Blumenthal Currency Manipulation Sends Japan

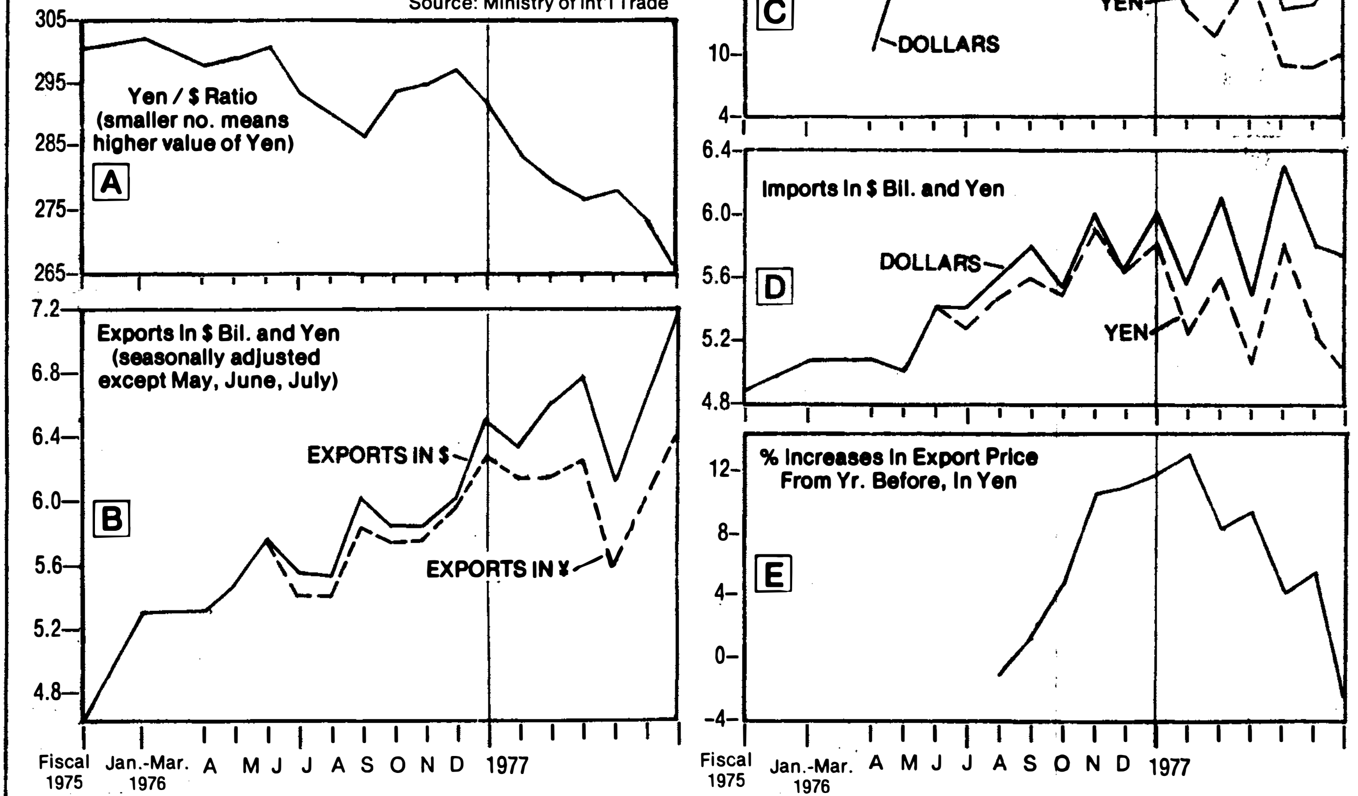
An alarmed Bank of Japan warned last week that leading Japanese corporations are resorting to severe cost-cutting measures — including cuts in capital investments, inventory liquidation, and putting workers on short-time — to try to solve Japan's new acute liquidity crisis. Some firms are going so far as to cut necessary operating expenses in order to gain cash for short-term speculation in real estate and the stock market. According to confidential internal reports of the majority of Japan's leading banks — reports which they say they are afraid to show to their clients — these cost-cutting measures will lead to unmitigated recession within months unless the process is arrested by large-scale government stimulus.

The responsibility for this debacle lies squarely with the Carter Administration and its backers in lower Manhattan. Every one of that faction's fundamental international economic policies has hurt Japan's exports — the sole basis of Japan's financial stability and economic growth over the past two years. Carter and Wall Street have forced the developing countries and weaker advanced countries to restrict their imports. In the U.S. and in certain European countries they have set up protectionism shields against almost every major Japanese export: steel, automobiles, ships, textiles, TVs, even ball bearings.

The result has been a seven-month long stagnation of Japan's exports. (Graph 1B) The 10 percent yen ap-

Graph 1

Trade Indicators In Dollars Vs. Yen



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preciation that Treasury Secretary Blumenthal forced upon Japan, transformed this into an immediate, unmanageable liquidity crisis. Many of the export corporations, which had provided a critical margin of liquidity for the economy as a whole, are now selling below the cost of production.

