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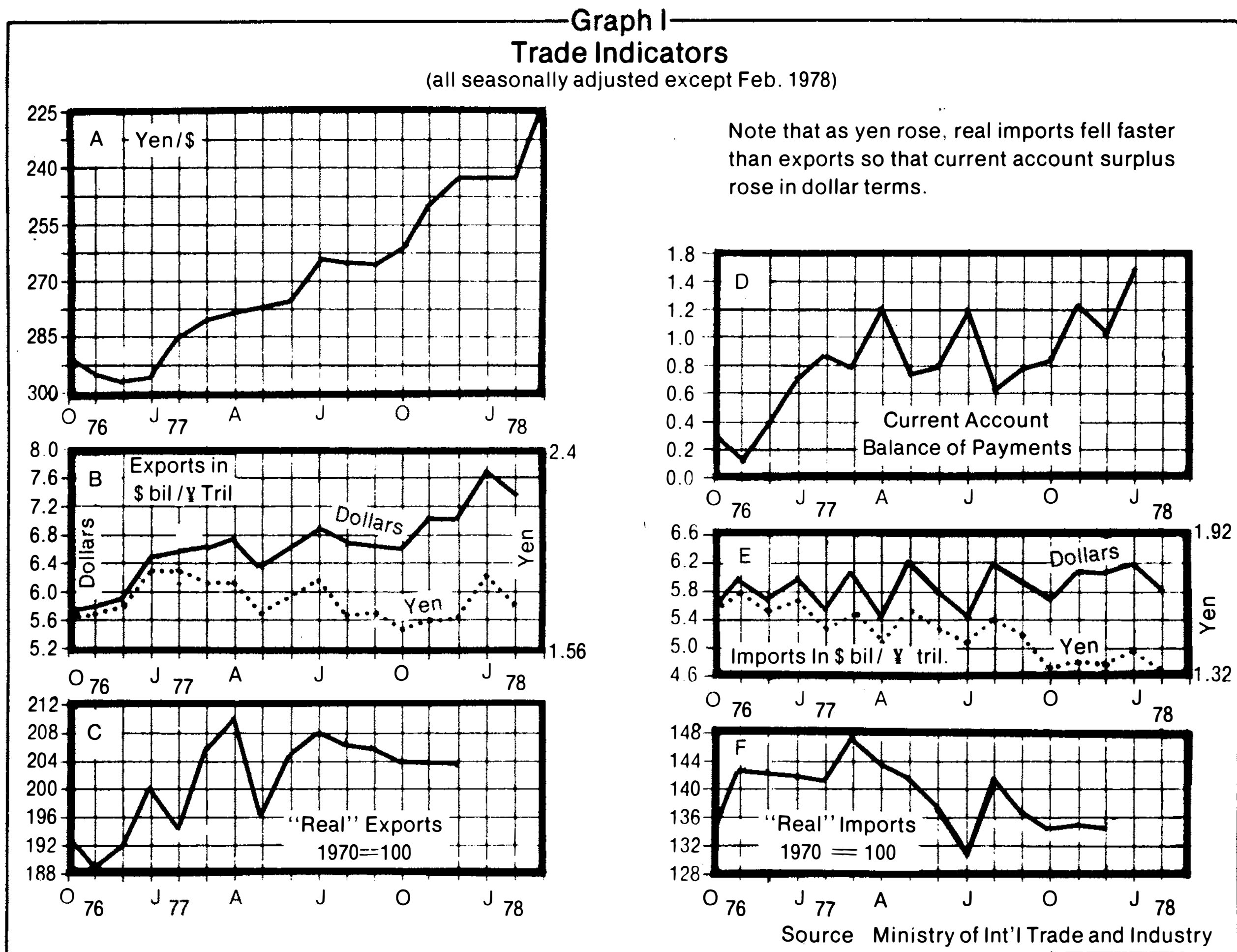
Blumenthal's Yen Rise Seeks Japan's Downfall

Since his inauguration, U.S. Treasury Secretary Michael Blumenthal and his "soft dollar" cofactioneers have jacked the Japanese yen up 33 percent relative to the U.S. currency. At this writing, the yen is up to 221 to the dollar and fast rising toward the 200 mark and beyond, and Blumenthal is looking to drive it even higher.

As the intended result of Blumenthal's policy, Japan is being driven into bankruptcy.

"Blumenthal's motivation is not economic, but political," a top British official of the Lazard Freres investment bank told a reporter last year, at an earlier stage of Blumenthal's declared economic war against Japan. "You see, Japan and the Europeans resisted the Blumenthal-Healey line" — the package of reflation, export cuts, low-growth, and International Monetary Fund policing that Blumenthal and his British counterpart Denis Healey were demanding — "but if Japan can be forced to surrender, this will show that resistance just isn't possible."

Just as Blumenthal and Co. planned, the yen's rise has caused a continuous fall in Japan's exports since early 1977, in current yen as well as constant-value terms. (see Graph I) The results for this export-dependent economy have been catastrophic:



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* **Ten percent of all Japanese corporations are "virtually bankrupt,"** according to Sanwa Bank. That is, these corporations are being saved from the Japanese version of Chapter 11 only by either under-the-table bank debt moratoria or government bailouts, or both.

* **Twenty-five percent of all corporations are in deficit this term** (October 1977-March 1978).

* **Profit rates overall are the lowest since the takeoff of Japan's postwar revival,** worse than at the depths of the 1974-75 recession.

* **The firms facing deficits and bankruptcy are not marginal or mismanaged businesses,** but multi-billion-dollar enterprises, including the most prestigious leaders in steel, chemicals, ship-building, and so on.

