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Q: So you would completely separate Japan's relations with China and Japan's relations with the Soviet Union?

Miki: It may not be possible to separate these two issues, but Japan will endeavor to improve relations with the Soviet Union. This is an inevitable thing for Japan, but it takes time.

Q: Well, shortly after the treaty was signed between Japan and China, Yuri Brezhnev, President Brezhnev's son, who is a Deputy Soviet Trade Minister, visited Japan, and the Japanese press reported that Mr. Brezhnev made a series of proposals to Japan on economic cooperation which were apparently similar to the proposals his father made to Chancellor Schmidt when he was in Bonn last May. Very broad-ranging and long-term cooperation proposals. Do you consider this type of economic cooperation one way that Japan and the Soviet Union could improve relations?

Miki: The improvement of relations between the Soviet Union and Japan can take place in great part through economic cooperation.

Tokyo capital market puts muscle behind 'Bremen East'

The Japanese are making "banzai" charges again, announced an alarmed London *Financial Times* on Oct. 26, only this time it is Japan's bankers rather than its soldiers that are threatening the British Empire.

Over the last year Japan has emerged as a major international financier. Its overseas loans have almost tripled, to an annual rate of $13-15 billion this year, versus $5.3 billion in 1977. (See Figure 1.) Behind this amazing growth lies a new institution yet little noticed in the U.S. press, the Tokyo capital market.

Japan has been involved in normal, private international lending since the early 1970s. The new Tokyo capital market, however, is being implemented by joint government-private cooperation to rechannel dollars, now being primarily used for rollover and-or speculative purposes, into long-term productive uses. Since approximately last February the Tokyo Capital Market has functioned in conjunction with West German and French efforts and the emerging European Monetary System first formalized at this past summer's summit at Bremen as the seed-crystal of a new international monetary system. Japan intends to make the efforts to reform the monetary system the subject of next summer's heads-of-state summit in Tokyo.

The ultimate purpose of the Tokyo Capital Market was made clear at an emergency meeting of Japan's Finance Ministry on Oct. 25, called to deal with the rise of the yen above 180 per U.S. dollar. At the meeting the Finance Ministry decided that measures must be taken to either freeze or recycle back to the U.S. the $500-600 billion pool of loose dollars which serve as a hotbed of international monetary turmoil. Japan intends to propose such measures to the meeting of the Organization for Economic Cooperation and Development, and the advanced capitalist industrial nations, at the end of November as well as the upcoming Tokyo summit. At the same time, Japan proposed immediate large-scale swap arrangements to stabilize the dollar, a move incorporated in President Carter's Nov. 1 announcement of a dollar-support package.

The heart of the Tokyo capital market is the cooperative relationship between the Bank of Japan and selected commercial banks there. The BOJ has been lending dollars to these banks at somewhat less than Eurodollar rates, the source of those dollars being the speculative inflow into Japan. As a result, the private banks have an added margin of profit, enabling them to make long-term, productive loans for capital development projects in the developing countries. In certain cases, the Japanese banks have made loans at rates undercutting the prohibitive Eurodollar rates. In the case of yen-denominated loans, the rates have been as low as 7.5-8.0 percent per annum, far below the 10-13 percent rates prevailing on the Eurodollar market. As a result, many developing countries, unable to borrow for capital projects at the higher rates, have now borrowed from Japan to revive stalled industrialization programs.

Japan's challenge to offshore banking's high-interest-rate regime has drawn a predictably sharp reaction from austerity-minded officials. The U.S. Treasury's C. Fred Bergsten, for example, one of the architects of the dollar's fall, denounced the Tokyo capital market as a form of "credit dumping analogous to export dumping." An almost apoplectic *International Currency Review* — published by the Rothschilds — told its readers in September, "It could well turn out that the origins of the 'crash of '79' should