The crisis has polarized Japanese political and business circles into three distinct points of view, all demanding drastic action.

Prime Minister Takeo Fukuda and his allies are willing to follow the dollar empire to its final collapse. They insist that Japan increase imports to bail out countries in debt to the U.S. banks, while simultaneously permanently switching to a low-growth economy.

Most representations of business reject this point of view. For the moment, however, they have not determined a positive alternative, but demand that the government launch an $11 billion reflation program and give them the cash to avoid bankruptcy.

A third grouping, still a small minority of business, has seen that the crisis demands a break with the dollar and positive action to restore world trade.

The Crisis

The alleged purpose of the assault on Japan's trade launched by Wall Street is to force the country to decrease exports to, and increase imports from, the developing countries and weaker European countries. Wall Street hopes this will give the latter countries sufficient revenue to pay their debts to the New York banks. It is assumed that Japan, West Germany, and the U.S. will all carry out the same policy: giving the scenario the title "the three engines of recovery." As anyone three weeks in a first college semester economics course could have told Mr. Blumenthal, the stagnation in exports has not produced an increase in imports, but the opposite. (Graph 1D).

Because of the stagnation in exports, Japan has been on the brink of recession for months. Production at the end of June was no higher than last November and is estimated to have fallen again in July. Real wages have fallen to a 1-2 percent annual rate of increase. Machinery orders fell 7.5 percent in April-June. Capital investment is predicted to fall in July-September, for the first time since early 1976, then by another astounding 8.4 percent in October-December! By July, corporations were selling solid stocks because they needed the money, and the market hit its 1977 low.

As one chief economist at a leading New York bank put it, "Well, I agree that the yen revaluation won't achieve what Blumenthal says it will. But, you have to admit it's better than having the yen fall in value."

The Three Options

Pushed by a panicked business community, Premier Fukuda met with government and party leaders for three days during the first week in August and announced a hastily prepared $4-6 billion reflation program. Three weeks later business raised its demand to $11 billion and Fukuda raised his offer to $5-7.5 billion.

This step Fukuda desperately wanted to avoid. As late as two weeks before the emergency meetings, his deputies were insisting that the economy would soon resume its "paused" recovery and that no new stimulus was required. As longtime public protégé of David Rockefeller, Fukuda has insisted that Japan adhere to the Trilateral Commission strategy of the "three engines of recovery." In the summer of 1976 then-Brookings Institution economist, now Assistant Treasury Secretary, C. Fred Bergsten called for a substantial revaluation of the yen, then at 300 to the dollar. Within days Fukuda publicly echoed the call (at the time he was director of the Economic Planning Agency and Deputy Prime Minister.)

Chase Manhattan officials have told *EIR* that an essential part of the "three engines of recovery" policy is a permanent restructuring of Japan's economy away from export-dependent high growth to "low, stable growth." Fukuda has repeatedly castigated business for demanding government measures to end the three-year recession. Last spring, when the renewed stagnation became evident, he spent months bickering with business over whether a piddling $1 billion tax cut could be added to an $80 billion budget already one-third in deficit.

Fukuda attempted to seize upon the current liquidity crisis as an opportunity to enforce the restructuring program. His instrument in this effort is a group called the Industrial Planning Council. The council is chaired by Takeshi Sakkurada, a fervent Fukuda supporter and the head of the Employer's Association. Two weeks ago the council issued a statement calling for sharp restrictions in exports of steel, autos, ships, and home appliances — exactly the demands of Blumenthal. On a long range basis they demanded lowering exports from 13 percent to 8 percent of Gross National Product (GNP) and restricting growth in nine "pollution-causing and resource-consuming" industries including steel, autos, electric power and chemicals! According to the Aug. 15 *Mainichi*, the council's credo is that Japan must end its "blind faith in the concept of ever higher GNP and growth rates" because "raw materials can't last forever." It threatens that unless Japan turns to "low growth" it will suffer a permanent recession.

The disastrous results produced by Blumenthal and Fukuda have so weakened Fukuda politically that he has been unable to carry out his preferred policy. Instead, business forced him to acquiesce to the reflation program.

These forces are led by Toshio Komoto, a former shipping magnate now heading the Policy Affairs Council of the Liberal-Democartic Party, a rumored potential successor to Fukuda.

The reflation program itself, however, is not a genuine recovery program but a short-term inflationary gimmick. Although the full details were not available at press time, most of the program as presently announced consists of financial giveaways to industries and firms threatened with bankruptcy due to the recession and or yen appreciation. The public works aspect of the program consists mainly of accelerating existing programs for highway and railroad construction and building of oil stockpiles; few, if any, major new programs are being initiated. In addition there will likely be another cut in the discount rate of 0.5 percent or 1.0 percent from the present 5 percent level — the one healthy anti-inflationary measure in the entire program.

