Taking Stock of the Japanese Economy

By Isamu Miyazaki

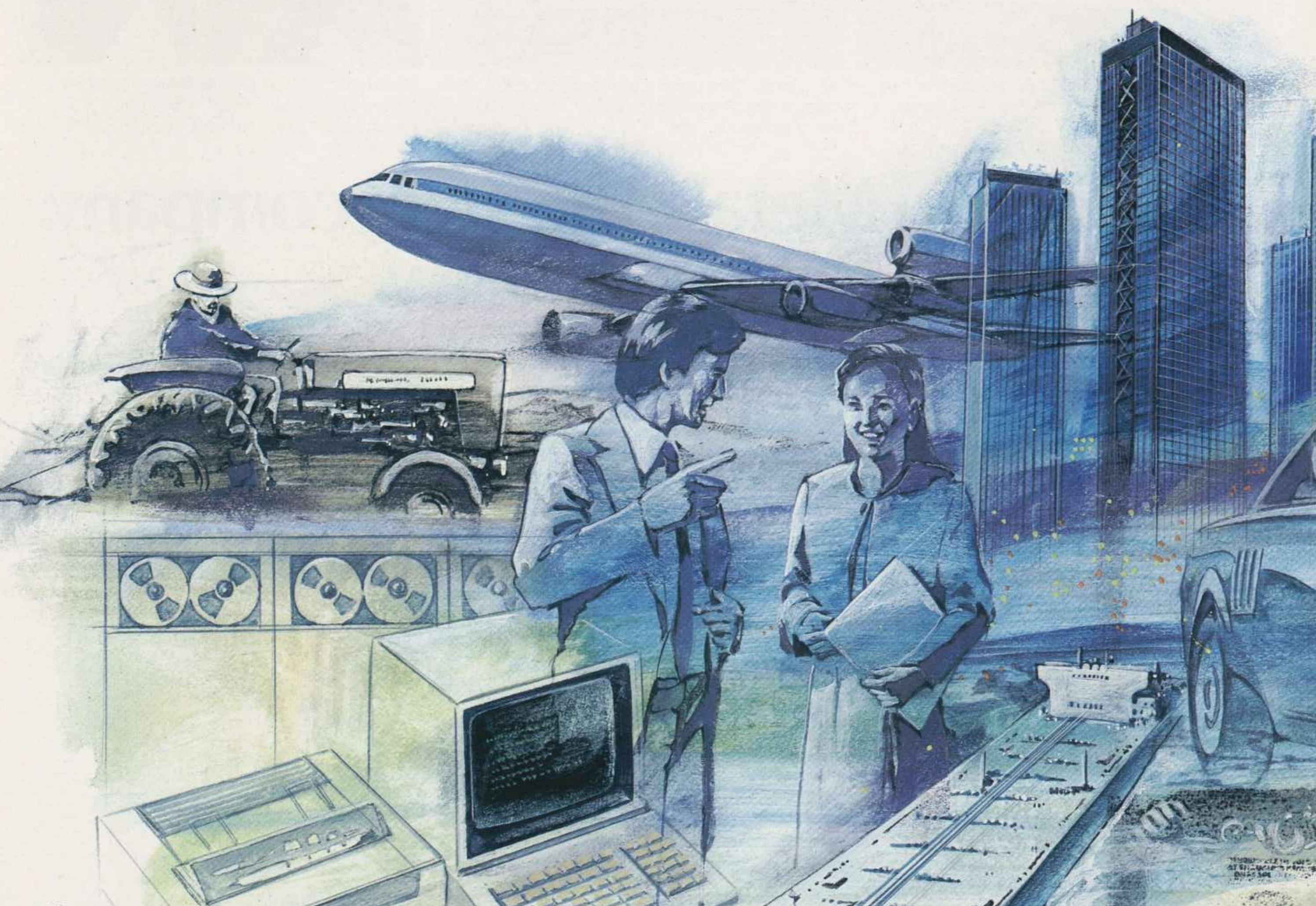
One of Japan's best-known economists, Dr. Isamu Miyazaki is chairman of the Daiwa Securities Research Institute. Before joining Daiwa, he served as administrative vice-minister of the Economic Planning Agency 1979–1981.

In these times of unprecedented global interdependence, it is unwise to begin an analysis of any one nation's economy without first seeing how it fits into the complex web of the world economy. The present state of this web is viewed differently by different people. Some are optimists and others pessimists.

In June 1984, the leaders of seven industrialized nations met in London to discuss the world economy. Although they noted that there are still some very serious problems, such as the cumulative external debts of the Third World countries and the protectionist trends in the industrialized countries, the general mood at the London Economic Summit was one of optimism as they saw the United States leading a smooth global recovery.

