companies and limiting the acquisition by financial enterprises of stock of other companies. In hindsight these provisions might appear to have been ineffective barriers to the creation of excessive economic control and equally ineffective as measures to ensure competition in Japan's economy. These arguments were made when Japan enacted the Act for partial Amendment of the Antimonopoly Act in 1997 by which act Japan finally eliminated the 50-year old ban on holding companies.

The *zaibatsu* were dismantled by (i) destruction of pyramid control structures via liquidations, (ii) public dispositions of *zaibatsu*-owned shareholdings, (iii) reorganization of large existing monopolies, and (iv) strengthening of the legal prohibitions on monopolies and unfair competition. The Imperial Order of 1946 Concerning the Restriction, etc., of Securities Holdings by Companies also forbids certain interlocking relationships among former *zaibatsu* members via personnel, shareholding, loans, and contractual ties. In all, 1200 companies and 56 individual members of *zaibatsu* families had their assets frozen and transferred to what was known as the Holding Company Liquidation Commission.

Political Overtones of Dissolution: While the Allied presence influenced the dissolution of the *zaibatsu*, there are also suggestions that bureaucrats in Japan desired to liquidate the *zaibatsu* for political reasons of domestic politics, including perhaps for the purpose of strengthening the Ministry of Finance's (MOF) control over Japan's economy. From the late 1930's, powerful Japanese stockholders were also under public attack for emphasizing private profit interests over what were perceived to be public interests and the interests of labor. On the domestic level, zaibatsu became targets of social

resentment, and managers of leading *zaibatsu* were sometimes even subject to terrorist attacks. The theory that *zaibatsu* dissolution implicated a power coup between the MOF and the zaibatsu rather than a real desire to eliminate concentrations of economic power is arguably consistent with the circumstances which followed dissolution, namely, the emergence of new and powerful corporate groupings in Japan.

New Corporate Groups – Emergence of *Keiretsu*: Within years of dismantling the zaibatsu, changes on both the domestic and international fronts are thought to have led to a relaxation of regulations upon the concentration of economic power in Japan. On the latter front, following the establishment of communist China, U.S. foreign policy toward Japan could be seen shifting to one supporting a shoring up of Japan's economic power. Secondly, industrial growth and increased production capacity in Japan supported the U.S. need for supplies during the Korean War. Domestically, legislation in 1949 and subsequently in 1953 relaxed restrictions under the Antimonopoly Act. By 1953, financial companies were permitted to own up to 10% of the outstanding shares of non-financial companies and the prohibition upon holding the stock of competing companies was eliminated.

Government policies in support of economic and industrial growth also tended to promote a new pooling of resources and grouping of enterprises during this period. When the Korean War ended and some large industrial companies faced over capacity problems, governmental policies supported greater cooperative efforts among enterprises. For example, in 1953 the Ministry of International Trade and Industry's (MITI, now known as METI) Industrial Rationalization Counsel called for the grouping of trading and manufacturing companies to concentrate scarce capital in the domestic economy. Antimonopoly restrictions were also relaxed during this period. In this environment the currently existing corporate groups began to crystallize.

By the 1960's six "quasi-*zaibatsu*" had emerged, including the following groups: Mitsui; Mitsubishi; Sumitomo; Fuyo; Sanwa; and Dai-Ichi Kangyo. Of these six, Mitsui, Mitsubishi and Sumitomo have been called the most direct successors of the pre-war zaibatsu. In contrast to actual *zaibatsu*, however, large financial institutions, under the influence of MOF, have been said to play a central role in corporate governance. The current groups are arguably so substantively different from original zaibatsu that it could be misleading to refer to them as "quasi"-*zaibatsu*.

As will be explained in Part III of this series, the current company groups that we often loosely lump together and refer to as keiretsu¸ include horizontal and vertical company relationships, and sometimes business ties that are held together not by capital but by mere transactional relationships among enterprises. The central role of main banks in corporate governance greatly distinguishes these groups from the *zaibatsu.*

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China: the "New Japan" of Trade Policy?

By Russell L. Smith and Caroline G. Cooper, Willkie Farr & Gallagher, LLP

In the 1980s and 90s, Japan was the scapegoat that was blamed for plant

closings and job losses in the U.S. manufacturing industry. These days, that label is more and more being conferred on China. In the past few months, many U.S. manufacturing sectors have united around the claim that their high production costs render them unable to compete with low-priced Chinese imports. They assert that their problems would be solved if the Bush Administration and Congress take immediate steps to force China to allow the yuan to float, or to impose tariffs that will offset China's claimed exchange rate advantage.