* **Industrial production has been virtually flat since early 1977,** thanks to the collapse in exports. The effects on corporate and bank finances have, in turn, been devastating. (See Graph II)

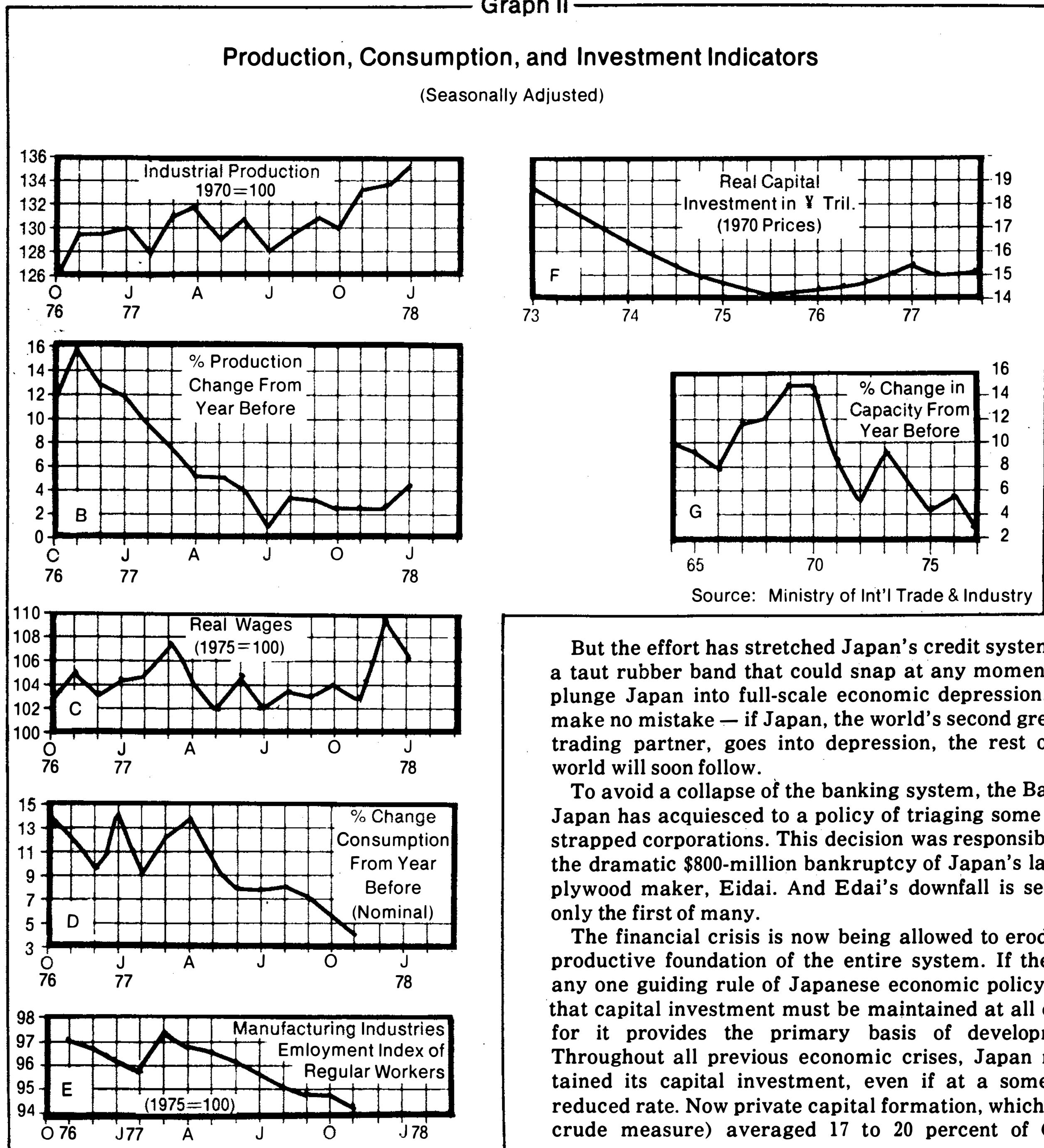
* **Bank profits are almost nil, and may turn into losses this year,** due to the strain of providing effective debt moratoria plus the effects of overall sluggish loan demand. The interest rate margin on total funds is only 0.07 percent, versus the normal 1.0 percent.

Hardly any other country could have survived this degree of pressure. Japan has done so by subordinating financial considerations to the necessity of maintaining its productive system as much as possible. This has been achieved through tight collaboration among the nation's corporations, banks, and government, the development-based dirigist system often nicknamed "Japan, Inc."

Graph II

Production, Consumption, and Investment Indicators

(Seasonally Adjusted)



Source: Ministry of Int'l Trade & Industry

But the effort has stretched Japan's credit system like a taut rubber band that could snap at any moment and plunge Japan into full-scale economic depression. And make no mistake — if Japan, the world's second greatest trading partner, goes into depression, the rest of the world will soon follow.

To avoid a collapse of the banking system, the Bank of Japan has acquiesced to a policy of triaging some debt-strapped corporations. This decision was responsible for the dramatic $800-million bankruptcy of Japan's largest plywood maker, Eidai. And Edai's downfall is seen as only the first of many.

The financial crisis is now being allowed to erode the productive foundation of the entire system. If there is any one guiding rule of Japanese economic policy, it is that capital investment must be maintained at all costs, for it provides the primary basis of development. Throughout all previous economic crises, Japan maintained its capital investment, even if at a somewhat reduced rate. Now private capital formation, which (as a crude measure) averaged 17 to 20 percent of Gross

National Product throughout the postwar miracle, has dropped to 12.5 percent — the lowest ever since Japan's recovery took off in the mid-1950s, lower even than 1974-75 recession lows.