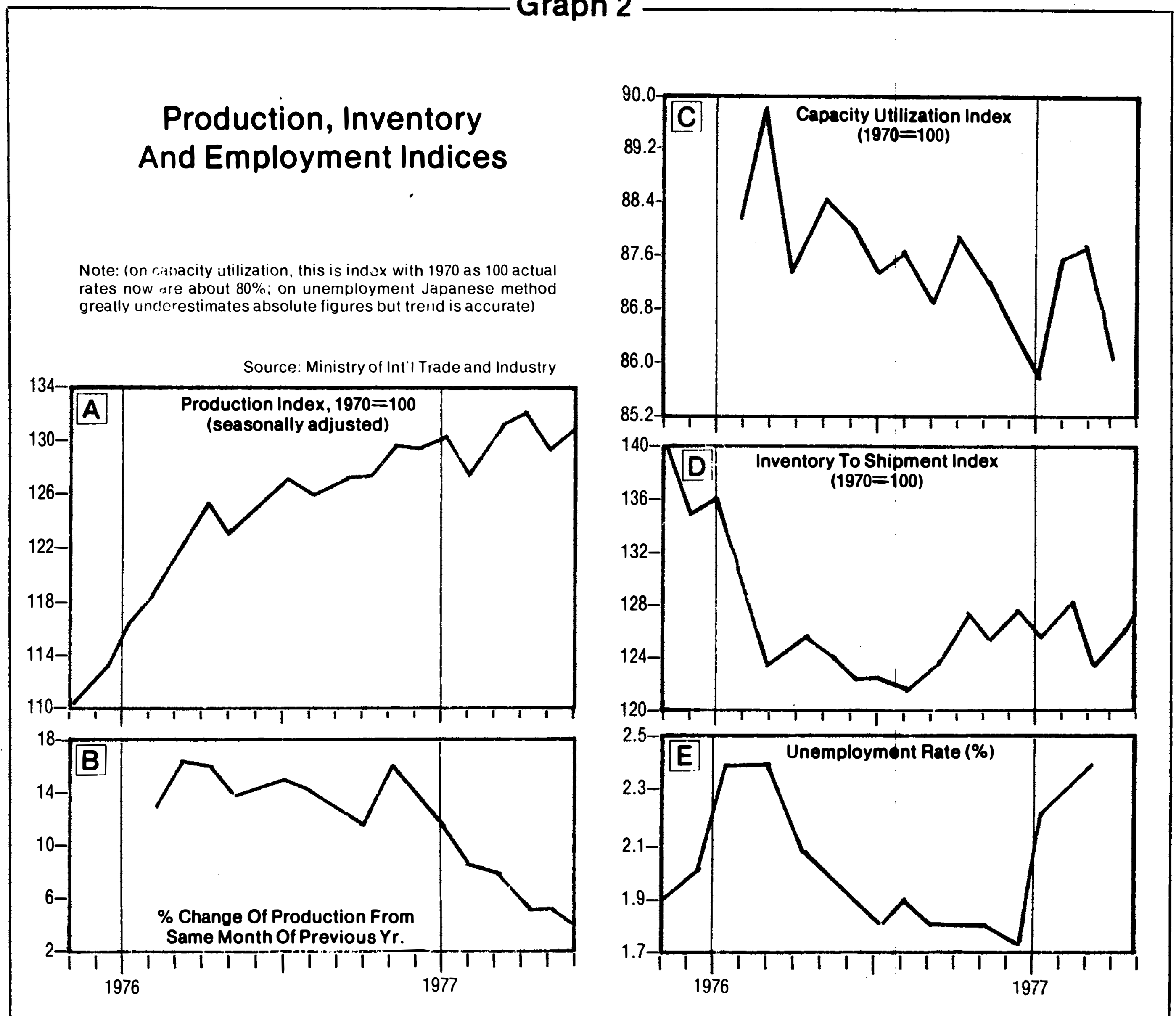
The Finance Ministry and the Bank of Japan have been quite reticent to approve the program because of its hyperinflationary potential. The Bank of Japan recently warned that corporations are reducing capital expenditures and other necessary operating expenses in order to gain cash to make quick bucks on the stock market. This speculative fever sent the market from 1977 lows in July to 1977 highs in August. The Bank of Japan fears any new injection of liquidity will simply accelerate that process. For this reason it even opposes the discount rate cut, while the Finance Ministry wants to limit the reflation program to $1-2 billion.

The majority of business is so desperate for immediate cash that they have ignored both the danger of inflation and the need for a genuine recovery program. Even Mitsubishi Bank, well known as the most bearish in its predictions and the most fearful of inflation, supports the financial bailout. In a confidential internal report, they said preventing a financial panic is more important that worrying about inflation.

Only a minority among leading businessmen has pointed out that disaster awaits Japan if it follows either Fukuda's low-growth or the bogus alternative of an inflationary binge. According to Japanese banking sources, this group is trying to design an institutional basis by which petrodollars can be used to stimulate trade and development rather than fill the coffers of the New York banks and the Eurodollar market.