So far, the Administration has reacted to these industry pressure tactics by encouraging China to free float the yuan, but not insisting on immediate action. Officials, at least those from the Treasury Department, recognize it will take time for China to adopt a market-based exchange rate so as not to precipitate an implosion of what is, for its massive bulk, a quite fragile Chinese economy. In a move more directly responsive to industry and Congressional pressure, the Administration has also encouraged major trading partners, especially those in Asia, to support flexible exchange rates. At the recent G-7 Finance Ministers meeting, Treasury Secretary Snow successfully convinced Ministers to include in the final communiqué a mild statement that endorsed more exchange rate market flexibility. Even this rather reserved action has caused temporary turmoil in exchange markets, driving up the value of the yen quite significantly.

Members of Congress are significantly less sophisticated in their approach to this issue, and are acting mainly in response to 2004 election prospects, which are expected to be strongly influenced by employment levels. In the past month, a number of resolutions were introduced in Congress demanding action on China's alleged currency manipulation, and one urging (but not requiring) new initiatives by the President has passed the Senate. While more aggressive legislation may never be enacted into law, the message to policymakers and U.S. trading partners is clear--continuing exchange rate problems are heightening trade tensions and therefore the prospects for imposing trade remedies.

Addressing the China Problem: China's alleged currency manipulation became a priority issue for Congress last May as a result of a hearing convened by House Commerce-Justice-State Appropriations Subcommittee Chairman Frank Wolf (R-VA). Agricultural producers joined furniture and pharmaceutical manufacturers in testifying that the Chinese government supported a monetary policy that kept the yuan pegged at an artificially low exchange rate relative to the dollar. They considered China's undervalued currency to be a subsidy, warranting action under U.S. trade remedy law.

The issue continues to warrant attention because legislators claim they can quantify the extent to which China can manipulate the yuan and the impact this has on the U.S. economy. Legislators say that China can intervene in the exchange rate market at any time because it has large foreign exchange reserve holdings. They also claim that China's currency manipulation has given rise to a soaring U.S. merchandise trade deficit. The latest Census Bureau data shows the U.S. merchandise trade deficit with China through the first seven months of 2003 comprised nearly 21% of the overall U.S. merchandise trade deficit. U.S. imports from China in July 2003 reached a record monthly high of $13.4 billion, with no diminution in sight as the year-end holiday selling season approaches.

At a September 9th Senate Foreign Relations Committee hearing on U.S.–China relations, Republican and Democratic Senators charged that actions by the Chinese government to manipulate the yuan violated WTO rules. They expressed concern about statements by Treasury Secretary Snow following his trip to China that the Administration would do little in the near future to pressure China to float the yuan. Administration witnesses offered assurances that the United States would ensure that China complies fully with all of its WTO commitments. They cautioned, however, against thinking that the "structural problems" in the Chinese economy that are driving China's leaders to control the value of the yuan could be resolved overnight. These

include billions of dollars in doubtful loans, problems with state-owned industries, high unemployment, and potential instabilities resulting from burgeoning foreign investment flows.

It is also noteworthy that some major U.S. industrial sectors, particularly the U.S. auto industry, do not support these initiatives. They have substantial investments in China, which would be adversely affected by a stronger yuan. While they have not publicly opposed the business community's efforts regarding China, when asked they argue that for them, Japan's intervention in currency markets is more detrimental that China's refusal to float the yuan.

This caution seems to have had little impact either on the affected U.S. industries or the Members of Congress who support them. Since September there has been a continuing flow of legislative proposals threatening trade restrictions against China, and justifying such threats by asserting that currency manipulation violates U.S. trade remedy laws and WTO subsidy rules. S. 1586, introduced on September 5 by Senators Schumer (D-NY), Bunning (R-KY), Dole (R-NC), Durbin (D-IL), and Graham (R-SC) authorizes the Treasury Department to enter into negotiations with China to float the yuan and to certify to Congress that the Chinese government is no longer intervening in the exchange rate market. If the Chinese government fails to value base the yuan on an acceptable market rate within a specified period of time, the Administration would be authorized to impose an across-the-board tariff on all Chinese exports to the United States of 27.5%--an amount equal to the claimed average percentage rate by which China has devalued its currency.