Export Controls Versus Expanded World Trade

Japan's leaders are frantic, terrified that further appreciation of the yen will produce financial pressures they cannot control. They are rightfully frightened that Japan could descend into unstoppable financial panic and depression. In their desperation, some leaders have seized on a treacherous deal offered by the Blumenthal axis: pressure on the yen will be eased if Japan imposes export controls.

Considering how much falling exports have already hurt Japan, there is only one explanation why anyone would advocate export controls: fear that a rising yen could cause even more harm. The foremost advocates of export controls are the Ministry of Finance and the Bank of Japan, both traditionally inclined to accomodate to foreign pressure against a high capital-formation policy. Even more worrisome is that some of the most fervent advocates of dirigism and development have acceded to the demand for export controls, for example ruling Liberal Democratic Party leader Yasuhiro Nakasone and the *Yomiuri Daily News.* Only International Trade and Industry Minister Toshio Komoto has come out firmly against controls.

Clearly, Nakasone and Yomiuri are motivated by a pessimistic evaluation of the political situation in the United States.

In mid-March, a delegation of top-level Japanese business and political leaders, led by Mitsui and Co. president Ikeda, visited the U.S. Leading members of the mission repeatedly told this reporter that they found the U.S. Administration split down the middle. Some U.S. officials, they said, such as Trade Negotiator Robert Strauss and Commerce Undersecretary Frank Weil, are firmly behind expanded U.S. exports as the solution for the dollar crisis, and eager to reach a realistic arrangement with Japan. Others they found were not so cooperative.

The message the Ikeda mission brought back was that in general the U.S. would not commit itself to defending the dollar — the Blumenthal faction still prevailed. Indeed, since the visit the yen has been clobbered even harder, rising from 240 to 221 to the dollar during March. Following the return of the Ikeda mission, the demand for export controls — never even mentioned publicly before — became front-page news.

What the Japanese pessimists apparently overlook is that agreeing to export controls to "save" Japan would be a futile gesture. Blumenthal will never keep any promise he makes, for his objective is not, as he claims, to eliminate Japan's trade surplus. If it were, why does he continue to force the yen up — since he knows that yen appreciation increases Japan's trade surplus in dollar terms: Japan would go bankrupt long before yen revaluation could end its trade surplus.

Nor will export controls keep the yen from rising. What is hiking the yen is not Japan's trade surplus, but the profound crisis of the dollar. And this fact points up the truly monstrous political motivation on which the policies of the Blumenthal crowd are based.

For the dollar is weak primarily because of the stagnation in world trade that is eroding the powerful U.S. economy. This stagnation, caused at root by a gigantic expansion of debt in both the Third World and the advanced sector at the expense of real economic development, is effectively the economic "base" of Blumenthal and the financiers he speaks for. It is for that interest that the U.S. Treasury Secretary and the investment houses to whom he is personally tied are actively undermining the dollar in the international currency markets, in the hopes of reviving the supremacy of the historic center of economic stagnation, the City of London.

Blumenthal has no interest in a settlement with Japan. What he seeks is an end to the high-growth, high capital-formation system that Japan embodies — a crucial step in imposing no-growth medievalism on not only Japan, but the U.S. and Europe as well.

The prodevelopment leaders in Japan are not unaware of this fact. Whatever temporary accomodations a man like Nakasone might propose, he and his allies in business and politics are organizing with similar groupings in the U.S. and Europe for a trade-and technology-oriented answer to the dollar crisis.

Moreover, these leaders are not concerned simply with bilateral Japanese-U.S. or even Japanese-European trade as the solution for economic difficulties between the U.S. and Japan. Rather, they are proposing that both countries expand their trade to the underdeveloped nations as part of an aggressive development strategy. It is from this standpoint that they are vitally interested in the outcome of the factional struggle inside the U.S. government.

The Japanese business newspaper *Nihon Keizai Shimbun,* whose editorials tend to reflect the consensus within business, wrote that Japan must "demand, in collaboration with European countries, that the U.S. take steps to bring stability to international currency trading." By contrast the accomodationist Foreign Ministry has insisted that Japan deal only bilaterally, with Blumenthal. Plans for currency stabilization efforts include the gold option desired by the Europeans. A few days ago, *Mainichi* newspaper's Econoscope column noted "reinstatement of gold as a monetary reserve and standard guage of currency value . . . (i.e.), remonetization of gold, would thus restore financial substance and prestige to the dollar." In a previous column, Econoscope targetted "that tribe who call themselves English gentlemen" as behind the sabotage of gold remonetization. Business Federation chieftain Toshio Doko presented Japan's policy when he stated recently that technological stagnation as well as liquidity imbalances were at the heart of the monetary crisis.

The prodevelopment group in Japanese business, exemplified by the organization called the Industrial Structure Council (ISC), is behind the politicians Nakasone and Komoto. It includes such fervent prodevelopment dirigists as Industrial Bank of Japan

chairman Sohei Nakayama and Nippon Steel chairman Inayama, as well as centrists like Doko, Fuji Bank chairman Iwasa and Mitsui Trading Co. advisor Tatsuzo Mizukami. This group and its predecessors are responsible for Japan's economic miracle. They would like to see either Komoto or Nakasone become Prime Minister when the term of current Prime Minister Takeo Fukuda ends in November.