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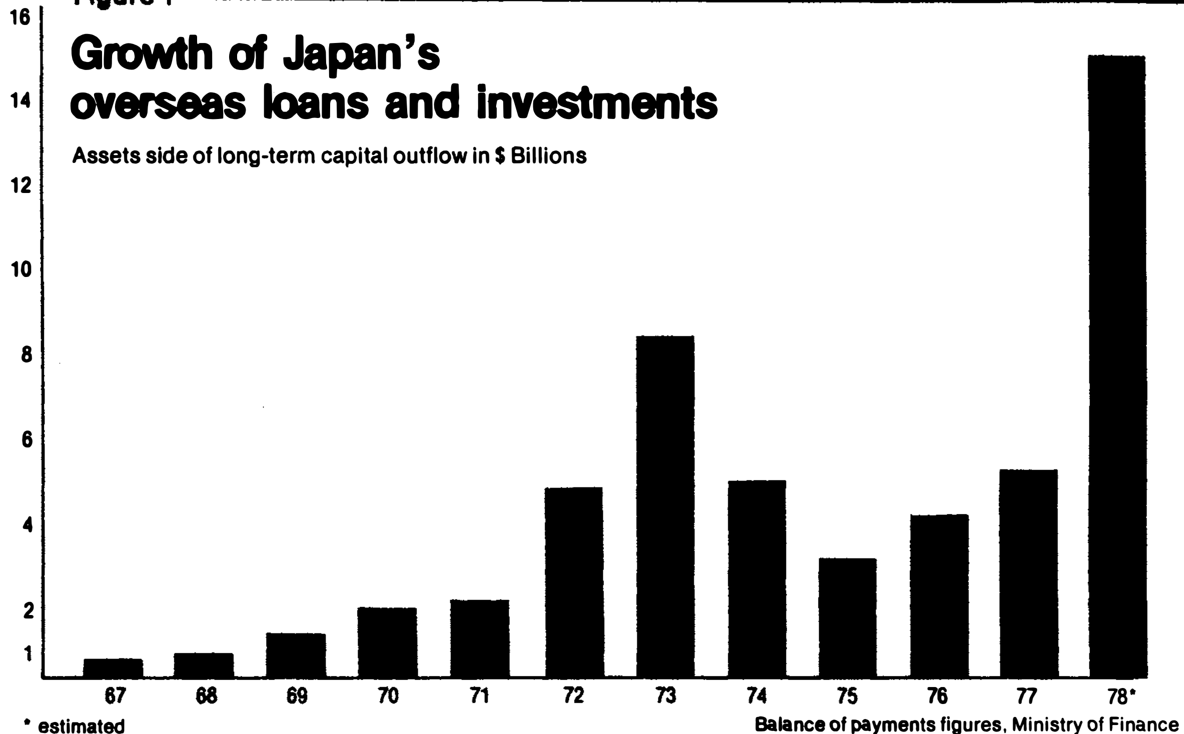

be sought not in Saudi Arabia, but in the challenge to the Western banking system coming from the Far East."

Certain short-sighted U.S. bankers are also complaining that their Japanese colleagues are cutting them out of the lending business. A cursory look at the loans involved, however, indicates that at least a plurality have been for projects that the London-dominated International Monetary Fund-World Bank has been trying to prevent, and that the U.S. had declined to lend to in deference to the IMF. For example:

- *$700 million for the Tuburao Steel project in Brazil,* a project the IMF-World Bank has been trying to stop for two years;
- *$1.2 billion in credits to Mexico* for projects involving *port expansion, oil,* and *electricity*. The loans, involving the Japan Export-Import Bank as well as private lenders, were signed during the just-concluded visit of President Lopez Portillo to Japan, and are seen as only the beginning of much larger economic cooperation. The pact gives a big boost to the industrialization program of Lopez Portillo's government, and a defeat for his opponents of the London-allied Monterrey group.
- *$300 million to the Asahan steel project in Indonesia,* another target of the IMF-World Bank.

