# The Uses of Prosperity

By Yuji Masuda

Stock prices are down, bond prices are down, and the yen is down on international currency markets. Understandably, this triple-downer has sparked considerable pessimism about Japan's economic future, as seen in the talk about the sun's also setting or the Japanese economy's being at three o'clock (i.e. well past its zenith). Even the private think tanks have begun to backpedal from their earlier forecasts that Japan would manage 4% growth in fiscal 1990. And the pessimists have numerous facts to marshal in their support, including the dulling of manufacturing output growth, the slump in exports, the surge in imports and the erosion of the trade surplus.

In May 1990, the Economic Planning Agency announced that the current expansion had reached the 42-month mark, making it tied for second place in postwar economic annals. Overcoming the yen's appreciation sparked by the September 1985 Plaza Agreement, the economy started a long and powerful expansion in late 1986 that has yet to stop. The only longer period of postwar expansion was the 57-month boom from October 1965 through July 1970. The current expansion is closing in on even that record. However, there have recently been a number of ominous clouds on the economic horizon—the introduction of the new consumption tax, the series of official discount rate hikes, the yen's exchange slippage and more—and many people have concluded that the economy is running out of steam.

The June 1990 *Toyo Keizai Monthly Statistics* carried the results of a survey of Japanese economists conducted during the worst of the triple-downer. Over two-thirds of the economists (41 of 60) said the expansion would last no longer than the October-December quarter of this year. Of these, 19 claimed that the economy was already in or entering a recession. Only five of the economists maintained that the nation's economy would continue to expand in fiscal 1991 and beyond.

Yet even though there is a strong current of pessimism, many economists continue to be optimistic, and optimism remains the dominant mood. Capital investment and personal consumption are both doing very well, and there is plenty of budget money left for public works projects. In fact, the labor shortage has pushed construction prices up to the point where there are public works projects that no one will bid on, which means the government has money left over. So the outlook is not entirely bad for the economy.

## Clouded crystal balls

The current expansion has gone through a number of phases to date. The first two years, starting in September 1986, were years of rapid growth as the economy pulled out of the doldrums induced by the yen's appreciation. This growth was born of and nourished by determined public works spending and a housing boom sparked by super-low interest rates, and it quickly spread to capital investment and personal consumption. In effect, the economy shifted into four-wheel drive, pushing the growth rate over the 5% mark in both fiscal 1987 and fiscal 1988. This strength was fueled by a strong yen, low interest rates and cheap oil to give Japan a triple advantage, and the fuel-injection pressure was provided by the glut of liquidity and optimism derived from high stock market and real estate prices.

Yet now opinion is divided. Can the economy keep driving forward, or is it going to stall out? The May 22, 1990 *Ekonomisuto*, a leading economic weekly, ran a special series of articles on the outlook for the economy in fiscal 1990 featuring interviews with 10 prominent economists. All of the economists were asked what they thought the outlook was for the real economic growth rate, the yen's exchange rate, Japanese, American and German interest rates, the current account, and the stock market. While most of them were agreed that the real economic growth rate will slow in the second half of the year, they were divided on whether this signaled a recession or was merely a temporary down-shifting. It would seem that the mainstream position is to assume that the economy will gradually taper off.

Two stand-outs among the 10 economists were the chairman of the Japan Center for Economic Research, Hisao Kanamori, and the president of the Research Institute on the National Economy, Yoshikazu Kano. Both have reputations as bulls on the economy, and they have lived up to these reputations in forecasting real economic growth of better than 5% a year.

Kanamori explains that companies make their investment plans well in advance and that, since there is still plenty of liquidity left in the market, they are not going to be swayed all that much by higher interest rates. Thus he professes to see nothing that would hurt the economy as a whole and says that there is a very good chance this will develop into the longest expansion in Japan's postwar history.

Likewise, Kano maintains that the triple-downer will not have that much impact on the real economy. Personal consumption and capital investment are still going strong, and much of this capital investment was used to keep up with technological advances—investment that companies will pretty much have to make no matter what the economy looks like. In addition, he points out that efforts to expand capacity have been another major element of Japanese capital investment since the second half of 1989, and says he expects such investment to continue.