For the present, business is putting pressure on Fukuda to resist Blumenthal. Fukuda himself, who would like to continue for another term after November, is close to Rockefeller circles in the U.S., with both the virtues and flaws of that connection. He is thus for maintaining the value of the dollar, but so far he has restricted Japan to "Maginot Line" defenses. He is hampered by his own susceptibility to low-growth ideas (e.g., endorsement of the Club of Rome), but is under severe pressure from business. When he visits the U.S. in early May to see President Carter, he will make a trip to New York, to visit Kurt Waldheim, but, according to reliable sources, to secretly visit David Rockefeller.

The Fukuda-Komoto-Nakasone group is under attack by the closest thing to a London ally in Japan, LDP Secretary-General Masayoshi Ohira, who also hopes to succeed Fukuda. Long an associate of London circles in Tokyo, Ohira advises accomodation to low-growth policies under the guise of "accepting a *fait accompli.*" His main economic advisor, Osamu Shimamora, openly advocates low growth on the grounds that technology is exhausted. Back in 1971 he called for zero growth in capital investment in the 1980s. Another London associate, Employer's Association head Takeshi Sakurada, also heads a group called the Industrial Planning Council which called for adjusting to yen rises by cutting exports, cutting growth, and cutting capital investment.

Ohira's strength depends on an unprincipled alliance with him by former Premier Kakuei Tanaka, who actually opposes Ohira's economic policies. Together, the Ohira-Tanaka group is the most numerous faction in the party. Tanaka believes he could control Ohira if the latter became Prime Minister. In fact, Japan's ability to resist Blumenthal would be crippled.

The Attack on Development

It is only partly true that the pressure on Japan is simply political blackmail, as stated by the official from Lazard. Beyond that short-term goal lies a campaign to eliminate Japan as a force for development in the world, to destroy Japan as an evolving, modernizing economy, to reduce it to the status of a Southeast Asian sweatshop "writ large" — all under the slogan of "restructuring to low, stable growth." This policy is explicit in press articles blaming Japan's "overinvestment in capital goods" for its export drive. It is also see in attacks on collaboration among bankers, producers, and government, which is said to block fair trade. In fact, such collaboration was the heart of the dirigist system responsible for Japan's economic miracle.

Japan's economic miracle was based on a policy of continuously upgrading Japan's basic economic structure to successively higher modes of production through successively higher rates of growth, of capital formation, of advanced technology, and of labor productivity. Japan's leaders recognized that this could only be achieved through an export orientation. In succeeding years, basic exports shifted from textiles and apparel to steel and basic assembly, to autos and stereos, and now increasingly to capital goods and computers. The mind of the Japanese is exemplified by an energy official who recently said, "In 20 years Japan will be the main supplier of energy to the world as fusion power comes on stream."

Japan never hesitated to scrap obsolete methods in its pursuit of investment. Within one generation, the postwar world saw the population change from a majority of farmers to only 15 percent farmers. Textiles, formerly one of the largest industries, now lags in size far behind more advanced sectors. Within the steel industry, managers repeatedly scrapped not-so-old plants to make way for the new, giving Japan the most modern facilities in the world. The oldest plant of the major manufacturers was built in 1962. Labor productivity surpasses the U.S. despite a lower living standard. Technology, not low wages, makes Japanese steel competitive.

And yet, Japan was prepared to shelve even this tremendous investment in steel in pursuit of still further advancement. As one leading economic thinktanker remarked in 1971, "Why should we sell steel at $200 per ton when we can sell it at $2 million per ton in the form of airplanes or computers?"

Integral to Japan's strategy was the upgrading of its Asian neighbors. As Japan moved to more advanced technologies, it financed the development of its own earlier stages in the Southeast Asia countries, e.g., textiles, steel, chemicals, assembly.

The Healey-Blumenthal international austerity drive has now cut short that process. By gutting trade and capital formation, they have cut off the avenue for shifting exports to capital goods. Valiant efforts are being made to maintain sales, particularly in the Soviet bloc, China, and the Mideast, but the high yen rate is calling forth a flood of cancellations. For example, the machine tool industry, which now exports one third of its product, must sell at a loss if it hopes to export. At the same time, Blumenthal's allies within Strauss's office have made Japan's computer industry a major target of their wrecking efforts, demanding that the Japanese government procurement give special consideration to U.S. makers.

At the lower end of the export spectrum, radios, steel, and textiles produced and exported by Korea, Taiwan, et. al — much of which was financed by Japanese investment — is now seen as a threat. Whereas before Japan wanted to steadily reduce the textile industry, what can it do if there are no more advanced jobs to transfer the workers to? The government still subsidizes beef farmers — leading to $15-a-pound steaks — when it knows that all rationality calls for imports. But where are the new jobs? Blumenthal has removed them.

Such an absurd competition with Southeast Asia over relatively lower-skill exports is exactly the mode into which the City of London wants to push Japan. *Far Eastern Economic Review*, published out of the British protectorate Hong Kong, devoted its Feb. 24 cover story

to this issue. Employer's Association chief Takeshi Sakurada used just such "competition" to justify near-zero growth in Japanese real wages for the fourth year in a row.

Japan is not prepared to resign itself to being an assembly shop. Nonetheless, the fait accompli presented by the yen rise has stymied its development strategy. Despite record foreign exchange reserves, the Finance Ministry estimates that foreign investment in 1977 dropped 25 percent from 1976 and investment in developing countries was down perhaps 50 percent from 1973 peak levels. Toshiro Tomabechi, the managing director of the top trading firm, Mitsubishi Corp., remarked, "Theoretically, we have to invest abroad in order to reap the harvest 5 to 10 years from now, but I don't think the time is ripe."