This optimism was echoed in the OECD, World Bank, and IMF forecasts. According to the OECD, the average growth rate for the 24 OECD member nations rose from zero in 1982 to 2.5% in 1983. For 1984, it is predicted that OECD members will register more than 4% growth, and the United States economy is expected to record at least 7% growth. Contrary to many economists' forecasts, the American economy has expanded without generating significant inflation. America's annual growth rate is vigorous, but the inflation rate is a modest 4%. Not only the growth rate, but the quality of the economy has improved more quickly than anyone expected, led at first by personal consumption and housing construction and later, since late 1983, by private investment. The private investment forecast for 1984 is for 15–20% growth. This renewed investment is both an important source of vitality in the economy and indicative of the soundness of the recovery.

However, the United States economy has several weaknesses. There are huge deficits in both the federal budget and in the balance of payments' current account. The budget deficit is estimated at more than 4%, and the trade deficit at about 2%, of nominal GNP. These two deficits may not hurt the United States economy itself, but they are having a most unfavor-



able impact on other economies, particularly in the way deficit-induced high interest rates affect the developing countries' debts.

The growth rate in Western Europe, although lower than in the United States or Japan, has been picking up steadily since 1983. In general, the industrialized countries are confidently resuming a noninflationary growth.

In contrast to this optimism among the industrialized countries, the developing countries remain quite pessimistic. I recently visited several of these countries, including Mexico, Malaysia, and China. In Mexico, I took part in a government-sponsored seminar on what kind of economic policy governments should pursue in the present age of "crisis." This is typical of the gloom that still pervades the developing countries. Although personally an optimist, I do not think we dare ignore the pessimism expressed by the developing countries.

Given this, what of the Japanese economy? Having bottomed out in the spring of 1983, the Japanese economy is now recovering steadily. The growth rate, 3.7% in 1983 compared to the official forecast of 3.4%, has continued up in 1984 and is now officially pegged at slightly higher than 5%. The original government forecast for 1984 was for growth of 4.1%, but the fourth quarter's GNP data indicated an annual rate of over 6%.

Three recovery factors

The Japanese recovery was initiated and has been supported by three major factors: low inflation, stable supplies of energy and other resources, and growth first in exports and now in domestic-market demand.

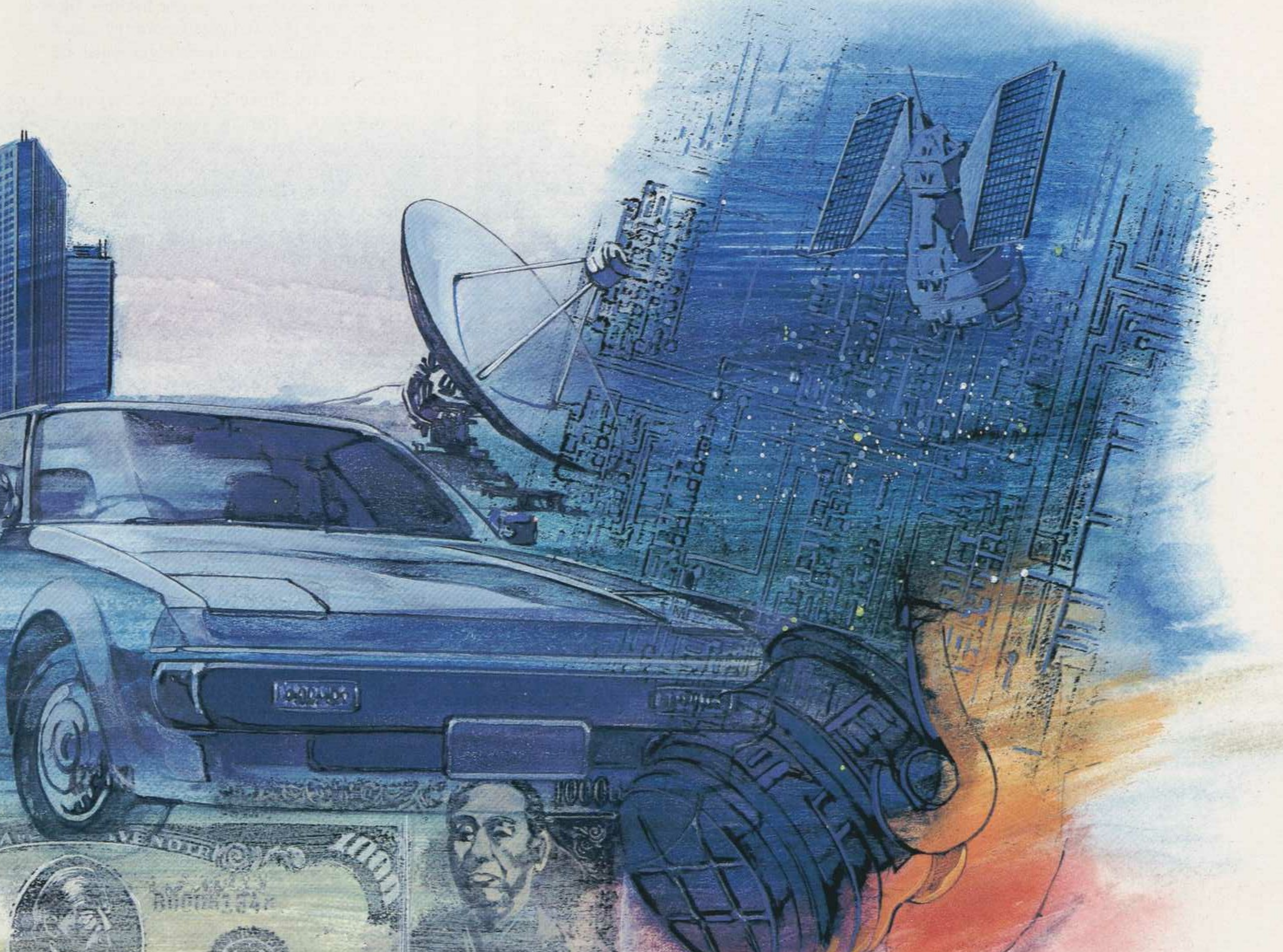
Like many other countries, Japan suffered high inflation in the wake of the 1973 oil crisis. Since then, inflation has been brought down to nearly zero, with consumer-price inflation about 2% and wholesale prices almost flat compared with 1983.