The House companion bill, H.R. 3058, would also require the Treasury Secretary to report annually to Congress on how China has manipulated its currency. The legislation authorizes the Administration to impose a tariff, and in some cases an additional tariff, on all imports from China at a percentage rate "equal to the rate of manipulation." Although these bills will most likely never become law, the extreme approach they take invite use of existing trade remedy laws, such as dumping and safeguards. These appear moderate by comparison although in reality are just as exclusionary.

The proposals that have received favorable attention on Capitol Hill and in the White House are those that are WTO-consistent and encourage, rather than threaten, affected countries. Some of these bills broaden the countries of concern by including Korea, Japan, and Taiwan, as well as China as alleged currency manipulators. Some also include potential calls for "unfair trade practice" actions under Section 301 of the Trade Act of 1974. This long-dormant provision permits the United States to investigate and negotiate with other countries on unfair trade practices, but any action to restrict trade could only come as a result of a successful WTO dispute resolution case. That, in turn, is highly unlikely, since it is unclear whether the WTO rules would permit such a case, whether exchange rates are a valid basis alleging WTO inconsistency, and whether the Administration would be willing to bring such a case.

Next Steps: Given the current "jobless recovery" in the United States, these trade-related political pressures are no surprise. The next step for legislators and manufacturers is getting the Administration to do more to press China to float the yuan. For now, President Bush wants limited pressure on China. The most that legislators can probably expect from the Administration in coming months is that the annual Treasury Department report to Congress on foreign exchange rates will include a lengthy section on China. If the White House decides to put more pressure on China, it is difficult to know how that will manifest itself. It is entirely possible, if not probable, that future cases seeking special safeguards against Chinese imports will be more successful than those brought in the past. This would be the type of "signal" that the Bush Administration could be expected to send to China. This would express that China is free to act as and when it wishes on exchange rates, but that as long as the perceived currency manipulation persists, the Administration will respond to political pressures with the tools over which it has discretion.

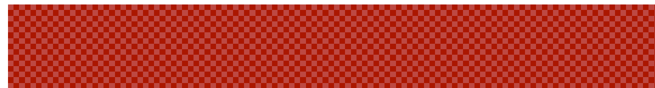
These include trade remedy laws, which allow affected U.S. industries to protect themselves, at least temporarily, from Chinese imports.

Emerging Market Briefs

By Scott B. MacDonald

Better in the Bahamas: The Bahamas have one of the higher rankings for a sovereign in the universe of Emerging Market credits, having received an A3 rating from Moody's. On September 29, 2003, Moody's affirmed the rating and maintained a stable outlook. As the rating agency noted: "The stable ratings outlook is based on a relatively strong external position, although the economy faces challenges posed by the negative effects on the tourism sector of terrorism and geopolitical uncertainties." Moody's also made note that while the negative impact of 9/11 on tourism appears to be bottoming out, the country has as of yet to revert back to more favorable budgetary trends. In addition, The Bahamas has embarked upon constructive legislative and regulatory actions, which prompted its removal from a blacklist of jurisdictions prone to money laundering. The Caribbean nation has also been removed from the list of non-cooperating tax havens by the Organisation of Economic Cooperation and Development because of the local authorities commitment to exchange information on a bilateral, non-discriminatory basis with other governments. The Bahamas is not rated by either Fitch or Standard & Poor's.

Dominican Republic – Mounting Problems: Standard & Poor's on October 1, cut the Dominican Republic's ratings two notches due to growing concerns that the island-state will default on $1 billion of debt coming due in 2004. The country has been hard hit by a major banking scandal, which has badly damaged investor confidence, forcing the government to turn to the IMF for assistance. The situation has only been made more complicated by looming presidential elections. Standard & Poor's took the Dominican Republic's ratings from B+ to B-, with a negative outlook. Depending on what the government can do to repair the economy, we see ratings pressure mount for an external debt default.



Indonesia – Moody's Upgrade: In September, Moody's upgraded Indonesia from B3 to B2, which places it on a par with Brazil and Ukraine. However, the B2 rating is well below Indonesia's ratings prior to the 1997-98 Asian financial crisis – Baa3/BBB. Key points that pushed the upgrade were improved foreign exchange reserves, a fall in external debt, corporate restructuring and relatively prudent fiscal policies. The rating agency also admitted that "there remain considerable risks to Indonesia's economic and financial outlook, particularly in 2004 and 2005". Those risks encompass a major presidential and parliamentary election, a shift away from direct IMF support, and dealing with the ongoing insurrection in Aceh, northern Sumatra.