Their viewpoint was presented in an Aug. 1 front-page lead in the *Mainichi Daily News* by Ichiro Takeuchi, Counselor to the Bank of Tokyo. Takeuchi locates current international monetary turmoil in the overvaluation of the dollar, adding, "The U.S. is seeking Japan's cooperation is 'correcting' the overvaluation of the dollar." He compares the current period to the crisis of February-March 1973 which led to the oil crisis and then the Herstatt bankruptcy, adding, "There is no guarantee that such an incident could not happen to the Japanese banks" (Last year Sumitomo Bank suffered a $300 million foreign exchange loss, the largest in history, when

Graph 2



Ataka trading company went bankrupt.) Takeuchi says the answer is to end Japan's "unnatural and irrational total dependence on the dollar." He proposes internationalization of the yen in such a way as to promote trade.

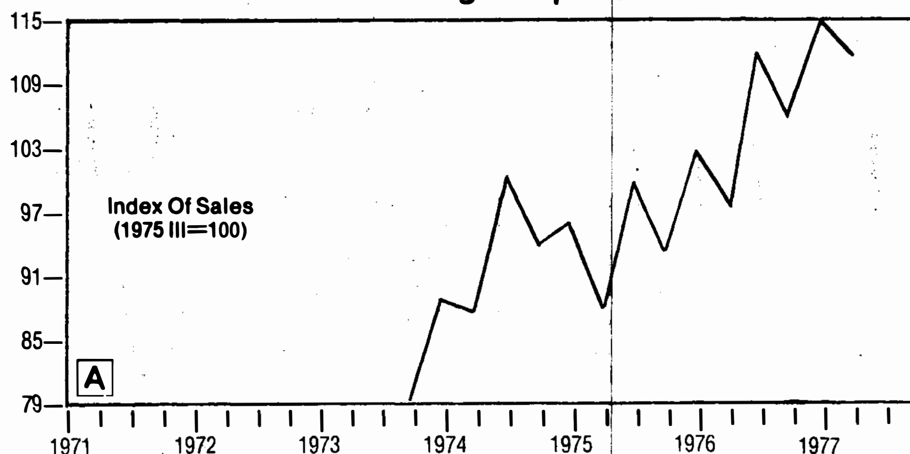
A high Japanese government official told *EIR* that a faction of business and the bureaucracy has now decided that Japan must coordinate its economic, trade and currency policies with West Germany, not the U.S. He reports that this faction is increasingly forcing its policies on the government. Setting up such an axis was the subject of the recent visit of West German Economics Minister Hans Friderichs, according to this source. The Vice Minister of the International Trade and Industry Ministry recently visited the OPEC countries to secure closer relations with them.

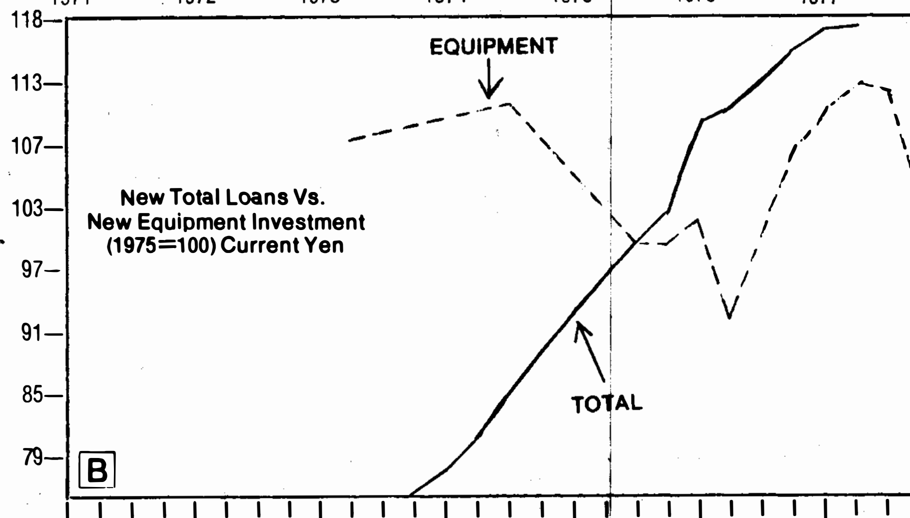
The most positive concrete proposal has come from a group of business leaders known as Keizai Doyukai. Acocrding to the Aug. 21 *Mainichi*, they called for setting up a new institution to fund capital investment projects in South East Asia. The institution would use funds from the industrialized world and OPEC. Neither the Bank of Tokyo article, nor Keizai Doyukai, nor the cited government official has yet concretely addressed the problem that Japan's survivial requires positive action to restore world trade as a whole, and their lack of strategy has enabled Fukuda to sabotage many of their best efforts. On his recent tour of South East Asia Fukuda was expected by Japanese business, as well as the countries of the Association of South East Asia Nations (ASEAN) to approve government aid to five regional industrial development projects amounting to over $1 billion. Fukuda refused to grant approval, claiming that more long-term feasibility studies are needed.

