

Expand Domestic Demand For Japan's Sake

By Kotaro Tsujimura

There is a Zen teaching that may best be translated: "Wherever you are, you must be your own self." Goes another: "A great mountain stands in solitary grandeur." The message of both seems plain enough. One should do what he believes, in his own way, instead of following what other people say. That message could be meant especially for Japan. The question at stake today is how Japan's economy should be managed in a way commensurate with its status in the world economy. It seems to me, however, that the majority of Japanese, including top government officials, are merely reacting to events. Their attitude is far from that of a "great mountain standing in solitary grandeur."

The Japanese make a tremendous fuss about the yen rate, exaggeratedly overreacting every time President Ronald Reagan or Treasury Secretary James Baker talks the dollar up or down. And they keep asking themselves the meaningless question: What is the tolerable yen rate for Japan's export industries?

The point I am trying to make, however, is that the question itself contradicts the objective of the agreement reached last September by the major monetary powers, Japan included—the so-called G-5—which set the pace for the depreciation of the dollar and the appreciation of the yen. Under that agreement the Japanese government of course accepted a further rise in the yen's exchange value against the dollar. At least from the American point of view, the G-5 accord was aimed at pushing up the yen to a point where Japanese export industries would find it difficult to sell its products to the U.S. market. The U.S. wanted, as it still does, to reduce the Japanese trade surplus and the American trade deficit.

What is tolerable?

For individual corporations dependent on exports, a "tolerable" yen rate means the marginal rate at which they can still maintain export competitiveness by cutting costs to offset the yen's rise rather than increasing their dollar prices. In fact, though, there is little sense to setting such a rate. Suppose the tolerable rate is ¥200 or ¥180 to the dollar, for example. Is there any assurance that the yen will stay at that level? The answer is an obvious "no."

Suppose, also, that Japan's export industries can manage to make a profit at ¥180 per dollar. For the U.S. this would mean that imports from Japan would stay at about the same level as last year. If that is the case, the objective of the G-5 agreement will not have been achieved. The only possible U.S. response, then, would be to seek a further correction in the yen-dollar exchange rate, that is, further appreciation of the yen against the dollar.

Japanese corporations that continued to expand exports to the U.S. up until last year are now trying to preserve their market share in that country. It is only natural for private business to try to maintain their stake in the American market. But if it is the Japanese government that is trying to achieve the same goal, it is not so natural. Tokyo is expecting, or so it seems, that Washington will not push Japan too hard and will be content to let the yen will stay at a "tolerable" level. That expectation runs counter to the G-5 agreement. One must take a hard look at reality and act accordingly. This is the point I wish to stress for Japanese policy-makers.

When the G-5 agreement was reached, few financial experts in the

U.S., Europe or Japan thought the yen and the mark would appreciate against the dollar as readily as had been expected by their governments. The general feeling was that, given the inherent unpredictability of floating exchange rates, one could only wait and see how the markets would react.

As it turned out, the currency markets reacted immediately to the G-5 agreement, with the yen rising rapidly against the dollar. That was hardly expected here in Japan, where it was generally thought that the yen would appreciate gradually and that there would be time to work out remedies before any serious damage was done. Presumably, it was in that hopeful mood that the Japanese government agreed to a yen appreciation in the first place.

Japan caught napping

The rapid rise of the yen and the rapid fall of the dollar also surprised the U.S. But it was in Japan that the consequences were greatest. The pace was so fast that Japan had no time to clear the decks. Domestic industries dependent on exports protested to the government, saying the yen was going too high. But the government was apparently at a loss over what to do. With officialdom sitting on the fence, the yen continued its ascent. At the economic summit of the Western industrialized countries held in Tokyo in May, Prime Minister Yasuhiro Nakasone asked for Reagan's help to slow the yen's rise, but to no avail.

The United States had a better grasp of events than Japan from the beginning. It called for Japanese action on the basis of an accurate analysis of what would be



Government housing projects under construction. Expansion of domestic demand in housing and other areas is vital.



forthcoming in the immediate future. As a result, Japan found itself completely on the defensive as it meekly followed U.S. initiatives.

The basic reason for this, it seems to me, has much to do with the underlying psychology of the Japanese government, a sense of dependence on Washington. I have the impression that government leaders in Tokyo feel that, so long as Japan professes willingness to accept American demands, the U.S. will somehow tolerate the kind of export-led economic policy which this country pursued until last year. This is wishful thinking.