This tight lid on inflation has been made possible by raw-material price stability which has kept wholesale prices low despite the yen's depreciation, and by the moderation shown in wage negotiations. Wage increases in leading private-sector organizations averaged 4.1% in 1984. At the same time, productivity growth has revived. Manufacturing productivity has been growing at an annual rate of over 10% in recent months, which is very encouraging even though this sharp upturn is typical of the initial stage of recovery.

The recovery is not likely either to trigger renewed inflation or to reduce unemployment conspicuously because it will demand more automation and highly technical work. With the rapid aging of the Japanese labor population and the advances being made by women, the government's most important concern is not so much to increase employment per se as to raise the quality of employment and to facilitate the shift from declining industries to new growth industries.

Stability in oil and other raw materials supplies is the second factor supporting Japan's recovery, particularly since raw-material imports are 60–70% of Japan's total imports. Japan is highly dependent on oil as an energy resource, and the oil shock was more severe in Japan than in any other oil-consuming country, but the currently stable oil-supply situation has eased anxieties about a possible shortage. In addition, the innovations Japan has made in fuel-conservation technologies have also contributed to stability and economic recovery.

Before the oil crises, Japan's oil-consumption increased faster than the GNP, but subsequent energy-conservation meas-



ures helped slow oil consumption to less than GNP growth. The government's energy policy is to reduce Japan's dependency on external sources, especially in oil. Already the oil dependency is less than 70% of total energy needs, and the plan is to reduce this to less than 50% by 1990, in part through conservation technology and in part through developing alternative energies.

Given that the United States accounts for 22–23% of world GNP, the American recovery has sparked renewed growth in world trade. Japan's exports expanded by more than 10% in 1983 and are continuing up—so much so that there were complaints at one point that the Japanese recovery was engineered by exporting recession, exports booming even as domestic demand remained sluggish. However, this imbalance between the domestic and external markets began to correct itself as export growth sparked increased private investment in late 1983. Private investment is expected to grow nearly 10% in 1984. Stimulated by growth in both exports and private investment, personal consumption has also started to pick up. As a result, the economy is shifting from export-led growth to domestic-demand-led growth.

Government response

In view of these three features, the government is responding with an economic policy focused on (i) refurbishing the social infrastructure to hasten the shift from export-led growth to domestic-demand-led growth and (ii) reducing Japan's huge trade surpluses to alleviate trade friction.

Unlike in Western Europe, which has a long history of emphasis on social infrastructural improvement, Japan's social infrastructure is still relatively backward, especially in housing. In addressing this problem, the Japanese government is trying to deregulate as much as possible to give the private sector a freer hand in infrastructure development and other growth activities.