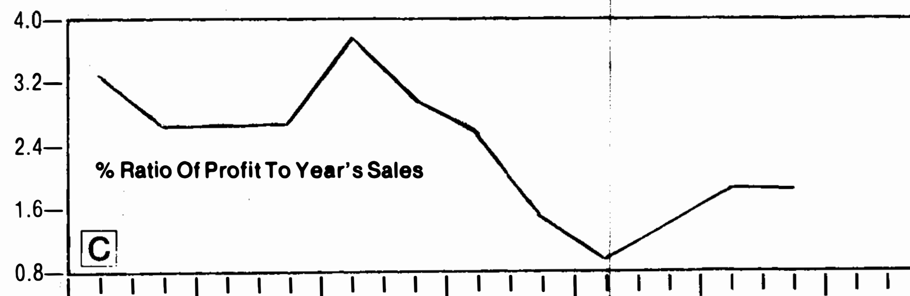
Japan's Financial Structure:
The Case of Steel

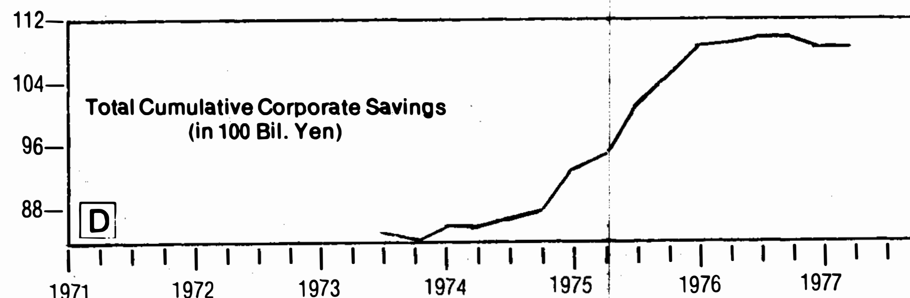
The havoc that Blumenthal's antics have wreaked upon Japan is epitomized by the plight of the steelmakers, whose product com-

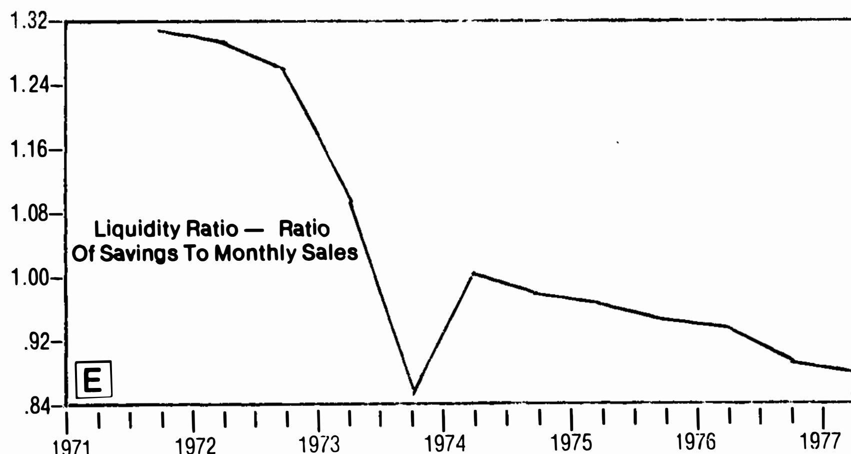
Graph 3
Financial Accounts Of 500 Leading Corporations