Why Yen Rise Bankrupts Japan

Japan's postwar miracle was built on a relatively delicate financial structure for which exports provided the foundation. High growth in capital investment was

Table I

Comparative Index of Growth Rates of Wages, Productivity and Prices:

1968 Vs, 1960 (1960=100)

	Labor Productivity (A)	Wages (B)	Labor Costs (B/A)	Export Prices
Japan	216	237	110	92
Italy	170	200	109	94
West Germany	157	184	117	111
France	149	181	121	110
United Kingdom	132	165	122	112
United States	129	133	104	113

Source: National Institute Economic Review and Ministry of Labor

Japan's Economists: Hamilton, Hegel, and Kanamori

Japan didn't get where it is today by relying on the crackerbarrel notions of "free enterprise," "anti-big government," and "our job is to make profits, not products" popular among U.S. businessmen. On the contrary, its industrialists as a group have more advanced notions of development than any others in the advanced capitalist sector.

A public official paper titled "Knowledge intensification; Can human beings build a Tower of Babel to Heaven" by the Ministry of International Trade and Industry appropriately referenced the early 19th German philosophical giant G.W.F. Hegel to the effect that Japan's task is to change the economy from the level of thing-in-itself to the level of being-in-and-for-itself — that is, from one in which jobs use people as mere talented beasts of burden to one in which jobs require the most human qualities of creativity, a fusion-power-dominated economy, in which laborers are skilled technicians, engineers, and scientists.

Saburo Okita, advisor to former Prime Minister Takeo Miki and leading economist of the Japan Economic Research Center (JERC), expressed the best outlook of Japanese business when he said productive consumption is that which "will contribute to the activities of tomorrow, to the qualitative elevation of labor in the long run, i.e. to enable the qualitative expanded reproduction of labor."

The head of the JERC, Hisao Kanamori, pinpointed Japan's policy in a winter 1971 article in the *Japan Interpreter*. He wrote that neither high growth nor low growth is "normal"; the norm is constant acceleration of growth rates. Kanamori is an influential thinker behind the Industrial Structure Council faction of Japanese business. In 1971 he predicted that by 1980 Japan would surpass the U.S. in per-capita GNP and, by 1990-95, in absolute GNP. This, he said, would be achieved by a 20-fold increase in spending on research and development to $75 billion per year by 1985!

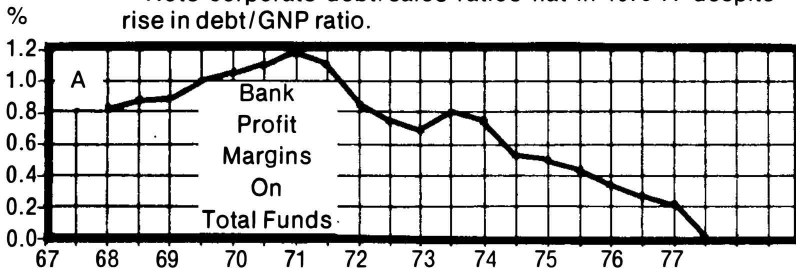
The progrowth thinkers in Japan have been constantly forced to respond to arguments by economists attached to certain London-New York circles that Japan should slow its growth. Kanamori responded in the article cited above by demolishing the theoretical basis of arguments — founded on the theories of British economists J.S. Mill, Malthus, and Keynes — that the so-called laws of marginal utility and diminishing returns require low growth for "mature" economies. Kanamori simply pointed out that constant increases in technology and the capital-labor ratio voided these "laws." Another economist wrote that the problem with low-growth advocates is that they think economic "stability" is analogous to a hard table. In fact, he said, it should be thought of more like the "stability" that is true of the larva that is changing into a butterfly.

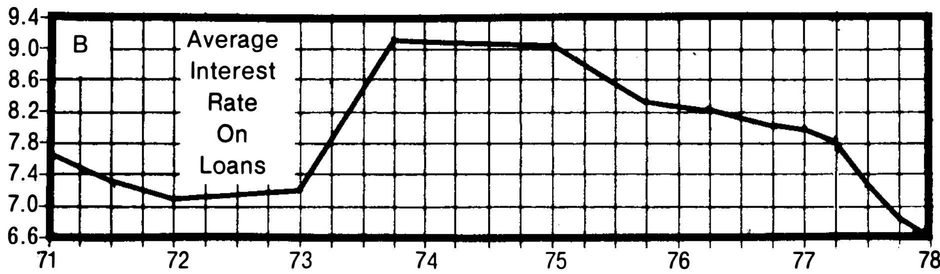
Japan's fight against the low-growth line is not a postwar phenomena but goes back to the days after the 1868 Meiji restoration. The predecessor of today's prodevelopment faction was Yukichi Fukuzawa, who fought for a national bank policy explicitly modeled on Alexander Hamilton's. His opponent was Japanese banker and British agent Eichi Shibusawa, the institutional ancestor of the Luddite environmentalist commandoes who attacked Japan's Narita Airport last week.