For instance, the government already provides low-interest loans for infrastructural development, but many developers have given up rather than try to cut through the complex maze of bureaucratic procedures. The government is trying to eliminate this red tape while continuing to offer low-interest loans and other incentives.

The difficulty of carrying out these measures comes not only from bureaucratic inertia but also from severe fiscal restraints. Like many other countries, Japan has a huge budget deficit. The budget deficit is equivalent to more than 4% of the GNP—one of the highest figures for any industrialized country—and nearly one-fourth of the budget must be earmarked for debt service.

Fortunately, however, Japan's very high savings ratio offers a valuable tool for stimulating the domestic economy. Household savings, for instance, are around 18 or 19%—the world's highest. These savings have facilitated the very large capital formation which has been so vital to Japan's economic health. Although savings are expected to decline slightly as taxes go up and social security arrangements are enhanced, it is unlikely the household savings rate will go below 16% in the near future.

Japan must put these savings to best use. Currently, much of the capital is going to high-interest countries such as the United States. Better that these savings be used to stimulate the domestic market and improve the social infrastructure. This would help raise living standards and, with the growth in imports, lower the trade surplus.

This brings us to the second economic policy focus—reducing the trade surplus and trade friction. Three things are being done to reduce this mammoth current surplus, expected to climb to US$33–37 billion in fiscal 1984.

First, measures are being taken to dismantle residual import barriers. Despite the widespread but mistaken belief in some quarters that Japan has more trade barriers than other industrialized countries do, Japan's tariff rates are among the

Table 1. Economic Outlook for Japan

(percentage change except where otherwise specified)

CY	1983	1984	1985
Nominal GNP	3.7	6.7	7.4
Real GNP	3.0	5.4	3.9
Real gross domestic demand	1.6	4.2	3.7
Real net exports (% of GNP)	7.2	8.2	8.5
Consumer price index	1.9	2.9	4.2
Wholesale price index	-2.2	0.9	2.6
Industrial production index	3.4	10.0	4.1
Unemployment (% of labor force)	2.67	2.67	2.59
Money supply (M_1) as of end of year	-0.1	2.5	8.8
Money supply (M_2 + CD) as of end of year	7.3	7.6	8.5
Call money rate (average %)	6.39	5.94	5.95
T&T bond yield (average %)	7.52	7.32	7.45
Bank loan rate (average %)	7.05	6.75	6.68
Corporate profits	-0.2	38.2	12.6
Current balance (US$ billion)	20.8	29.6	32.7
Net capital inflow (US$ billion)	-17.7	-29.9	-19.8
Basic balance (US$ billion)	3.1	-0.3	12.9
Exchange rate (¥/$)	237.5	233.9	222.1
Employee wage income	3.0	4.2	5.8
Personal savings rate (% of income)	17.3	17.5	17.4
Government deficit (% of GNP)	4.2	3.5	2.5

Sources: Economic Planning Agency for 1983 figures. Daiwa Securities Research Institute for 1984 and 1985 forecast figures.

Table 2 Gross National Expenditures

(percentage change except where otherwise specified)

CY	1983	1984	1985
Gross national expenditures	3.0	5.4	3.9
Private final consumption expenditures	3.3	3.5	4.1
Private housing investment	-4.7	3.8	7.9
Corporate gross fixed investment	2.0	8.7	4.5
Inventories	-69.0	80.7	41.1
Government final consumption expenditures	2.6	2.7	0.5
Government gross fixed investment	-0.2	-0.8	-1.6
Exports of goods and services	4.8	14.2	7.3
Imports of goods and services	-4.5	10.7	7.6
Industrial production	3.4	10.0	4.1

Sources: Economic Planning Agency for 1983 figures. Daiwa Securities Research Institute for 1984 and 1985 forecast figures.

lowest in the industrialized world in terms of ratio of revenue to total import value.

Nevertheless, there are still over 20 agricultural items restricted in Japan, putting Japan on a par with most West European countries. As an economist, I believe that these residual restrictions should be abolished. However, I also realize that such liberalization has to overcome formidable social and political barriers, in Japan as in any country.

As I have traveled around Asia, I have heard complaints that Japan's import liberalization measures are centered on imports from the industrialized nations while markets for developing countries remain closed. Many of these complaints are unfounded, but the emotions they represent are very real. The secondary sector is at least as liberalized in Japan as in the United States, but further deregulation is needed in the primary and tertiary industries. The existing regulations were framed in an era of relative isolation, and Japan must harmonize its arrangements with international standards, especially in the agricultural and financial sectors. It is imperative that Japan adjust to being part of the global marketplace.

