"Bureau Pluralism"

Let me try to respond to Ambassador Hugh Cortazzi's questions published in the last issue. Japanese civil servants tend to put their ministries' interests before national interests, but this is not because politicians are too powerful in influencing civil service appointments. In my view, this is because they are trained that way. Their way of thinking is deeply imbedded in Japan's social structure. Japanese civil servants behave rationally within their own jurisdiction. Free speech and innovative ideas are encouraged within the ministry so long as such activities enhance the ministry's power and status. However, they will exercise self-restraint when it comes to issues that will jeopardize the very existence of their own ministry (like the creation of an International Trade Commission-type independent agency as suggested by Professor Kimura Fukunari). This is chiefly because civil servants remain loyal to their ministries throughout their lives, even after retirement. My current boss at the Research Institute of Economy, Trade and Industry, Professor Aoki Masahiko, calls this "bureau pluralism."

Many of us are aware that we must now act beyond bureau pluralism, but it requires tremendous courage. I must confess that when I participated in one of the many meetings of the Liberal Democratic Party's (LDP) agricultural caucus (where they were debating the safeguard issues) as a Ministry of Economy, Trade and Industry representative, I had no courage to speak up for the national interest. We were sitting quietly and helplessly while LDP swashbucklers were making protectionist speeches.

Araki Ichiro,
Director of Research,
Research Institute of Economy,
Trade and Industry (RIETI)

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Government Set to End Full Protection of Deposits

Prime Minister Koizumi Jun'ichiro pledged at a New Year's press conference on Jan. 4 that the government will go ahead with its plan to end a full refund guarantee on bank deposits in April this year as scheduled.

State-backed guarantees for full repayment of deposits at failed financial institutions are to end on April 1. After that, the state-run Deposit Insurance Corp. will only guarantee up to ¥10 million plus interest for each time deposit account holder. The full protection for ordinary deposits will be scrapped a year later, on April 1, 2003.

The limited-guarantee system for ordinary deposits was set to be introduced in April this year but was postponed in December 1999 for a year because the ruling coalition feared it could trigger a financial crisis if depositors shifted money away from troubled banks en masse.

The blanket guarantee was introduced as an emergency step during the financial turbulence in 1996 to discourage companies and individuals from withdrawing deposits due to fear of bank failures.

As the abolition of full protection draws closer, more troubled financial institutions are approaching bankruptcy. Last year, nine *shinkin* banks (credit associations) and 37 credit unions collapsed. Shinkin banks and credit unions are similar to savings and loan associations in the United States. Recently, even some regional commercial banks have gone under.

Against this backdrop, municipalities throughout the nation, which altogether hold more than ¥20 trillion in public money, are becoming increasingly concerned about the safety of funds deposited at local financial institutions.

According to Bank of Japan (BOJ) data, the outstanding balance of large-lot time deposits with a principal of ¥10 million or more fell 13.6% at the end of September 2001 from a year earlier. Of these, deposits held by public entities dropped a hefty 34.2%.

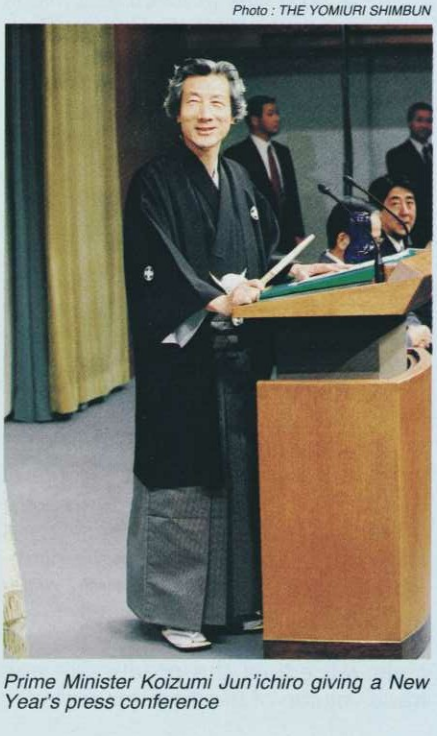
One local government in Osaka said that while it used to deposit 90% of its funds at one particular financial institution, it now puts its money in seven different institutions. An official of that government said a larger share of funds is deposited at the state-run postal savings as well as local agricultural cooperatives which, backed by their national association (such as the Norinchukin Bank), offer better interest.

Meanwhile, regional banks are now facing a wave of consolidation as more troubled borrowers are going under while healthy borrowers are accelerating moves to cut bank loans.

