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What's Behind Japan's No To An IMF Bailout

JAPAN

Sometime around February of this year the businessmen and bureaucrats who guide Japan's economy decided that, from a global standpoint, the economic policy of the Carter Administration was an unmitigated disaster. Previously they had resisted this or that aspect of Trilateral policy — upvaluation of the yen, reduction of Japan's exports, domestic reflation, import cuts by developing nations, etc. — on the basis of its deleterious effect upon Japan. Nonetheless, they usually ended up compromising — on the assumption that the measure was yet another temporary burden to be endured until they were rescued by a world economic recovery that always seemed to lie several more months into the future.

Sometime around February their views changed. These gentlemen determined that the New York banks, the Brookings Institution, and the Carter Administration in fact have no economic strategy for global recovery. They simply have a policy of collecting the debt owed to Chase Manhattan, Citibank, et. al. and "let the real economy be damned." As one Japanese banker recently put it, "It is now widely believed in Tokyo banking circles that the International Monetary Fund austerity policy means five or six more years of zero growth for Japan."

At first the new attitude was expressed in cautious, hesitant tones. The Bank of Japan released a report March 1 that the Southeast Asian nations were "running deeper and still deeper into international debts with no hope of an early financial recovery." They noted these countries' 300 percent increase in private debt and 180 percent increase in public debt between 1974 and 1976 and said they feared this situation would become protracted. The Japanese then became a bit more forceful when, at the February OECD meeting in Paris, their delegation joined West Germany in criticizing Carter's three-nation reflation strategy as ineffective and fraught with inflationary dangers. Prior to the meeting, Japanese delegate Vice-Finance Minister Matsukawa had held consultations in Bonn.

By the end of March, the normally discrete Japanese adopted a strident pose. On March 97 the prestigious business daily *Nihon Keizai Shimbun* reported a leak from the International Finance Bureau of the Ministry of Finance (MOF) denouncing a proposed increase in IMF funds and a special new fund as "for the purpose of bailing out the unsound credits of the U.S. banks, (and) we cannot agree... They (the banks) must take care of it themselves by stretching out payment deadlines or some such."

Ten days later, Bank of Japan Governor Teiichiro Morinaga — usually restrained in his comments — told a Tokyo press conference that the proposed IMF fund "may have stemmed from an ulterior intention to make the governments of various affluent nations take over the huge overdue American commercial bank credits to collect from such developing nations. The U.S. commercial banks would then be the principal beneficiaries."

While the Bank of Japan has been resistant to David Rockefeller's reflationary strategy for a year and a half, hitherto the Ministry of Finance had been advocating a softer posture toward New York. The change in the Ministry's view is due to a shift among those influential businessmen who previously had bent over backwards to cooperate with the U.S.

These businessmen and bureaucrats have not decided upon a positive alternative strategy beyond determining that a commitment to capital formation is central. According to Japanese banking sources, Morinaga is counterposing to the IMF a proposal to increase aid to the developing sector tied to definite industrial development projects, exactly the type of projects that the New York banks want to sacrifice in favor of pure raw materials extraction. On the other hand, Morinaga and his business advisors are quite willing at this point to accept other types of austerity.

Not having a clear alternative, the Japanese have remained paralyzed with fear at the possibility of the collapse of the international monetary system, a fear admitted by the March 27 *Nihon Keizai Shimbun*. Their only actions have been negative: to refuse to accede to the IMF bailout plan and to refuse to commit Japanese funds to syndicates being organized by the New York banks. The Japanese refused to go in with Chase Manhattan and Wells Fargo on two consortiums for Brazil's Petrobras totalling $300 million and they are now very reluctant to go in for proposed syndicates for Indonesia and Mexico. Japanese bankers observe that there will even be some cases in which they will refuse to roll over existing syndicate loans coming due in the next two to three quarters. According to the Long-Term Credit Bank of Japan, surveyed financial institutions in Japan plan to decrease direct overseas investment in fiscal 1977 by 48 percent from 1976. This is sheer panic.

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Unfortunately for the Japanese businessmen and bureaucrats, barring an early reform of the international monetary system, if they are not able to keep up their high export levels — which already show signs of deterioration — then within two or three months, their economy could be in a shambles. They would face the spectre of 30 percent inflation or 20 percent annual rates of production decline.

