banks to which it owed money. Failure to receive a payment could lead to a "domino" effect rippling through the time zones in Europe and North America. However, considering the Japanese government's and Bank of Japan's assurances that banks with international dealings will not be allowed to renege on their major obligations, and with the problems at the major banks waning, this scenario presents little threat at present.

Weakness at Japanese banks affects their ability to borrow funds. Until recently, a "Japan premium" was being charged in international markets which would have a negative impact on profits. With increasing costs, Japanese banks could reduce projects dependent upon borrowed funds, adversely affecting Japanese firms located at home and abroad.[25] In addition, the financial crisis could dampen Japanese economic growth, limiting import demand.[26]

The fear that the Japanese financial crisis will significantly affect Japanese portfolio investment abroad is subject to debate. If the financial crisis exacerbates economic stagnation in Japan, this could reduce Japanese domestic investment. The gap between Japanese domestic savings and investment would increase. In the short run, this situation implies a larger, not a smaller, flow of funds abroad.[27] Lower interest rates in Japan, associated with expansionary monetary policy, would also increase the attractiveness of investing abroad. However, it is also believed that the long-term prospects for sustaining the amount of Japanese capital flows to Canada at their bubble-era levels are dim.[28]

The most visible result of the financial crisis will be reform of the Japanese financial system, including increased transparency and the decline of the "convoy"

[25]That is, assuming the *keiretsu* structure prevents the firms from raising capital directly in international markets or using other sources of funds.

[26]This could negatively affect Canada's exports to Japan, currently around 4.5 per cent of total Canadian exports. (See Statistics Canada Catalogue No. 65-001-XPB, Canadian International Merchandise Trade, November 1995.) However, it has also been noted that the post-bubble decline in real wages and job security have caused Japanese consumers to balk at paying inflated prices for domestically-produced goods. This "frugal" change in tastes could be an advantage for imported Canadian goods. (R. Wright, *op. cit.*, p. 48.)

[27]D. Ostrom, *op. cit.*, p. 13.

[28]R. Wright, *Japanese Finance in Transformation: Implications for Canada,* The Canada-Japan Trade Council, 1994, p. 44.