Yet that it is the dominant thinking is evident in the passive attitude of the government toward the all-important question of stimulating domestic demand. The government continues to deal with this question in terms of U.S. pressure. What is lacking is a strong sense of purpose, a firm belief that expansion of domestic demand is in Japan's own best interest.

The Japanese people reacted to the oil price spiral of the 1970s with a deep sense of crisis. Now, however, in post-G-5 circumstances, they still have an easygoing attitude, despite the fact that the economic situation here and abroad has worsened fundamentally since G-5. The seriousness of the oil crisis was grasped by every Japanese because it took such tangible forms. Even a child could understand why gasoline was in short supply, why there was not enough heating oil, or why electricity supplies had to be cut back. But the present crisis is far harder to comprehend. Many Japanese find it hard to see why Japan should heed U.S. demands for an increase in domestic demand. They think that to do so is not in Japan's interest.

Many people also believe that the Japanese government is wrong to cooperate with the U.S. in guiding the yen higher. They do not understand that an adjustment in the yen-dollar rate is

necessary to prevent the spread of protectionism in the U.S.—a dangerous development which could prompt the U.S.A. to set up a system of unilateral import restrictions.

Until early last year the Japanese phrase "*boeki masatsu*" (trade friction) was taken by the Japanese to mean the following: Rapid expansion of exports would offend the Americans and Europeans, making it difficult for Japan to maintain export-led growth on a long-term basis; therefore, Japan should limit its export increase to a level that would not anger them.

Actually, Japan's trading partners were already angry last fall, and Japan had to swallow a further yen appreciation. Nonetheless, the term *boeki masatsu* is still used largely in the context of avoiding sharp export increases that would offend Japan's trading partners, particularly America and Europe.

That perception is no longer relevant. The fact is that Japan can no longer afford to care much about the feelings of other countries, now that the yen has broken through ¥160 to the dollar. Now is the time to think anew about what is the best way to protect Japan's own interest.

Spur demand at home

Under the present circumstances, the only way to protect Japan's national interest is to expand domestic demand. Internal demand must be stimulated, not because U.S. government officials are asking Japan and West Germany to reflate their economies, but because Japan has no other way to protect its own interests. Export-oriented corporations must cope with the high yen by cutting costs, including labor costs. Production costs must be reduced by purchasing, where possible, cheaper products from abroad. Subcontractors must bear part of the burden.

At ¥160 to the dollar, small exporters cannot make a profit because they cannot pass on any of their cost burden. There are numerous businesses in Japan that are so small they are not even included in bankruptcy statistics when they go under. Many such marginal companies are now vanishing from the business scene. At this rate, unemployment will probably exceed 3% by the end of the year for the first time since 1955. In this sense, the "high yen crisis" is far more serious than the oil crisis.

Americans are now talking of depression in the midwestern states where the oil businesses, mining and agriculture have been hit hard by falling prices. Increasingly, jobs are felt to be more important than price stability. That feeling is adding to protectionist pressures in the United States.

So a vicious circle of yen appreciation is likely to continue: The yen will go up still higher, and Japanese businesses will effect more cost savings, offsetting the appreciation. In short, the crisis in exports cannot be resolved through efforts by private business at the microeconomic level. The only solution lies in macroeconomic management designed to ensure that the Japanese products shut out of overseas markets find new takers in the domestic market.

Take table- and houseware for example. This is often cited as a representative example of an export product hit by the high yen. Yet more such goods can be sold at home. Newly married Japanese couples do not usually feel they can afford to buy Western-style decorator tableware. Additional family incomes could be spent on such domestically produced household items. Japan, the largest net creditor in the world, can afford to spend much more to boost domestic demand.

The general question of the need to stimulate domestic demand almost always leads to the specific question of how this can best be accomplished. Certainly, it is a herculean task. But judging from the experience of the oil crisis, one need not be pessimistic. Once a clear-cut policy goal is set, the Japanese government and private sector have both the wisdom and ability necessary to overcome these difficulties.

The Japanese are capable of great systematic efforts to marshal wisdom in many specialized fields and thereby achieve given national goals. The difficulty at present is not that Japan is incapable of finding specific solutions to its problems, but that it is not yet ready to set itself such a definite goal. ●