Japan fully intends to expand the Tokyo capital market, using additional forms of finance to supplement Bank of Japan-private bank mechanisms. Last month Japan's government announced a proposed change in the law governing its foreign aid agency, the Overseas Economic Cooperation Fund. Rather than have the Fund lend its limited money, under the new law private banks would make approved aid loans and the Fund would pay the interest, the recipient paying only the principal.

It is clear that these efforts are necessarily limited. They are seen by the Japanese not as new systems in and of themselves, but as part of the process of creating a new, investment-oriented monetary system, of which the European Monetary Fund is the foundation. Last April the Mitsubishi Research Institute proposed a $500 billion, 20-year scheme for worldwide industrialization projects, and Premier Fukuda presented the proposal to President Carter when they met last May. This is the economic content of the monetary proposals Japan will present to the OECD at the end of this month.

The facts behind 'Bremen East'

The Tokyo capital market is the implementation of an international "save the dollar" strategy worked out in a series of meetings beginning early this year. From the Japanese side, key participants were representatives of Prime Minister Fukuda, the Industrial Bank of Japan, and sections of the Mitsubishi corporate group. From the West German side, the most significant figures were emissaries of Chancellor Helmut Schmidt, the Deutsche Bank, and business leader Otto Wolff von Amerongen. Both

Deutsche Bank and Wolff von Amerongen have long-standing business ties to Japan, and Schmidt and Fukuda have known each other personally since both were Finance Ministers in 1973. Not unimportantly, Schmidt's specialty as an economics student in the late 1940s was Japan's dirigist financial system.

The predicament these leaders met to discuss was that the vicious cycle of Eurodollar monetary inflation and IMF austerity made it exceedingly difficult to arrange long-term productive loans. From the standpoint of the private sector, the dollar had become almost worthless as an instrument of international investment. Only state intervention could restore the dollar's value and private lending capability. This realization led to the creation of the European Monetary System and its Pacific adjunct.

The situation of the Japanese banks was particularly acute. They were under "advisement" from the Ministry of Finance to lend long-term only with funds acquired long-term, not with short- or medium-term funds. The reason: the Ministry hoped to avoid a repeat of the 1974-75 "Japanese premium" crisis.

During the Herstaat bankruptcy flap in the summer of 1974, the tight Euromarket slapped a special "Japanese premium" on Japanese borrowers, who had heavily borrowed following the oil crisis. With $30 billion in outstanding international loans, and with foreign reserves dropping to $10 billion from $16 billion, Japan was at the mercy of the international bankers. And Japan's financial dependency was not unrelated to the success of the London-engineered removal of Prime Minister Kakkuei Tanaka in November 1974 and, later, the ouster of Takeo Miki in December 1976. Both men had been trying to implement the kind of policies now embodied in the Bremen accords.

The Finance Ministry wanted to make sure that Japan never got caught in that kind of bind again. And fears of a repeat appear to be well founded. For example, one banker told this reporter that whenever the Eurodollar market gets tight, such as during a Mideast crisis, surreptitious ways are found to once again impose a de facto "premium" on Japanese borrowers.

But since "window guidance" from a powerful ministry is almost always followed, Japanese bankers followed the Finance Ministry's advice and restricted their long-term lending to funds acquired long-term. There is a problem, however. The margins in the Eurodollar market between the rate for acquired funds (called the London interbank overnight rate, or LIBOR) and the lending rate had so shrunk so much that long-term lending for projects was practically impossible. Therefore, in 1976-77 Japan's long-term lending rose very little from the low rates of the post-oil-shock period.

It was this condition in the Eurodollar market that prompted Japanese and West German leaders toward the EMS policy and its "Bremen East" corollary. Ostensibly in order to avoid a repeat of the 1974 crisis, the IMF forced less developed countries and weaker OECD nations to cut borrowing needs by cutting capital formation, fertilizer imports, and other

"excessive expenses" vital for economic growth. This did cut borrowing, of course, but made management of already acquired loans more difficult by cutting deep into future production potential. Meanwhile, bankers desperate to lend already overbloated assets in the Euromarket fell all over each other cutting margins in order to attract customers. The margin over LIBOR fell even though LIBOR itself remained high, too high in fact for the less developed countries to borrow for urgently needed projects. The LDCs simply borrowed funds at the lower margin, to pay off the loans originally made at a higher margin. In this atmosphere productive lending ground to a standstill.