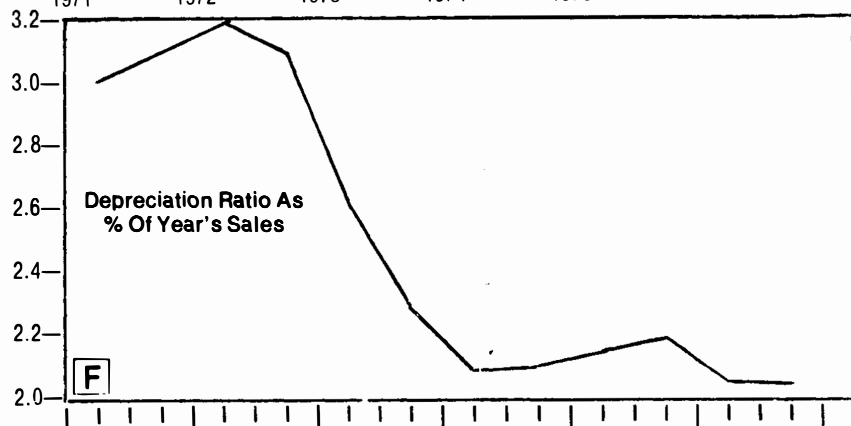


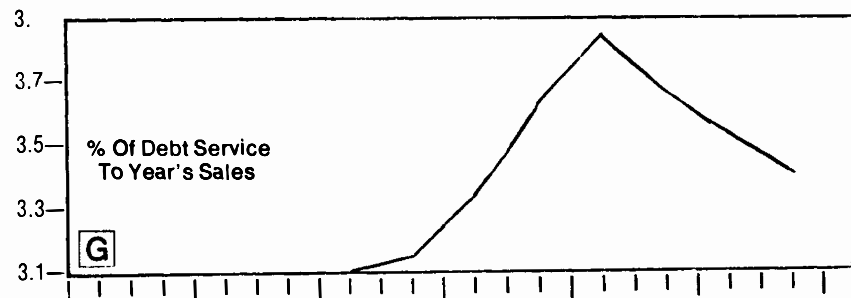


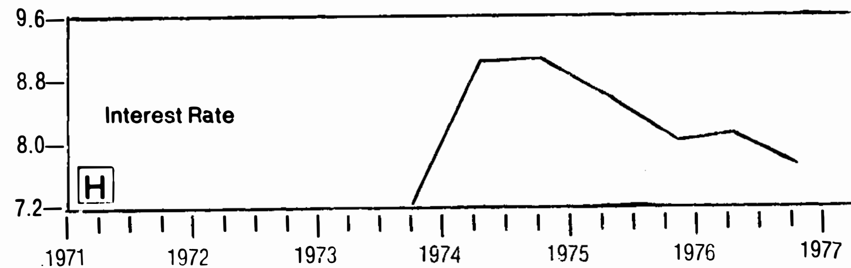












Note: in **Graph G** the ratio of debt service to year and sales at about 3% underestimates impact on economy, since sales involves double counting from firm to firm. Debt's Impact can be realized when it is known the debt cost equals about half of labor costs for the average firm.

In **Graphs D, E,** and **F**. in liquidity ratio, cumulative savings, sales and total loans, the figures for the first two quarters for 1977 are Bank of Japan predictions. For equipment investment all of 1977 is predicted level. **(Graph B)**

Source: Bank of Japan

prises 15 percent of Japan's exports. Like most of Japan's major corporations, the steelmakers have huge debts. This is not because they imitated U.S. corporations' practice of increasing debts while refusing to modernize, but just the opposite. They have tremendously modernized their equipment — the oldest furnace of the second largest steelmaker was built in 1962. By 1975, Japan's steelmakers achieved labor productivity superior to that of U.S. producers. This would have been inconceivable — given U.S. workers' superior living standards and skill levels — except for the modernization of their plants as compared to the stagnation in the U.S. But this program has produced debt loads which mean that for the average firm among the top 500 in Japan (among all industries) debt service costs on an average half of labor costs.

This debt can only be managed if the economy sustains high growth rates. Any significant drop in production makes the debt unmanageable. For steel, as for the economy as a whole, the key to high growth was high export growth. This became especially true during the current recession when exports rose to 33 percent of total sales. So important financially was it to maintain production levels, that the steelmakers — faced with declines in domestic sales — increased exports in 1976 by 16 percent in tonnage by means of a 3 percent price cut. Throughout 1975 and 1976 many of the steelmakers ran losses, but would have run still larger losses if they had allowed production to fall.

At the end of 1976, the steelmakers began raising prices and thus achieved significant profits for the October-March period. Then the effects of the New York banks' austerity policies began to take their toll. Due to declining domestic demand and stagnating exports total steel production began a decline in the last months of 1976 which is still continuing and has now begun to hit exports as well. Total steel production for the July-September quarter is predicted to be 9 percent below the year before, and exports — which were 5 per-

cent below the year-before in June — are predicted to fall to 8.4 percent below the year before in July-September. The weakness of demand means the Japanese steelmakers cannot raise their prices in dollar terms and must absorb the yen appreciation. For the largest makers the price necessary to break even requires a yen no more valuable than 270 to the dollar. It is now 265. Blumenthal has sent the steelmakers back into deficit.

The high debt load of the firms means they have no choice but to cut other expenditures to maintain debt service. They must institute radical inventory liquidation and capital investment cutbacks, and — as we have seen in the stock sales — even liquidation of valuable financial assets. Throughout July the major steelmakers announced 15-20 percent cutbacks on their original capital investment plans for fiscal 1977. One leading maker, Sumitomo Metal, announced it was even cutting back maintenance expenditures by $50 million.

The dire financial straits of the steelmakers is particularly worrisome to the government since out of the entire profits of Japan's 500 corporations in the October-March term, the 26 steelmakers had accounted for 48 percent.

As the cost-cutting policy spreads to the other industries in the same predicament, Japan will be thrown back into depression.

The Financial Retrenchment Program

It is accepted without debate that the annual growth rate in exports over the past two years was the sole basis for the 15-16 percent production growth rates during the same period. What little growth that did occur in capital investments and personal consumption (4-5 percent growth rates in each) was primarily a result of the export boom, and has now been reversed: preliminary figures indicate that real capital investment in the second quarter of 1977 will show the first fall since 1975, and real wage increase rates have also fallen as the export boom petered out. (Graph 4E)

Therefore, even without an appreciation of the yen, the stagnation of exports would have led to a financial crisis. Since January, exports have stagnated at a seasonaly adjusted level of about $6.5 billion. Japan has become so dependent upon sustained high growth in exports that production as a whole slowed as a result. In addition, the markets became so soft that since December corporations have been unable to raise wholesale prices at all. (graphs 1, 2, 4C)

The no-growth situation in production and the inability to pass on cost increases has meant a stagnancy even in nominal sales while labor costs and outstanding debt each continue to rise by 10 percent a year. The debt service burden has been alleviated somewhat by successive interest rate cuts, but nonetheless remains unmanageable under a situation of zero growth in nominal sales. Therefore, even without a yen appreciation, Japan's leading corporations would have been obliged to enforce inventory liquidation, and cuts in capital investment, i.e. production cuts in order to save cash.