Second, measures are being taken to reduce the trade surplus by strengthening the yen, thereby facilitating imports and damping exports. However, there is little Japan can actually do in today's free-floating market to boost the yen's value. Basically, Japan must wait for American interest rates to come down.

Third, Japan is trying to stimulate domestic demand through a variety of means, although this has only an indirect impact and the benefits may not be felt for a couple of years at least.

Table 3 Exports and Imports of Goods

(US$ million except where otherwise specified)

CY	1982	1983	1984	1985
Exports (FOB)	137,955	145,369	168,096	182,197
Exports in constant prices (% change)	0.5	8.5	14.4	3.9
Imports (FOB)	119,650	114,210	127,636	139,857
Imports in constant prices (% change)	-3.6	-0.6	10.0	5.8
Imports (CIF)	132,054	126,049	142,552	154,674
Crude oil imports by value	46,235	39,974	40,425	40,584
Crude oil imports by volume ('000 b/d)	3,671	3,570	3,753	3,768
Others by value	85,819	86,075	102,127	114,090

Sources: Ministry of Finance for 1982 and 1983 figures. Daiwa Securities Research Institute for 1984 and 1985 forecast figures.

Table 4 Japan's Balance of Payments

(US$ million)

CY	1982	1983	1984	1985
Trade balance	18,079	31,454	40,460	42,341
Current balance	6,850	20,799	29,595	32,667
Long-term capital balance	-14,969	-17,700	-29,910	-19,793
Change in assets	27,418	32,459	41,333	31,185
Change in liabilities	12,449	14,759	11,423	11,394
Basic balance	-8,119	3,099	-316	12,874
Short-term capital balance*	3,148	2,078	-4,287	-1,620
Overall balance	-4,971	5,177	-4,603	11,254
Change in banks' positions overseas	35	-3,570	1,653	-3,631
Change in assets	1,360	11,428	5,748	9,034
Change in liabilities	1,395	7,858	7,401	5,403
Foreign reserves	23,262	24,496	21,776	29,399
Change in net foreign reserves	-5,141	1,234	-2,725	7,623
Exchange rate (¥/$)	249.08	237.51	233.85	222.10

Note:* Errors and ommissions are included in the short-term capital balance.
Sources: Bank of Japan for 1982 and 1983 figures. Daiwa Securities Research Institute for 1984 and 1985 forecast figures.

Free access would have minor impact

It is crucial that Japan adopt these measures for import-market liberalization, strengthening the yen, and stimulating the domestic market. But it should be recognized that even doing all of these things will not correct the trade surplus. Easing trade restrictions takes time, and even completely unrestricted import access to Japan's market would have only a minor impact in terms of volume or value. Since raw materials account for 60–70% of Japan's total imports, import growth cannot possibly keep pace with economic growth. Complete liberalization of the agricultural market would boost imports less than US$2 billion, making only a small dent in Japan's current account surplus at the cost of destroying most of what is left of Japanese agriculture.

Japan's current surplus is currently about 2% of nominal GNP. At best, this can be reduced to perhaps 1%, but that 1%-of-GNP surplus will remain as long as Japan retains its technological edge. Japan's export strength is based on the competitiveness of its high-technology products and the continuing structural shift toward higher-value-added items.

Using ever-new technology to produce ever-better products, Japan has shifted its leading exports from textiles to such heavy industrial products as chemicals, steel, ships, and automobiles, and, most recently, high-tech items such as video tape recorders and semiconductors. Given the near-inevitability of this technology-backed trade surplus, the question is not so much how to reduce the surplus as how to best utilize it.

One way is to increase transfers of technology. Japan has a wealth of technology to share with other countries, especially the developing countries. Some Japanese business leaders have warned this will have a "boomerang" effect in which recipient countries will use Japanese technology to make products for export to the Japanese market. Such arguments are incompatible with our belief in free trade. Japan's economic security lies not in defensively protecting market shares but rather in unwavering efforts to pioneer new technologies for higher value-added products.

Another way to utilize the trade surplus to good effect is to increase Japan's capital exports. In the long run, Japan should export capital as a direct investment in other countries' industries to help create local jobs and to assist development. This would also help to redefine international trade as the combination of goods, technology, and capital.

For the future, Japan can best contribute to global development with efforts centered on extending economic and technical cooperation to the developing countries and promoting free trade. Political and economic stability in Japan has been crucial to postwar peace in Asia, and postwar peace in the world to Japan's economic and social development. Japan should thus continue to contribute to Free World security and development through peaceful means. ●