Meanwhile, the dollar became increasingly useless as an instrument of international trade and investment, and therefore easy prey for engineered speculation. Dollars flew to Japan, raising the yen rate from 300 to the dollar at the time of Jimmy Carter's inauguration to almost double that, 176 to the dollar, just prior to Carter's Nov. 1 dollar-support announcement. Japan's foreign exchange reserves rose to almost $30 billion.

But unlike in 1973-74, when dollars poured into Japan and then immediately poured out again, this time very few international loans were made. In fact, Japanese bankers report that they had turned down many offers from New York banks to join loan syndicates. Who wanted to lend dollars when the currency's value might fall 20 percent, or 30 percent, or even 50 percent by the time it was repaid?

Therefore the Japanese and West Germans agreed on a system of government-private cooperation to provide relatively cheap long-term funds for long-term productive lending while stabilizing the dollar — that is, the Bremen system. The growth in Japan's overseas lending was possible only because of the Japanese government and Japanese bankers confidence in the soon-to-be-announced EMS. On the other hand, the growth in loans since February was itself part of the process of putting the EMS together and insuring its victory over IMF austerity policy.

The increasing international hegemony of the Bremen system comes none too soon from the standpoint of Japan's domestic financial situation. Despite booming trade surpluses in shrinking dollars, Japan's exports for the April-September term in real, constant-value terms were over 3 percent below those of April-September 1977 — a disaster for this export dependent country (Figure 2). Industrial production was virtually stagnant during the same months. The economy is being kept afloat by government public-works spending and money supply increases at an 11 to 12 percent annual rate. Despite Fukuda's oft-repeated promises of 7 percent growth in real GNP, most observers think 4.5 to 5.0 percent is more likely. Even so, the industrial production figures are a more accurate barometer of the nation's economic health at this time than are the GNP indicators.

In order to stave off bankruptcies in such a situation, the banks have been providing corporations with under-the-table debt moratoria and cut-rate loans, leading to negative interest margins on most bank funds. Without restoration of world trade, Japan is heading for financial catastrophe.

Japan versus the IMF

One feature of Japan's loans that should not be underestimated is the extent to which Japan is funding specifically key projects that the IMF and World Bank had tried to kill. Japan, together with its allies in Europe, is fighting toe to toe with the IMF. Asked about this recently, one Japanese banker demurred. "No," he said, "these loans are just sound banking business." But in fact that is the point. Simply making normal, "sound banking" loans these days for productive projects means taking on the full powers of the IMF and its international allies.

Japan has a certain amount of experience in this regard. Since the mid-1960s and especially since 1970-71 — the date of the report on long-range economic policy by the Industrial Structure Council, an industrial advisory body to the Ministry of International Trade and Industry — Japan has regarded the industrialization of Asia and Latin America as integral to its own further development. As Japan sees it, in order for Japan to move on to the "knowledge-intensive" level of computer and fusion power production, steel and auto assembly must be transferred to Korea, the Philippines, and so on. A successful transfer of technology of this type requires building up indigenous nation-builders in Asia and Latin America with the same commitment to and understanding of industrialization as has existed in Japan itself. Much of Asian history over the last 20 years has been the fight between Japan's modernization efforts and the obstruction of such efforts by the networks of the IMF and the Hong Kong and Shanghai Bank. The fight in Indonesia between the "Berkeley Mafia" and the prodevelopment Pertimina group is a classic case in point. The success story is the Republic of Korea, where a fiercely independent and committed elite has made optimal use of Japan's resources.

And in all these efforts Japan has sought to involve the U.S. in a partnership for Pacific development. The Pacific Basin conferences of the late 1960s are exemplary. Japan is making another such effort now, when the fate of the U.S. itself is at stake.

—Richard Katz