This raises the question of how to characterize Japanese capital investment—a question that the interviews did not go into much detail on but that is crucial for forecasting the economic outlook. Japanese companies are now investing heavily

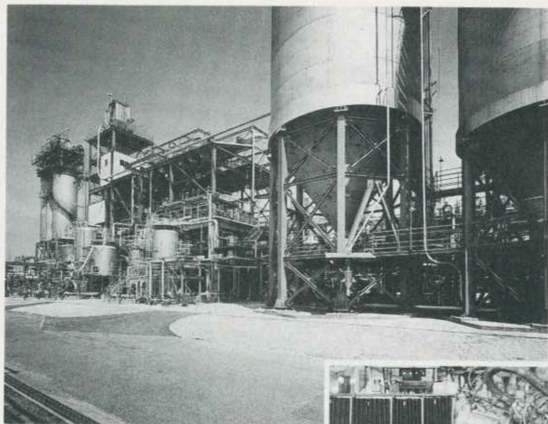

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Photo: Nissan Motor Co.

Due largely to continued economic growth and a labor shortage, Japanese manufacturers are actively investing in production facilities.

both to survive the competition and to position themselves advantageously for the future. Part of this, of course, is to offset the current labor shortages, and there is strong investment across the board in all industries. Thus it looks like Japanese companies will continue to invest in modernization, making them even more competitive in international markets. Regardless of whether this leads to increased friction with Japan's trading partners, there is little likelihood that the Japanese economy will go into recession so long as it is sustained by this strong investment. There is no way the real economy is at three o'clock.

## Tolerance for the surplus

Japan has recorded sharp increases in its current account surplus over the last five years until it is now the world's largest creditor nation. And as a result, the feeling is spreading that a collapse in Japan could well drag the rest of the world down with it. This has become especially pronounced with the hefty investment needs for economic reform in the Soviet Union and Eastern Europe and the development needs of the Third World—both of which have contributed to a growing global demand for capital and hence to increasing expectations of Japan, West Germany and the other surplus countries.

Until recently, the international clamor was for these surplus-running countries to bring their balances of international payments into better alignment, but some people are now changing their tune and starting to call for policies to ensure current account surpluses so the capital will be available to meet these emergent needs.

Since the most vocal advocates of this position are to be found within the Ministry of Finance, it may well be that this is in part an attempt to fend off U.S. pressure for public works spending above and beyond what was already agreed. Yet in its plainest form, the argument maintains that Japan's external surpluses should be tolerated because they enable Japan to recycle these funds to the rest of our capital-hungry world. Of course, there are also those who say that allowing current account surpluses in the hope that they will be recycled as investment capital is letting the tail wag the dog, and there is by no means any consensus on the desirability of Japan's running a current account surplus. And of course the U.S. Commerce Department and others have reacted strongly against any suggestion that Japanese surpluses are tolerable.

Although the battle lines have been drawn, there is more to this argument than meets the eye. To start with, there is no hard-and-fast rule that a country cannot be an international capital supplier unless it runs a current account surplus. Japan itself is proof of this, its overseas investments running well ahead of its current account surplus for the last few years. Where did this money come from if not from the current account surplus? And how is the United States still a capital supplier nation despite its chronic current account deficits and despite having become the world's largest debtor country? The truth is that any country can be a capital supplier so long as it has unfettered capital mobility, its short- and long-term capital markets function smoothly, and its currency is accepted as an international currency. The current account surplus is not the key.

As such, the current advocacy of surplus-tolerance rightly strikes many people as very ethnocentric, and it appears to be just one more example of the selfish streak in Japanese economic policy management. Following World War II, the United States Marshall Plan provided the capital that Europe needed to recover from the ravages of war. Now it is Japan's turn. If Japan expects to play an active role in the world economy, it is imperative that it abandon its ethnocentric rationalizations and conceive and implement a new global framework for contributing to world growth and stability. Although it has often been said that charity begins at home, it might just as well be noted that prosperity begins abroad.

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