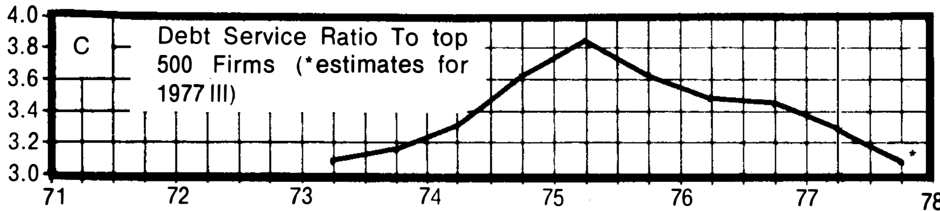
Graph III

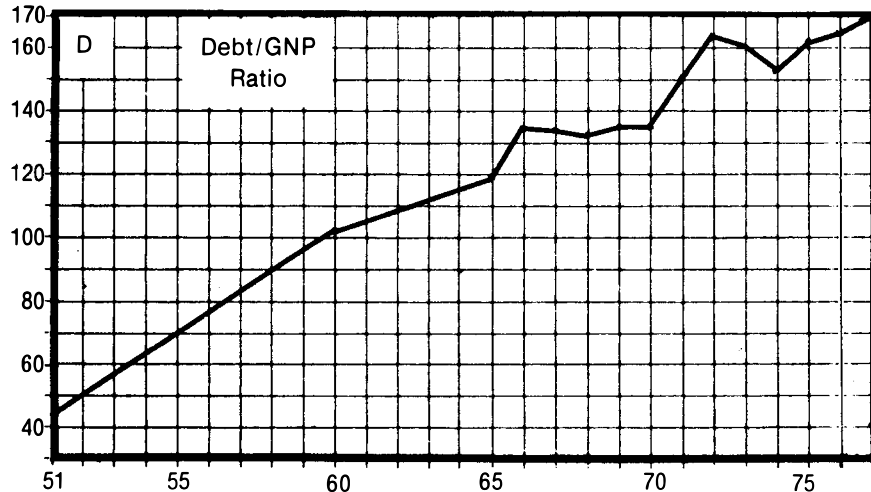
Debt and Debt Service Ratios

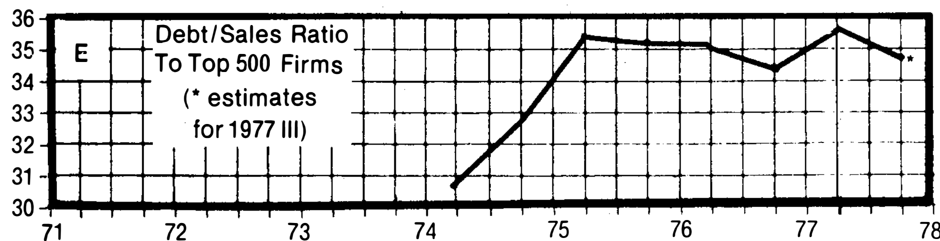
Note corporate debt/sales ratios flat in 1976-77 despite rise in debt/GNP ratio.











Source: Bank of Japan

financed through extremely high corporate debt levels that can only be carried by means of still higher growth at higher technological levels.

Throughout the 1960s, except for recession periods, industrial production grew at a 15 to 20 percent annual rate, private investment in plant and machinery averaged 17 to 20 percent of GNP, and real wages increased 10 percent yearly — all accomplished with wholesale inflation below 2 percent!

Export orientation made this possible. Capital investment was made on the basis of being realized through the nation's exports while domestic consumption increased as a byproduct of national growth. In this way 10 percent annual real wage increases were offset by equal improvements in labor productivity; unit labor costs thus remained flat throughout the 1960s while consumption as a percentage of GNP decreased from 60 percent to 50 percent. In one generation, living standards rose from near-Third World levels to half of that of the U.S. itself, and equal to the best in Europe. (See Table I)

Restructuring of the economy to eliminate backward industries or equipment was no problem economically. At 15 percent annual rates of growth, within 7 to 8 years, two thirds of all industrial equipment would be entirely new, even if noneof the old were scrapped!

The entire process was financed by a huge mushrooming of corporate debt. Unlike the U.S., where a similar debt explosion fed speculation and hindered investment, the debt was used almost entirely productively. Nonetheless, debt steadily grew relative to GNP, and debt service of corporations relativetosales. (SeeGraph III D)

What made it possible to sustain this debt without inflation was surplus profits earned through trade. This can be shown easily through the case of steel. From 1960 to 1970, labor time per unit of steel fell 75 percent, while iron ore costs fell 10 percent. Despite real wage

increases, overall costs fell one third in those ten years, but the export price did not fail to reflect lower costs. Thus Japan could sell steel to the advanced industrial countries cheaper than the latter could make it themselves, but at a price way above its own costs. Through such mechanisms within overall trade, this author estimates that by 1970, as much as one third of all corporate profits in Japan were the result of surplus profits in real terms of trade. This is not seen on the books of the trading corporations, but is spread over the economy through the credit system. This is a large part of the reason for the stability of Japan's debt-GNP ratio during the 1965-70 period. (See Table I)

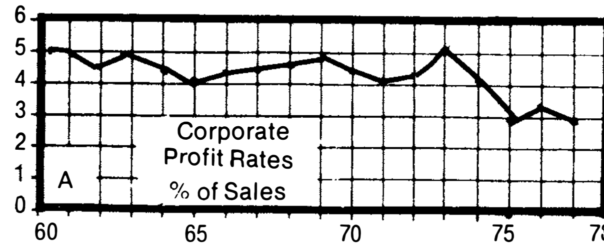
Such a system requires a constant acceleration in technology and productivity. In 1971, the Industrial Structure Council — the group behind Komoto and Nakasone— pushed for a shift to what they termed "higher value-added, knowledge — intensive" industries, e.g., computers, capital goods, et al. They recognized that this required a major improvement in living standards. Although they rose constantly in the 1950s and 1960s, living standards were still too low to produce sufficient skilled workers. Even now, in time of recession, Japan has a shortage of hundred of thousands of skilled workers. They also recognized that the program required the industrialization of Southeast Asia.

Ironically, Japan would benefit from a steady rise in the yen, since that would improve terms of trade — if it occurred under conditions of a growing world trade volume.