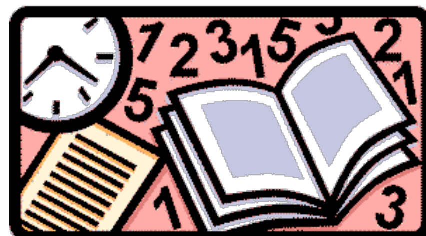
Pemex – Mexico's Oil Company Under the Moody's Gun: In early October Moody's placed Pemex, Mexico's state-owned oil company on review

for a possible downgrade. Although the rating was affirmed in September, Moody's suddenly appears to have been alarmed by many of the same things that it noticed earlier, but now have it concerned. The rating agency is now concerned over the oil producer's rising debt obligations and other liabilities as it needs to make investments to boost its oil and gas production. Another newly-reconsidered fear is the company's high tax burden. Ironically, many of the concerns that Moody's is fingering are being addressed. The company has a new CEO who is expected to be smoother in dealing with the unions, government and board; foreign companies are being allowed to do some of the costly exploration and infrastructure development -- something that has a big price tag and is not Pemex's forte); and prospects for an improving economy in 2004 could take some of the government pressure for upstreaming Pemex revenues to the government in the form of taxes. It appears that Moody's has more concerns with having Pemex sit one notch above the sovereign Baa2 rating and attending to housekeeping as opposed to any new development.

Philippines – Cloudy Skies Ahead: On September 30, 2003, Moody's changed its outlook for the Philippines from stable to negative. The country is rated Ba1. The key reasons for the change entail "political uncertainties" stemming from the failed July coup attempt and the upcoming presidential elections. As the rating agency stated: "Recent political developments, including the brief coup attempt and legal maneuverings against senior officials in the central bank, reflect deep political tensions." Sadly, the political uncertainty comes at a time when the administration of President Gloria Arroyo is making headway in narrowing the budget deficit. The government projects the gap in its finances will narrow to 202 billion pesos this year from a record 211 billion pesos in 2002. This year's deficit was 113.6 billion pesos at the end of August, well ahead of economists' forecasts after the government spent more than planned for a second month. Standard & Poor's earlier in 2003 downgraded the Philippines BB+ rating to BB, due to concerns over the fiscal deficit.

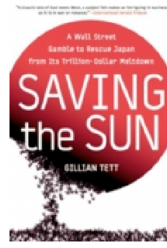
Thailand – Heading Back Up the Ratings Ladder: In early October Moody's indicated it was considering upgrading Thailand's Baa3 rating, probably to Baa2. The key reasons for this change are strong economic growth (6.4% real GDP expected for 2003), stronger revenues, robust foreign exchange reserves, and low inflation. Factors that remain of concern include the government's overall fiscal situation and bad debt in the banking system – which remain from the 1997-98 financial crisis. Bad debt in the banks are reported to be as high as 16% of all loans as of June 2003. Standard & Poor's rates Thailand BBB-.

Book Reviews



Gillian Tett, Saving the Sun: A Wall Street Gamble to Rescue Japan from Its Trillion-Dollar Meltdown (New York: Harper Collins, 2003). $26.95 337 pages.

Reviewed by Scott B. MacDonald



Click here to purchase "Saving the Sun: A Wall Street Gamble to Rescue Japan from Its Trillion-Dollar Meltdown" directly from Amazon.com

Gillian Tett, the former bureau chief for the Financial Times in Tokyo, has written an excellent book about the rise and fall of Long Term Credit Bank and its attempted rebirth as Shinsei, owned by a group of American investors. In many regards, the fundamental thrust of Saving the Sun is that in Japan there has been reluctance to taking the tough measures needed to deal with the massive piling up of bad bank debt and that the solution could be with what Shinsei has done – a painful, yet committed effort to cut down on bad debt, even if it incurs the wrath of the government and vested interest groups. As she states: "…what this LTCB-Shinsei saga does do is to offer a general moral about structural reform: namely, that if a country continually tries to avoid short-term pain by clinging to outworn institutions, and refusing to adapt to a changing world with 'creative destruction' – in Schumpeter's famous phrase – this can carry a terrible long-term cost, not just in terms of lost growth but also shattered lives."

The LTCB saga has its roots in the Meiji era, though its formal start was in 1952, when the bank was created to provide long-term credit to priority industrial sectors in the postwar period. The Japanese government had a strong preference for putting the raising of capital for key industries, such as steel and shipping, in the hands of the banks, rather than in the hands of capital markets, which could be volatile. Consequently, LTCB and other long-term credit banks played a major role in the Japanese economic miracle during the 1950s and 1960s. By the 1970s, conditions had changed, with large successful Japanese companies no longer needing long-term credit banks and instead having the option of going to international credit markets. This meant that LTCB was forced to come to terms with the need for change. If not a long-term credit bank, what then? By the early 1980s the answer was to become an investment bank. Yet, as Tett notes, this was a revolutionary idea and LTCB has "the wrong staff to run an investment bank."

