U.S. Taking the Initiative in Japan–Bashing

By Sakamoto Sakae

A consensus among many domestic and foreign economists about the prospects for the Japanese economy in 1998 is: "The growth rate of the Japanese economy will be 0% in real terms, and the growth of exports will counterbalance the stagnation of domestic demand." From the United States' viewpoint, this scenario means (1) a further expansion of the U.S. deficit in the balance of trade with Japan, (2) concentration of exports from Asian countries on the U.S. and (3) a consequent stalling of the U.S. economy and the destabilization of the capital markets. How will the Clinton administration respond to this scenario? The answer to this question can be found in the joint statement issued by the Group of Seven finance ministers and central bank governors at their meeting in late February.

To be specific, there are three things to be done by Japan: Expanding domestic demand by taking additional economic stimulus measures, bolstering the weak yen (foreign exchange adjustment for a stronger yen) to weaken the competitiveness of Japanese industrial products in export markets, and opening the Japanese market to Asian countries. There has been no such blatant case of Japan-bashing by the six other members of the Group of Seven (the U.S., Canada, the United Kingdom, Germany, France and Italy) in the group's history. Nor has there been a case of U.S. economic strategy being reflected so unabashedly in a G-7 statement.

Japan alone fails to get pass mark at G–7

At the G-7 meeting in London in February, the seven member countries were classified into three groups based on their economic performance. The first group consists of the U.S., the U.K. and Canada, whose economic performance is good and the only problem, if any, is the existence of inflationary pressure. The G-7 said: "In the United States, the United Kingdom and Canada, where growth has been strong, domestic inflationary pressures have been weaker than past experience would have suggested. Their authorities will continue to monitor developments closely and act if necessary to maintain conditions for non-inflationary growth." They receive pass marks due to their current situation and the fact that fewer tasks lies ahead for them.

The second group consists of Germany, France and Italy, whose growth has been weaker than that of the U.S., the U.K. and Canada but whose economic performance is better than Japan's. Commenting on the three countries, the statement said: "In Germany, France and Italy, growth has generally continued to pick up. We welcome its greater balance but economic activity still remains below potential. While this recovery will help to create new jobs, reducing unemployment to acceptable levels in these countries on a sustainable basis will require implementing further significant structural reforms especially in the labor market but also elsewhere in the economy." It said that their problem lies in the labor market.

The third group consists of Japan alone, which is faced with a host of problems. The statement said: "In Japan, activity is low, and the outlook is weak. Recovery will require continued action to strengthen the financial system and regulatory reforms of the financial and other sectors, so as to increase openness. We welcomed the progress so far on the Big Bang reforms of the financial system. In the view of the IMF there is now a strong case for fiscal stimulus to support activity during 1998." In a nutshell, it said that the present state of the Japanese economy places it short of a pass mark, and that recovery requires (1) reconstruction of the financial system which exposed its unsoundness in the succession of bankruptcies of banks and securities companies, and (2) opening of the financial markets through the Japanese version of the "Big Bang" and the abolition of various regulations that hamper Japanese market openness.

The carefully planned U.S. campaign to besiege Japan

Regulatory reform of the financial sector, the Japanese version of the "Big Bang," and easing or abolition of various regulations are what the Japanese Government has been tackling in a positive manner since last year. Therefore, the Ministry of Finance did not feel any pain when these issues were enumerated in the G-7 statement as problems that need quick solution.

The statement said, however, in addition to these matters: "In the view of the IMF there is now a strong case for fiscal stimulus to support activity during 1998." This urging, made like a casual remark, took the form of an objective analysis by the IMF, not the form of a request by the six G-7 members. It is inferred that this soft approach was taken because of strong resistance from the Ministry of Finance, but its meaning is nothing else than a demand for an additional fiscal outlay to stimulate the economy.

At the beginning of last year, the U.S. Government sounded a tocsin against the danger of a tax increase by the Japanese Government (the consumption tax increase in the spring of 1997 and the abolition of the special income tax cut). Since last autumn, when the stagnation of the economy became clearer, the U.S. has been urging Japan to introduce an economic stimulus package that requires budget appropriations, including a tax cut. Such demands escalated last winter, when the problems with the nation's financial system showed up. The above G-7 statement is the final form of the

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Isolated island: Led by the U.S., the G–7 assigned extra homework only to Japan

U.S.–led campaign against Japan since last year.

Policy change by Japan near

Just before the G–7 meeting in February, U.S. Secretary of the Treasury Robert Rubin reportedly said, during his meeting with his Japanese counterpart Mitsuzuka Hiroshi, that the Japanese economy is weak, that the whole world is watching the Japanese economy and the policies Japan will take, that the U.S. has repeatedly said Japan needs growth led by domestic demand and such growth is very important in view of the condition of Asian economies, and that the expansion of domestic demand and the stabilization of Japan's financial system are important for Asia and the world economy as well as Japan.

Rubin further said that the U.S. trade deficit is swelling and he fears a rise of protectionism in Congress, etc. Also, he wants Japan to absorb exports from Asia which are expanding as a result of Asian currencies' depreciation, that he welcomes the tax cut by Japan (the ¥2 trillion income tax cut made in compiling the supplementary budget for fiscal 1997) and the front–loading of order placements for public–works projects (in the fiscal 1998 budget) as constructive steps. However, the fiscal 1998 budget is restrictive to the economy (the general account expenditures are 1.3% smaller than the corresponding expenditures in the fiscal 1997 budget in its original form). In addition, the world is watching to see what Japan will do after the tax cut and the front–loading of spending on public–works projects ends.

As of Feb. 28, the Japanese Government had not yet announced a fiscal policy change from an economically restrictive policy to a stimulative one as demanded by the U.S. and other Western countries. Within the Liberal Democratic Party, which is the largest party in the present coalition cabinet, there is a strong body of opinion that the fiscal reconstruction policy (austerity budget policy) advocated by the Ministry of Finance should be switched to one that attaches importance to economic recovery (expansive fiscal policy). A policy change is considered simply a question of time. It is generally expected that a supplementary budget of a stimulative nature will be compiled for fiscal 1998 after the Diet passage of the fiscal 1998 budget, which has been under deliberation in the Diet as of Feb. 28.

Need to correct the yen's weakness reaffirmed

In its statement, the G–7 expressed strong concern about the expansion of exports from Japan (the swelling of Japan's trade surplus) with the weak yen as the springboard. The passage "We reiterated that exchange rates should reflect economic fundamentals and that excess volatility and significant deviations from fundamentals are undesirable" had been included in previous G–7 statements, but this time, a new passage was added that said: "We emphasized that it is important to avoid excessive depreciation where this could exacerbate large external imbalances."

Without doubt, this vague expression is meant to say that 1) Japan's trade surplus is rising sharply as a result of the weak yen and 2) that the exchange rate should be corrected in the direction of a strong yen to reverse this trend. Rubin, Secretary of the Treasury of a major borrowing country, seems to be still sticking to the policy of a strong dollar, fearing a flight of capital from the U.S., but it could be that he attaches importance to a dollar which is strong against all currencies and considers the dollar's exchange rate in relation to the yen to be a different problem. He appears to believe that a corrective appreciation of the yen (improvement of the environment for imports in Japan) is necessary in order for the U.S. to fend off the export offensive from Asian countries and change the direction of exports from Asia toward Japan. JJTI

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