Fukuda's Program Is A Fraud

Business' shift in thinking was prompted by the spectre of the financial disaster that looms if the present economic situation continues. GNP in the October - December quarter rose only 0.6 percent and the January - March quarter will probably prove to have been just as dismal. Prime Minister Takeo Fukuda, a longtime loyal ally of the Rockefeller political machine, promised business that his policies would lead to 6.7 percent real growth in the fiscal year that began April 1, 1977. Instead business sees the following situation: 1) January was the only month since the summer that real personal consumption rose above levels of the previous year, and then only by 1 percent. February daily department store sales were only 6.4 percent above February 1976, far below 8.5 percent inflation. While real wages have ranged 1-2 percent above year-before levels in recent months, consumers have refused to spend for fear of inflation and unemployment. The brunt of the 1976 sluggish 4.4 percent rise in real consumption occurred in the first half of the year as a byproduct of the phenomenal export growth of that period.

2) Capital investment in fiscal 1976 increased by 1.7 percent in real terms (up 12.2 percent nominally) after a 14.5 percent fall in 1975. But most private sources now predict another fall in real terms for fiscal 1977. Predictions for nominal growth range from Bank of Japan's zero growth prediction (an 8-10 percent real cut) to 2.2 nominal growth from Japan Development Bank (6-8 percent real cut). Capital goods shipments already fell 3.7 percent in January and new orders for machinery fell 17 percent in February to a level below that prevailing for most of 1976.

Yet, Fukuda had in large part based his 6.7 percent GNP growth projection on a promise of 12.2 percent nominal (3-4 percent real) growth in capital spending, which comprises 30 percent of GNP.

3) After six months at the same level, exports rose at an annual rate of 40 percent in December-February. Nonetheless, production fell during that period to a level lower than July 1976 and no higher than 1973 levels. In contrast, a similar export boom last year at this time produced a 20 percent annual rate production increase. This was because of spinoffs in production of consumer, capital and especially intermediate goods based on expectation of sustained growth. No such expectation prevails now. (See Tables 1 and 2.)

4) The Economic Planning Agency, the section of the bureaucracy most supportive of Fukuda, admits that the export boom cannot continue. They project that in April-September, exports to the U.S. and Europe will be no more than 3 percent above year-before levels. This is in contrast to October 1976-March 1977 levels when they rose 24 percent above year-before levels to those countries. Seasonally adjusted exports in February were 3 percent below January.

Table 1 — Production

(SEASONALLY ADJUSTED INDEX 1970=100)

	PRODUCTION	SHIPMENTS	INVENTORY	OPERATING RATIO
1973	127.3	-----	-----	100.6
1974	123.3	123.3	148.9	91.4
1975	109.7	114.8	162.7	81.2
JAN 1976	115.7	-----	-----	84.3
APR 1976	126.2	128.9	158.3	90.6
JULY 1976	128.2	132.0	157.0	89.1
OCT 1976	125.4	127.4	160.4	85.5
NOV 1976	128.9	132.3	163.4	-----
DEC 1976	128.8	131.1	167.8	87.0
JAN 1977	128.6	132.3	168.3	85.8
FEB 1977	127.7	131.7	168.7	-----

Table 2 — Trade

(SEASONALLY ADJUSTED IN BIL $)

	EXPORTS*	IMPORTS*	BALANCE OF TRADE*	OVERALL BALANCE OF PAYMENTS (IMF BASIS)
1975	55.9	58.8	+5.0	3.1
JAN 1976	3.6	4.8	.4	- .07
APR 1976	5.3	5.1	.9	.3
JULY 1976	5.9	5.6	.7	.3
OCT 1976	6.1	5.7	.7	- .5
NOV 1976	5.6	5.8	.6	---
DEC 1976	5.9	5.9**	.8	.5**
JAN 1977	6.4	5.6**	1.3	.5
FEB 1977	6.4	5.3**	1.4	.5**

* EXPORTS, IMPORTS AND TRADE BALANCE ON CUSTOM-CLEARED BASIS (CURRENT SHIPMENTS). ON THIS BASIS, EXPORTS AND IMPORTS ARE MEASURED DIFFERENTLY IN TERMS OF WHETHER SUCH ITEMS AS FREIGHT COSTS, INSURANCE, ETC. ARE CONSIDERED; THUS COMPARING TWO ITEMS DOES NOT YIELD THE TRADE BALANCE THAT REFLECTS THE ACTUAL RELATIONSHIP.