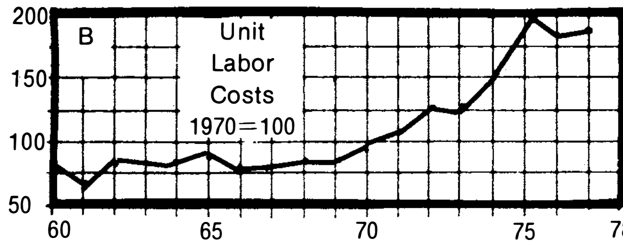
The entire program of the ISC was cut short by the dollar crisis which began on August 15, 1971, was worsened by the 1973 oil shock, and now is approaching cataclysm with Blumenthal's yen appreciation. Debt to GNP ratios sharply rose, corporate liquidity zigzagged and profit ratios plunged; unit labor costs rose for the first time. (See Graph IV) Previously inflation-free, Japan now experienced 30 percent inflation. Efforts to halt the inflation produced a 20 percent cut in production in 1974-75, the worst depression since the 1930s.

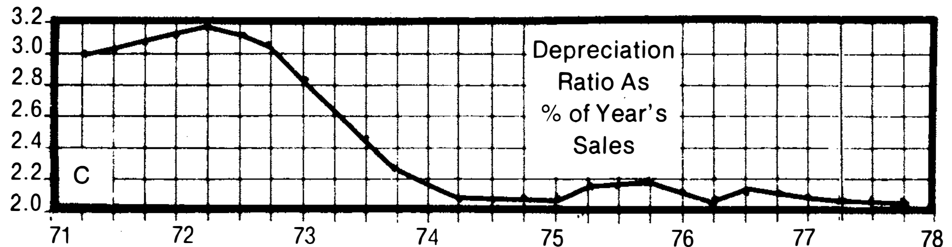
Graph IV

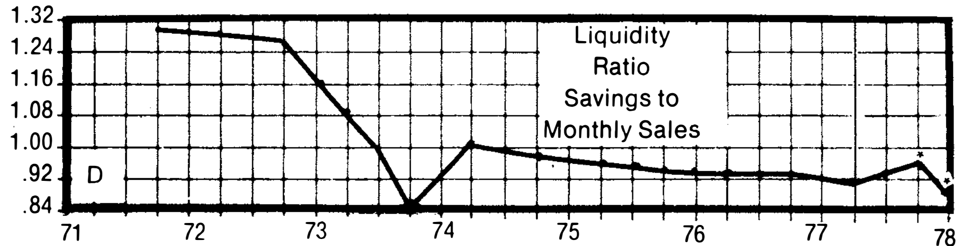
Accounts of Corporations

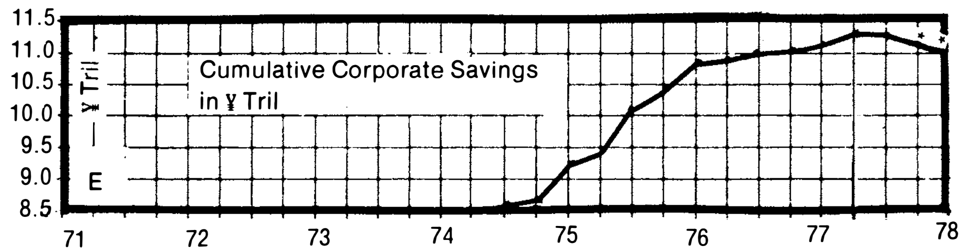


Note profits in 1977 are at lowest point since take-off of postwar recovery despite artificial boosting through cut in liquidity ratios and depreciation (i.e. money put away for capital investment)









* estimate

Source: Bank of Japan

Japan never recovered from that recession. The illusory recovery of 1975-76 was provided by an export boom that could not be sustained, since world trade as a whole never recovered. Now, the yen appreciation could lead to a catastrophe that would make 1974-75 look mild by comparison.

The Current Crisis

In many ways Japan's situation is far more dangerous than that prior to the 1974-75 collapse. The financial situation of the banks, corporations, and government is far more precarious. So there is very little financial cushion if the present flatness in production turns into actual downturn.

The danger of a downturn is imminent unless action is taken on an international scale to remove Blumenthal, stabilize the dollar, and restore trade. Although increasing in dollar terms due to the yen appreciation, exports are falling both in yen terms (which determines the financial condition of corporations) and in real terms (which determines production levels of an entire economy). (See Graph I) Certified exports, a two-to-three-month leading indicator, were down 2 percent from February the year before, after a 0.1 percent fall from a year earlier in January — the first such decline since November 1975.

The entire economy follows the gloomy results of exports:

(1) Industrial production was virtually flat from November 1976 through October 1977 and the government expects the February-March results to significantly reverse the November-January bulge; Japanese industry is now operating at 80-85 percent of capacity an average. (See Graph II)

(2) Quarterly consumption increases in household expenditures was the lowest in October-December since the government began the survey six years ago; real wages did not grow at all in 1977.

(3) While capital investment recovered somewhat in October-December, the level was still below the post-recession peak achieved in January-March 1977 and far below 1973 levels.

(4) Corporate profits for the term ending March 31 are estimated to have fallen 6 percent, following a 13 percent drop in the previous six-month term. One out of four firms will show a loss. Profit rates are the lowest since the start of the postwar recovery. Particularly hard hit have been export industries (see box).

(5) Domestic demand is so sluggish that both wholesale and consumer prices are falling, not because inflationary pressures have lessened, but because firms cannot pass on cost increases. Deflation of course worsens the debt position of the firms. (See Graph V)

(6) Corporate bankruptcies increased 30 percent in 1977 with liabilities totalling $12 billion, while bankruptcies in Feb. 1978 alone hit $2.1 billion (including the $800 million Eidai).