Late last year, two competing regional banks based in the Kyushu region of western Japan – Bank of Fukuoka and Fukuoka City Bank – formed an alliance to integrate their main computer systems.

Bank of Fukuoka President Teramoto Kiyoshi said the two banks are even in agreement to provide the necessary funds to each other in the

Photo : THE YOMIURI SHIMBUN



Prime Minister Koizumi Jun'ichiro giving a New Year's press conference event they suffer a massive outflow of deposits as a possible result of financial crises originating from the metropolis.

A majority of the public is, however, still not fully aware that the government's full protection of deposits will end in April. According to the Central Council for Financial Services Information, an affiliate of the BOJ, 66.8% of those surveyed said they were unaware of this fact, while 24.6% said they were somewhat aware. Only 8.2% said they were fully aware.

Japan Agrees to Repeal Safeguard Import Curbs against China

Japan and China have struck a deal to resolve their trade dispute over import curbs. Japan agreed not to impose formal safeguard restrictions on imports of three farm products from China, while China agreed to retract its retaliatory high tariffs on Japanese automobiles and other industrial products.

The accord was reached at a ministerial meeting held in Beijing on Dec. 21, 2001, with Japan represented by Minister of Economy, Trade and Industry Hiranuma Takeo and Minister of Agriculture, Forestry and Fisheries Takebe Tsutomu, and China by Foreign Trade and Economic Cooperation Minister Shi Guangsheng.

The meeting adopted a memorandum of understanding, under which the two countries will create a private-level trade consultation panel to promote orderly trade of three farm products – welsh onions, fresh *shiitake* mushrooms and rushes used in *tatami* mats. Negotiations at the panel will be held mainly by private-sector groups, but government officials will participate to give advice on the planting and production of the three products as well as on the healthy development of trade. Practically, the officials will adjust the production and trade volume of the three products.

The accord has finally put an end to an eight-month dispute that had become a source of trade frictions between the two countries since Japan invoked provisional safeguard import curbs on the three farm products in April 2001 at the urging of Japanese farmers who alleged that imports of low-priced Chinese products threatened their livelihood.

Photo : The Mainichi Newspapers

Takebe Tsutomu, Hiranuma Takeo and Shi Guangsheng (from the left) having a ministerial meeting on safeguards in Beijing

Japanese producers groups and the ruling Liberal Democratic Party had been urging the government to invoke formal safeguard measures at an early date according to international rules in view of the serious damage domestic producers had been suffering. The government, however, chose to broker a deal with China in consideration of the Japanese automobile industry, which was hard hit by China's imposition of 100% retaliatory tariffs and hard-pressed to start full-scale expansion into the Chinese market. The government regards the latest accord as a model case for settling bilateral trade disputes with China, which are certain to increase in view of China's full-blown expansion into global markets.

The proposed consultative panel will negotiate "appropriate" trade levels for the three disputed farm products. But the production management formula is not an orthodox way in free trade rules and there are concerns over whether the accord can be implemented. China, which has gained membership of the World Trade Organization (WTO), found direct control of trade volumes contradictory to the WTO agreement and thus agreed to cut export volumes through consultation.

From the outset of the negotiations, Japan had sought to settle the dispute bilaterally, but the talks hit snags, with Japan demanding restrictions on the volume of the trade of the three products and China objecting to quantitative restrictions. Prime Minister Koizumi and Chinese President Jiang Zemin, however, agreed in their summit talks in Beijing in October last year to settle the dispute through negotiations. In line with the agreement, Japan shelved its decision on whether to formally invoke the WTO safeguards, and continued ministerial-level and working-level negotiations with China after Nov. 8 when the 200-day provisional import curbs expired.

Japan's position in the latest trade friction with China was a reversal of that maintained in past trade talks with the United States. Hurt by an influx of Japanese products, the United States had urged Japan to voluntarily reduce exports of autos and steel, among others. In the latest dispute with China, Japan sought export reductions and won China's agreement to hold talks to discuss issues related to production.

The Japanese government places high expectations on the latest accord, which it believes will pave the way for broader regular bilateral trade consultations with China. But some trade experts warn that the management of trade at the production level may amount to an international cartel and runs counter to free trade. An agreement to curtail steel production facilities reached late last year among the member countries of the Organization for Economic Cooperation and Development was criticized in the same context.

China has argued that a large portion of surging Chinese exports to industrialized countries are based on the develop-and-import scheme arranged by Japanese, European and U.S. companies themselves. Japanese specialists in industrial structure issues warn that trade friction between China and industrialized countries could further increase over Chinese exports of various commodities, as industrialized countries are promoting the business model of investing in China and let Chinese manufacturers produce commodities.