** IMPORTS FOR DEC-FEB AND PAYMENTS BALANCE FIGURES FOR DEC AND JANUARY ARE NOT SEASONALLY ADJUSTED. PRESS REPORTS INDICATED THAT AFTER SEASONAL ADJUSTMENT IMPORTS ONLY ROSE AT 4% ANNUAL RATE IN DEC-FEB WHILE EXPORTS ROSE AT 40% ANNUAL RATE.

NOTE:

IN COMPARISON WITH 1975 TOTAL EXPORTS OF $55.9 BIL, 1976 EXPORTS WERE $66 BIL AND, IF JAN-FEB RATES CONTINUED, 1977 EXPORTS RATE WOULD HIT $77 BIL. TRADE SURPLUS WAS $9 BIL IN 1976.

Japan could produce nothing near Fukuda's 6.7 percent growth without fiscal measures that would be wildly inflationary. The government is now running a 30 percent budget deficit. With some qualifications as to degree, this judgment is generally accepted both in Tokyo and in New York. Columnist Mitsuo Kono reports in the April 6 *Yomiuri* that a majority of bureaucrats have determined that it is too dangerous to try to achieve the 6.7 percent growth. Since Fukuda had made the promise to Carter (as part of efforts to increase imports from debt-ridden developing nations) Kono reports, "The government will actually take the course of averting the danger of inflation, while pretending to be fulfilling honestly the role of a traction engine (the codeword for increasing imports)."

The problem faced by business and the bureaucrats is not "economic wizard" Fukuda, but the difficulty in producing growth at all, as export growth becomes impossible. Export-led high growth since the mid-1950's has been the only way Japan has been able to sustain its internal debt structure — the highest debt-to-GNP ratio in the advanced sector outside of the United States. Not only the high growth but the surplus profits gained on terms of trade on both export and import side were necessary to maintaining debt service. When exports are threatened there can be no effective domestic substitute for any significant length of time. Thus, the post-1971 stagnation in world trade produced a sudden rise in Japan's inflation from negligible to nearly 30 percent. When anti-inflation measures were taken, production collapsed 20 percent. Although inflation has stabilized in the last two-three months, it can erupt suddenly. Financial strain is indicated by a predicted 15 percent drop in corporate profits in April-September.

In order to alleviate the strain, the Bank of Japan — under strong pressure from politicians of the ruling conservative Liberal-Democratic Party — announced another 1 percent cut in the official discount rate to 5 percent following a 0.5 percent cut on March 12. This will not stimulate either capital investment or overall growth but will ease the pressure of interest charges of the immense debt of Japan's corporations.

Until recently, Japan's policymakers assumed they could hang on with an artificially based export-boom in consumer durables until world trade recovered. Now they recognize that such a recovery is impossible under current policies. Nonetheless, they will strive to sustain the export levels they now have for another few months. They will make compromises with protectionism and upward pressure on the yen in order to do it, as indicated in April 7 *Yomiuri* editorial.

How Long Can the Exports Hold Out?

Barring fundamental international monetary reform by midsummer, exactly how long the economy survives depends almost entirely on the export situation. This is difficult to assess because of its dependence upon political decisions in the U.S. and Europe on such matters as consumer credit and protectionism, as well as New York bank-organized upward pressure on the yen. At least in the short-term, the Japanese have shown an amazing ability to suddenly jack up exports at phenomenal rates, e.g. the 40 percent annual rate increase in December-February to $6.4 billion after a July-November period hovering around $5.9 billion.

Nonetheless, the situation looks weak. No one predicts any significant rise for the rest of the year from $6.4 billion monthly level — this is a $77 billion annual rate compared to $66 billion in 1976. Moreover, there are already signs of erosion, e.g. a 3 percent seasonally adjusted drop in custom cleared exports in February, and a seasonally adjusted 3 percent drop in February letters of credit for exports, a two-three month leading indicator.

In addition to the normal economic factors, the export situation will be determined by a political battle now in progress over the value of the yen. By April 13 the New York banks had managed to force the yen up 8 percent from its January level to 270 per dollar. According to press reports they were aiming at a 260 level. This, as one leading Brookings Institution economist indicated, is being used as a political bludgeon since they cannot budget the Japanese either on the 6.7 percent growth issue or on the IMF bailout. A Manufacturers Hanover official confirmed: "It's political."