In addition, the reformers within LTCB (regarded as the internationalists) faced considerable resistance to changing the bank. Tett captures the constitution of the domestic wing of LTCB: "The other was the 'domestic' tribe, or men who had forged their whole career inside Japan, making loans to Japanese corporations in the traditional way – over endless cups of green tea, building complex relationships of trust, recording it all on piles of handwritten paper, and occasionally skirmishing with the yakuza, Japan's ubiquitous groups of gangsters." The domestic tribe was initially successful in blocking meaningful reform. However, during the mid-1980s the landscape changed and with Japan's economic boom the bank made advances into the world of investment banking. At the same time, LTCB got into the real estate market, a development that was to prove its undoing. When the bubble burst in the early 1990s, LTCB struggled with an ever-rising amount of bad loans. Finally in 1998, the bank was nationalized by the Japanese government.

The rest of Tett's book focuses on the adventures of the Ripplewood Group, lead by Timothy Collins, who had a vision that the Japanese bank could be turned around if Western management was implemented. Although the Japanese government was to allow the foreign firm (which enlisted the help of the U.S. government, Vernon Jordan and Paul Volker) to assume control of Shinsei (the new name), the saga that followed was one of a substantial cultural clash on many levels. Shinsei, though led by Masamoto Yashiro, was soon regarded as not behaving as Japanese as it refused to supply new loans to dead-beat companies and instead preferred to put the bad loans (as under its agreement with the government) back to the government. Although this created all kinds of tensions with the government, Shinsei eventually showed

a profit and a cleaner balance sheet than many of its Japanese rivals.

Tett has produced a well-written, easy-to-understand book, dealing with a major international issue – Japan's bad loan problem. The final message is that the solution is going to be a painful adjustment in which Japanese banks find a way to assimilate some of the harsh lessons of Anglo-Saxon capitalism, while maintaining some of the traditional Japanese ways of allowing face and form. Change must come. The parable of Shinsei is that the bank "had only succeeded in cleaning up its bad loan book because it had a clear sense of leadership. Moreover, this leadership was willing to endure bitter controversy and short-term pain – and squarely face up the problem." To this she adds: "Thus far, however, these qualities were still in woefully short supply in Japan …"

What is at stake in all of this is the future of Japan. As Shinsei's CEO Yashiro proclaimed:

"If we don't change here in Japan, we will just keep slowly declining as a nation. We have to change our ways of thinking if we want a better future. By avoiding shorter-term pain we just keep creating a longer-term cost. The way we have been dealing with the problems of the last ten years in this country will lead to a continuous decline of this country, not only economically but also politically."

Clearly these are major concerns for Japan in the 21st century. For anyone interested in Japan, Tett's book is a must-read.

AsiaLinks

Recent Media Highlights

- AICC to Host Breakfast Meeting with Indonesian President Megawati in NYC on September 23, 2003
- KWR International to Support CSFB DNA's New Sovereign Data+ Information Service
- AICC: Remarks by President Megawati Soekarnoputri Of the Republic of Indonesia

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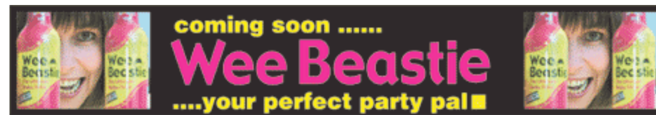

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- KWR International Advisor #16
- KWR International Advisor #15
- KWR International Advisor #14
- KWR International Advisor #13
- KWR International Advisor #12
- KWR International Advisor #11
- KWR International Advisor #10
- KWR International Advisor #9
- KWR International Advisor #8
- KWR International Advisor #7
- KWR International Advisor #6
- KWR International Advisor #5
- KWR International Advisor #4
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- KWR International Advisor #2
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- Program Design and Development
- Project Management and Implementation
- Program Evaluation
- Training and Technical Assistance
- Sovereign and Corporate Ratings Service

Business Development

- Business Planning, Development and Support
- Market Entry, Planning and Support
- Licensing and Alliance Development
- Investor Identification and Transactional Support
- Internet, Technology and New Media

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