The yen revaluation was a crushing blow because the export corporations were the crucial source of liquidity during a period of overall financial retrenchment by Japanese industry. Recognizing that the economic recovery was not soundly based, the leading corporations decided that they could not afford to increase their total debt load by more than 10-13 percent a year. (This is an aggregate figure for the top 500 firms; it varies widely from firm to firm and industry to industry.) This includes borrowing for both productive as well as financially necessary but unproductive purposes. The latter category includes borrowing for involuntary inventory accumulation, loans made to enable repayment of past loans, and loans to cover losses. For example, while up to date figures are not available, during the first half of 1976, 60 percent of all commercial bank loans went just to finance corporate losses.

How It Will Fall

The timing and rate of production collapse will depend on the export situation. The prospects are as follows:

TEXTILES: (6 percent of exports): In dollar terms textile exports fell somewhat throughout fiscal 1976, but have rebounded somewhat in recent months. The textile industry as a whole is running losses, and has been severely hurt by the yen appreciaiton.

CHEMICALS: (6 percent of exports): Chemicals are strongly effected since the majority of exported chemicals are fertilizer, which incredibly is one of the first things to be cut when developing nations institute import cuts.

STEEL (15 percent of exports): Steel has fallen both in tonnage and in dollar terms, since January. As percentage of total exports, steel has fallen from 17 percent to 13 percent in recent months. Exports had been half of total steel production and have been hurt badly by the yen appreciation. The firms are not running losses.

AUTOS (14 percent of exports): Autos remain a bright spot with exports still increasing at a 10 percent annual rate and the firms able to apply a 4 percent price increase. The profits are predicted to fall in April-December but they still remain high. Blumenthal has threatened protectionism. Exports are almost half of total production.

Ships (11 percent of exports): Ship exports remain high based on past orders. High orders continued in 1976 because Japan tremendously increased its share of world orders. But in the last few months, orders fell to half the monthly level of fiscal 1976. A backlog is dropping rapidly.

TV, STEREOS, TAPE RECORDERS (5 percent of exports): Protectionism has hurt. Japan was forced to agree to 40 percent cut in exports to the U.S. Exports to the U.S. alone were 30 percent of total production.

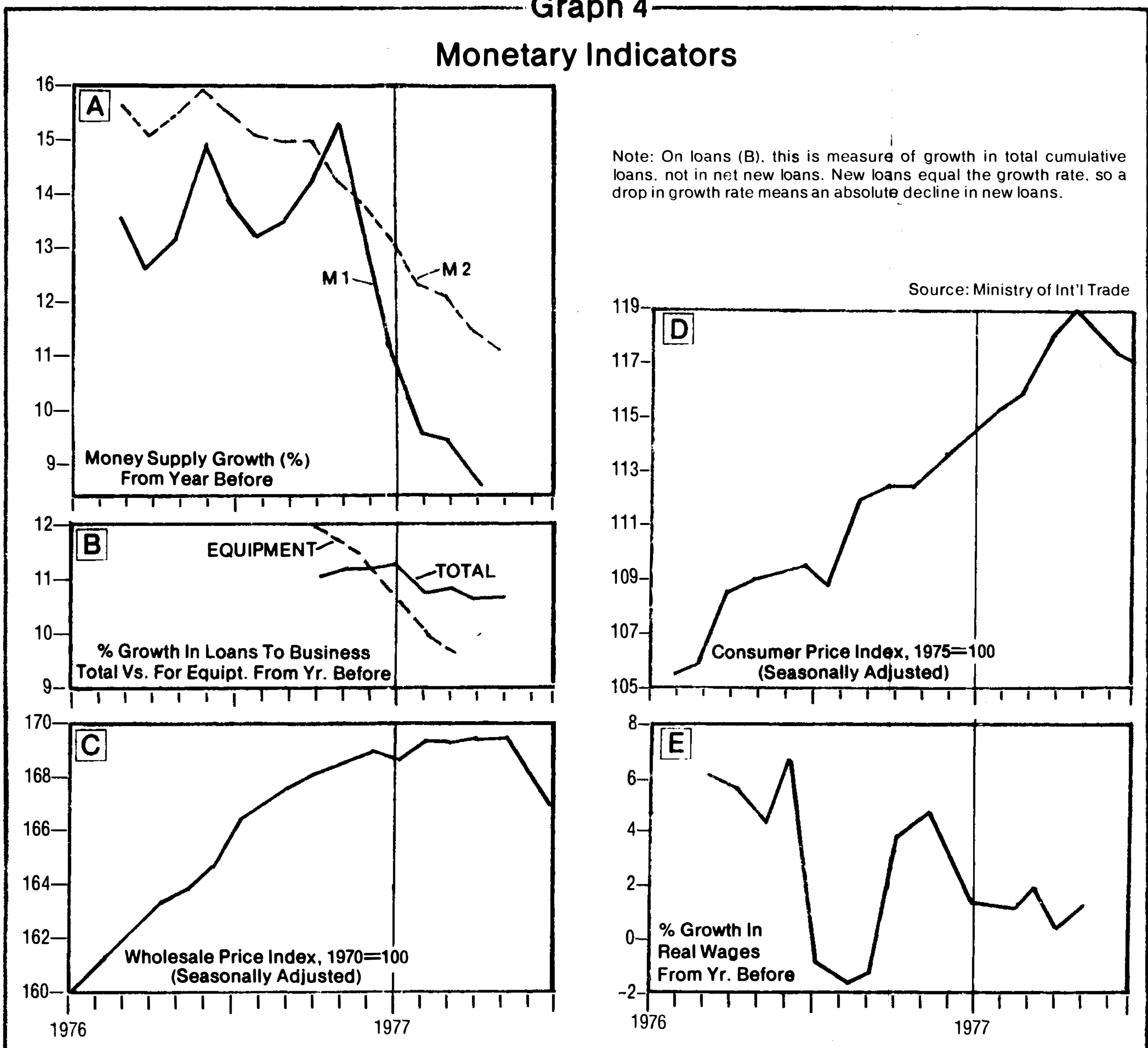
PLANT AND EQUIPMENT (10-15 percent of exports): This category is best prospect unless it is sabotaged by Fukuda. Exports rose from $5 billion in 1975 to $8 billion in 1976 and could rise to $12 billion in the current year. Best customers are Soviet bloc and OPEC.