While insiders report that Prime Minister Fukuda agreed to let the yen rise to 270 or higher, other political and business circles have since moved to force it back down. The discount rate cut announced by the Bank of Japan on April 18 sent the yen back to 277 as of April 21, and it may go a bit lower. The fight over the yen has not been settled yet by any means. (See Foreign Exchange report for more details.)

The 270 rate had already begun to hurt the steel industry and smaller and medium business who cannot raise their overseas prices due to slack markets, but would sell at a loss if the yen remained at 270. Prior to the discount rate cut, Economic Planning Agency officials and Federation of Bankers Association chief Toshio Nakamura both told press conferences that the yen was overvalued, and should be no higher than 280 to the dollar. Bank of Japan head Morinaga declared that "outside speculators" had helped fuel the rise.

Table 3— Inflation

	(1970=100) WHOLESALE	(1975=100) CONSUMER
1974	152.2	89.2
1975	156.8	100.0
APR 1976	163.5	109.3
JULY 1976	166.5	109.6
OCT 1976	168.2	112.5
NOV 1976	168.7	112.9
DEC 1976	168.9	114.1
JAN 1976	168.8	115.5
FEB 1976	169.4	116.1
MAR 1976	-----	116.7

Table 4— Bankruptcies

	CASES	VALUE
1974	12,600	$6.3 BIL
1976	15,640	7.5
APR 1976	1,205	.55
JULY 1976	1,223	.47
OCT 1976	1,489	.84
NOV 1976	1,597	1.10
DEC 1976	1.685	.73
JAN 1977	1,285	.68
FEB 1977	1,364	.63
MAR 1977	1,706	.90

The fate of exports will primarily be decided by the fate of the following products, each of about equal weight (10-15 percent) in total exports, together comprising 75-80 percent of total exports of Japan:

STEEL: Steel exports have been stagnating in recent months after a sharp rise in early 1976. Even before the yen rise it was expected that steel exports would deteriorate in April-June to a level 1.3 percent below January-March and 5.6 percent below the previous year. According to press reports, steel has been particularly hard hit by the yen rise. While prices (quoted in dollars) can be raised somewhat in the U.S., weak markets prevent such action in Europe. For the large makers, the breakeven yen rate was 290, for the smaller makers it was higher. Steelmakers now lose money on every ton they export. Some sources predict the smaller makers may cut exports 50 percent this year, leading to an overall cut of 15 percent. Exports, one-third of total production, had been vitally important to the deficit-ridden steelmakers whose domestic sales are 28 percent below peak levels.

COLOR TV, STEREOS, ELECTRONICS: Electronics goods are being hit hard by protectionism, particularly in the U.S. where a New York Customs Court has ordered countervailing duties on Japanese electronic shipments ranging from 5 percent to 40 percent of the product. The court reached back to an 1897 statute to countermand the rules of GATT (in which the U.S. participates) which state that it is not considered a subsidy for a foreign government not to apply to U.S. citizens the sales taxes it imposes upon its own. While the duties do not apply pending appeal, importers have been ordered to post a 13-15 percent bond in case they lose the case. In addition, the Carter Administration will most likely impose tariffs or quotas to reduce Japanese color TV shipments here from the 1976 3 million to 1-2 million. Talks in Tokyo to get the Japanese to voluntarily reduce shipments failed to reach agreement. As of this moment, there is no word on results of talks begun April 14 in Washington with Japanese representatives. In any case, in anticipation of protectionist action, Japanese color TV shipments here in January-February were 23 percent below 1976 levels for that period while Japanese total color TV exports at 290,000 in January and 380,000 in February were far below 480,000 unit levels prevailing in 1976. (TV exports are approximately half of total production.)

SHIPS: At present ship exports remain high, but these are based on orders from two to three years ago. While construction on these orders continues, new orders are falling rapidly.

AUTOS: One of the few bright spots, January-February automobile exports hit all-time record highs at 24 percent above year-before levels. This is only partly due to rise in total imports by the U.S.; a larger factor is the Japanese replacing other countries as top suppliers to the U.S. Exports have now risen to about half total auto production.

PLANT AND EQUIPMENT AND OTHER MACHINERY: Plant and equipment remain a bright spot with sales to the Mideast and the East bloc. The total is rising from $6 billion in 1975 to $12 billion in 1976. Other machinery is stagnating.

— Richard Katz