The best way for Japan to nip trade friction with China in the bud is to make strategic use of Chinese companies in sectors where Japan has no cost advantages and accelerate structural reform in such a way as to focus domestic production on sectors where Japan has higher added value.

Japanese Economy in Deflationary Spiral

The Japanese economy remains mired in recession and is falling deep into a deflationary spiral. The country's gross domestic product (GDP) shrank in both real and nominal terms in the third quarter (July-September) of 2001 for two consecutive quarters of negative growth. All indicators show that the economy is further weakening, and there is no bright prospect for corporate performance.

The government adopted on Dec. 19, 2001, an official projection of zero GDP growth in inflation-adjusted real terms for fiscal 2002 starting in April, with its nominal GDP set to shrink 0.9%. It was the lowest ever growth projection by the government and the first ever negative forecast in nominal terms.

The government said that the economy may show some signs of a slow pickup led by private-sector demand in the latter half of fiscal 2002, as exports are expected to expand with the U.S. economy resuming growth; corporate earnings and capital spending are expected to rebound; and the pump-priming second supplementary budget for fiscal 2001 focusing on public works projects will show the intended effects. However, the disposal of non-performing loans and structural reform programs would pressure employment and incomes in the first half.

According to the projection, personal consumption, which accounts for more than 50% of GDP, is expected to rise 0.2% in fiscal 2002 for the first increase in three years, while private-sector capital spending is expected to dip 3.5% for the first decline in three years due to the sluggishness, which is likely to continue until the first half of fiscal 2002.

The consumer price index is projected to fall 0.6% for the fourth consecutive year of decline. Average growth rates in the last quarter (October-December) and the first quarter (January-March) of fiscal 2001 are expected to shrink 0.1% in real terms from the preceding quarter. The growth rate in fiscal 2002 is seen likely to shrink 1.0% in real terms and 2.4% in nominal terms, revised downward by 0.1 points from the projection announced by the Cabinet Office in November.

GDP during the July-September period of 2001 on an annual basis and in nominal terms sagged by ¥9.3241 trillion to ¥501.9116 trillion from the same period of the previous year, underlining the contraction of the economy proceeding with lower commodity prices.

Meanwhile, the domestic wholesale price index in 2001 dropped 0.8% from the previous year, due to falls in personal computer prices associated with technological innovation and downward trends in integrated circuits following the burst of the speculative bubble in the information technology sector, according to an announcement by the Bank of Japan on Jan. 11, 2002. Wholesale price indices have been falling since 1992, except in 2000, and in 1997 when an increase in the consumption tax pushed prices up by 0.6%. They have sagged 10% over the past 10 years.

Companies are stepping up restructuring for survival, which raised the unemployment rate to the highest ever level of 5.5% in November, deteriorating 0.7 points from the same month of the previous year. Some economists predict that unemployment may soon hit 6%.

Against such a background, markets are becoming increasingly bearish. The 225-issue Nikkei average of the Tokyo Stock Exchange ended the year at ¥10,542.62 on Dec. 28, down ¥3,243.07 from the close of the previous year and marking the lowest level in 18 years.

Discouraged by the slack business conditions, selling of the yen is accelerating on the Tokyo foreign exchange. The market ended the year with the yen falling to the middle of the ¥131 level to the U.S. dollar, down more than ¥16 from the close of 2000. The yen's value continued to fall in stark contrast to the high approval rating of Prime Minister Koizumi's administration. The downward trend has remained unchanged since the turn of the year.

U.S. major rating agencies have lowered their sovereign credit ratings on Japan to AA, on a par with Italy and the lowest among the Group of Seven countries. The downgrading of ratings on Japanese national bonds started in November 1998 when Moody's Investors Service lowered the ratings from the highest AAA, citing Japan's financial deficits and uncertainty about the country's financial system.

The two consecutive years of contraction of GDP indicate that the Japanese economy is in a recessionary phase if the U.S. definition of recession is applied. The Cabinet Office has officially acknowledged that the Japanese economy has been deteriorating after reaching a peak of the business cycle in October 2000.

How long will the recession continue? The shortest recessionary period in Japan since 1951 was four months and the longest was 36 months, following the second oil crisis. The current recession is in its 14th month (as of January). Koizumi's reform initiative envisages an adjustment period of two to three years. Japan sees no light at the end of the tunnel yet.