The firms kept overall borrowing down to 10-13 percent growth levels by severely cutting borrowing for productive purposes. The extent of diversion to unproductive but financially necessary purposes can be seen by comparing the stagnation in equipment loans to the steady growth in overall borrowing (graph 3B). (What little growth did occur in capital investment was concentrated in the electric power and the export-oriented-auto and steel industries.) In addition, growth of borrowing for circulation of commodities is not a function of the absolute amount of commodities but the rate of growth. Since shipments have been stagnant since last July, the need for normal operating funds has also slowed.

In addition to triaging productive borrowing needs, the firms dangerously dipped into their financial reserves, both total savings and the depreciation funds which finance replacement of worn out equipment. (graph 3DEF)

Finally, instead of borrowing at high interest from the banks, the non-export corporations were able to sell large amounts of six-month bonds at fairly low interest rates to the quite liquid export corporations. While exact figures are not available, Japanese banking sources confirm that the amount of liquidity obtained through this method provided the critical margin of liquidity to the non-export corporations.

Despite the retrenchment policy, the financial situation of the corporations remained tenuous — even before the yen appreciation took full effect. In the October-March term profits for the top 400 firms increased only 5 percent above the term before if one excludes the 26 steel and nine electric power firms whose profits comprised 85 percent of the entire profits for the top 400 firms! Even before the yen appreciation took effect, it was predicted that profits would drop 13 percent in the current term, the first drop since 1975. (And even these low profit ratios (graph 3C) are fictitiously boosted since



the accountants are applying to profits money that should have gone to depreciation funds.

The Effect of the Yen Revaluation

The entire foundation for the financial retrenchment policy was the assumption that it was only temporary, to be endured only until a genuine recovery developed. Once exports flattened and the yen was revalued, the rug was pulled out from under their precarious financial stance. The export corporations could no longer afford to purchase low-interest short-term bonds and, as we have seen, had to massively unload their holdings of securities just to get cash. Thus, the other corporations were forced to turn either to the banks for money, or increase cost-cutting measures, or both.

So far, the corporations have primarily increased cost cutting measures. They are dipping further into savings while drastically cutting both equipment loans and overall borrowing. (graph 3F and 4A,B). There are continual announcements of drops in capital investment plans; machinery orders fell in July for the third month in a row; unemployment is up and capacity utilization is down. Full scale inventory liquidation has not yet begun. When it does the depression is on.

It was a desperate effort to stop this headlong rust to collapse that prompted business and the government to adopt the $4-6 billion reflation program. But, in the opinion of one leading bank, such a program can at best simply delay production cuts until December. Except for the cut in interest rates, the program is extremely inflationary. It adds $4-6 billion to an already high $24 billion deficit in an $80 billion budget, primarily for financial bailouts. In other words, the government will replace the export corporations as a source of liquidity. However, in the estimate of the Finance Ministry, almost all of the new bonds will have to be purchased by the central bank, that is, printing money. Even aside from increased spending, the government would have found its deficit rising due to tax shortfalls. The budget assumed tax increases of 16.5 percent in fiscal 1977, but in April-June as a whole receipts were only 15.3 percent above the year before, and in June only 13.5 percent The combination of increased spending and shortfalls in revenue threatens to raise the deficit from a planned 30 percent of the budget to 40-45 percent.

The inflationary consequences are enormous. Japan could easily return to the 30 percent price increase days of 1973. If the inflationary tendencies are not expressed in price increases, they will emerge in the form of a worsening financial situation for the corporatio
still further cost-cutting production cutbacks, and the demise of Japan's miraculous industrial economy.

— *Richard Katz*