Export Industries: How The Yen Rise Hit

Most export industries are now running losses due to the yen rise, and the threat of bankruptcy looms large. Several have been declared emergency cases qualifying for government aid:

TEXTILES (6 percent of exports, 10 percent of industrial production): The industry as a whole, both natural and synthetic, is running huge losses and has been declared an emergency case. It is feeling competition from Asia. The 16 largest firms are running a combined $1 billion loss.

STEEL (15 percent of exports, 7 percent of production): Exports continue to decline. China is expected to replace the U.S. as Japan's biggest customer when 1977's 2 percent decline to U.S. is followed by a sharper fall in 1978. Operating at only 70 percent of capacity, the industry as a whole is running in deficit, and will cut capital investment by half in 1978 from 1976 peak. Normally their investment is 20 percent of Japan's total.

SHIPBUILDING (11 percent of exports): Orders are being cancelled, and this industry is at only 50 percent of capacity and running huge losses. Six major bankruptcies in the last few months included Hashihama, at $100 million. Top-level shipping firms in trouble include the Japan Line, connected to Nakasone, which asked for debt moratoria from government and private lenders on $150 million. Komoto's own firm, Sanko Shipping, is in similar trouble, but has not yet asked for moratoria.

CHEMICALS (6 percent of exports, 9 percent of production): The top seven firms are running combined $87 million in losses.

TV AND STEREOS (5 percent of exports): TV exports were off 5 percent in 1977, due to protectionism.

AUTOS (15 percent of exports): half of the industry's production was exported in 1977 as exports rose 17 percent, but the industry expects only a 2 to 3 percent rise this year.

PLANT AND EQUIPMENT (10 to 15 percent of exports, 23 percent of production): This had been a major bright spot, but now is losing orders due to the yen rise. In machine tools, exports rose as a percent of production from 7 in 1970 to 30 in 1977. But now orders are falling off, and what is sold is sold at a loss.

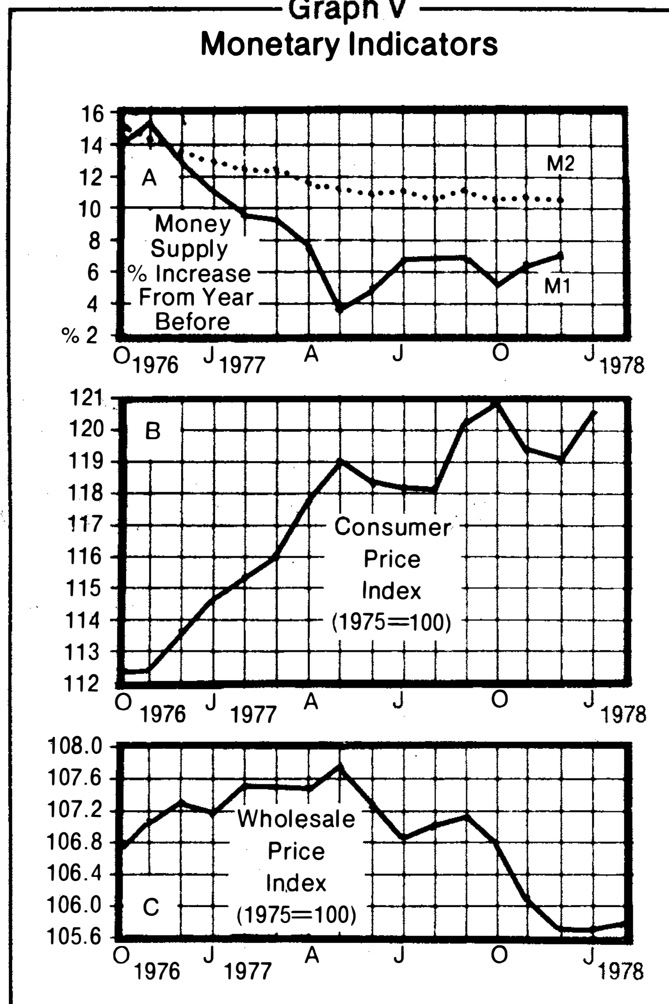
The government's policy has been to avoid widespread bankruptcies and a full-scale recession by combining government stimulation of the economy with measures to help cut corporate costs. In particular, the government has tried to cut the debt-service-to-sales ratio.

In pursuit of that aim, the government has cut the discount rate to 3.5 percent, a postwar low, leading to a drastic drop in interest rates. The government itself has taken on tremendous debt, raising its deficit ratio to 37 percent in the 1978 budget. This is debt which corporations would normally have acquired. This is why flatness of corporate debt-sales ratios contrasts with rise of the debt-GNP ratio. The banks must absorb the government debt, which amounts to 40 percent of new loans in 1977, at yields lower than normal. In addition, banks are offering under-the-table debt moratoria. (See Graph III)

This cooperation among government, banks, corporations is the "Japan, Inc." system. It cannot be stretched much more. How high a deficit can the government run? Moreover, the banks themselves are in an immediate crunch. Due to debt moratoria, sluggish loan demand, etc., interest rates on loans have fallen more than that on deposits — the margin is now negative 2 percent. *Nikkei* on March 14 attributed this to "suspension of interest collection by banks from slump-ridden clients." On total funds (adding borrowed money, investment in securities, etc.) the margin as a positive .07 percent against a normal 1.0 percent. This could disappear with the latest discount rate cut.

Recognizing that the banks could not maintain all firms, the Bank of Japan let Eidai go bankrupt in February. But corporate managers fear there will be many Eidai's in the April to June-period. There will be, unless Blumenthal is put out of office.

— *Richard Katz*



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