

TABLE 3

**Composition of foreign-owned investment in United States, 1999**

(billion \$)

Foreign direct investment	\$282.5
U.S. liabilities (largely banks) to foreigners	67.7
Net foreign purchase of U.S. stocks	94.9
Net foreign purchase of U.S. corporate bonds	231.0
Net foreign purchase of U.S. Treasuries	-21.8
Other	94.5
Total	\$750.8

Source: U.S. Department of Commerce.

account, the U.S. experienced a net surplus of \$378.2 billion, representing the fact that \$378.2 billion more in capital was invested in the United States than flowed out. During 1999, that capital/financial account surplus covered the U.S. current account deficit of \$338.9 billion.

The composition of the \$750.8 billion by which foreigners increased their assets in the United States gives a glimpse of the nature of the movement of financial flows between the United States and the rest of the world (**Table 3**).

Thus, foreigners sold \$21.8 billion of U.S. Treasuries. Still, they increased by record amounts their purchases of U.S. stocks and corporate bonds, by \$94.5 billion and \$213.0 billion, respectively. Moreover, they made direct investment of \$282.5 billion, which is largely foreigners buying out U.S. companies.

This represents a diminution of national sovereignty, and hence a strategic danger, which cannot be remedied by a quick fix, but would require the elimination of the underlying post-industrial-society policy which has destroyed the U.S. economy. The United States is able to survive only through a rigged game, which brings in large amounts of foreign capital to cover the current account deficit. With increasing instability caused by the deepening of worldwide financial disintegration, the possibility is that either foreigners decide that they no longer wish to hold so much of U.S. assets, and begin pulling out funds, or, several U.S. markets crash, prompting foreigners to get out as quickly as they can. It is possible that one event would quickly follow the other, either precipitated by, or also precipitating, a crisis in derivatives instruments.

This would produce two catastrophic consequences: First, U.S. ability to bring in imported goods would fall steeply. This would intensify the rate of contraction of the U.S. economy, with noticeable drops in the standard of living of the population. Second, as foreigners fled out of dollar instruments, and dollars in general, this would produce a dollar crisis that would de-leverage the highly leveraged U.S. financial system.

The rigged game which covers up for the fundamental inadequacies of the U.S. economy, cannot be sustained.

## Debt crisis builds: What Japanese recovery?

by William Engdahl

The sudden political loss of Prime Minister Keizo Obuchi, who suffered a stroke and remains in a coma, coinciding with the March 31 end of the Japanese fiscal year, has put the spotlight on the fragility of the world's second largest industrial economy.

The Japanese stock market in recent months has been focus of great excitement from foreign fund managers looking for large gains, as their holdings in the inflated U.S. Nasdaq high-tech market threaten to disappear in a cloud of electronic smoke.

At the beginning of April, Tokyo's Nikkei Dow stock index soared well above 20,000 points, its highest level in more than three years. Only ten months ago it was flirting with lows of 12,000. The Japanese high-tech stock index, the Nikkei OTC index, had risen 213% in the past year, before a recent sell-off. Internet-linked stocks such as Softbank or Sony have been soaring until recently. Even hedge fund guru George Soros, whose Quantum Fund lost big when the Internet boom went bust, has decided to open a Tokyo office to profit from the revival of investment prospects there.

Yet a booming stock market does not a healthy economy make. The underlying catastrophic reality of Japan's \$3 trillion economy, underscores how fragile the present state of the world economy is.

### The world's worst public debtor

Several weeks ago, Moody's Investors Services announced that it was placing the rating of the government of Japan's yen debt under review for possible downgrade. The reason, they noted, was "structural problems in Japan's economy that have resulted in a level of public sector debt that will soon be the highest, relative to GDP, among the advanced industrial economies." Japan's gross public debt is already \$5.5 trillion, 130% of GDP, well beyond the 60% levels in Germany and even more than that of Italy. By next year, even under the best assumptions of the Finance Ministry, debt will rise to 140% of GDP.

This may only be part of the full debt picture. According to Akio Ogawa of Tokyo Chuo University, the Ministry of Finance is hiding another \$1 trillion of public debts in a special account used to make loans to state corporations.

Moody's debt warning stated that, given the scale of Ja-

pan's fiscal debt imbalances, to say nothing of the problems of the state pension system, health care, and contingent claims of the banking system on state credit, any attempt by the government to correct the fiscal deficit and to bring the debt under control, would destroy what fragile economic growth exists.

Since the Japanese stock and real estate bubble collapsed in early 1991, the government has passed no fewer than nine major fiscal stimulus budgets to try to revive the economy. When Finance Minister Kiichi Miyazawa announced the latest such fiscal stimulus last November, amounting to some \$180 billion, which began to be spent on April 1, he proclaimed it to be "the final one."

It brought the total of government economic stimulus since 1992 to more than \$1.12 trillion. Without the regular stimulus of public spending, Japan's economy would have contracted over an entire decade.

Yet, the spending has not created the basis for a self-sustaining recovery. By informed Japanese accounts, the money has mostly gone to finance the traditional Liberal Democratic Party patronage machine in rural areas, by funneling public funds to LDP-tied construction companies.

According to Masahiko Iishizuka of *Nihon Keizei Shimbun*, the country's major business daily, the fiscal spending has gone for "nothing but the worst of pork-barrel politics, to represent benefits for the construction industry — not coincidentally, a major backer of the ruling Liberal Democratic Party — throughout the country." He points to the incredible proliferation of such small construction companies — more than half a million in all — "the ultimate beneficiaries of public spending of this archaic character." Press accounts abound of bridges being built in remote areas where no roads exist.

The public spending injections create spurts of growth, which stop, as soon as the budgets run out. In the last quarter of 1999, public spending fell by 8.5% as the stimulus funds were exhausted, and the economy fell back into official recession, with GDP contraction of 1.4%, after a 1% fall in the previous quarter, leading some economists to compare Japan's economy to a "junkie economy," dependent on endless injections of public money.

But Japan is rapidly approaching the physical limits of the present system of debt-financing. For the Japanese fiscal year just ended, tax revenues were barely above the level of new public bond issuance needed to cover the deficit: 34 trillion yen in taxes versus 31 trillion yen in bonds. Fully 38% of the total budget had to come from new bond issues. Prospects over the next several years are even worse. In the fiscal year just ended, the public deficit, local and national, reached an Ecuador-like 9.1% of GDP. Debt service on existing debt, despite the de facto zero interest rate policy of the Bank of Japan, is the largest single budget item, 22 trillion yen in FY 99-2000, or 26% of the total budget outlays.

Adding to the Finance Ministry's woes, one source of financing for this huge debt has been the state's Postal Savings

System. In 1990 and 1991, it issued ten-year savings bonds in huge sums to finance the deficit. Beginning April 2000, some 110 trillion yen of these Postal Savings Bonds mature. With interest rates now at well under 1% for new Postal Bonds, much of those savings are likely to go elsewhere, or even out of Japan entirely, as older Japanese savers desperately search higher gains to finance retirement or even daily living. Even if half the amount is lost to the Postal Savings System, it means a devastating loss of funds to absorb the public debt. The option is either to offer far higher interest rate returns to sell the Postal Bonds, or hyperinflate the economy, as was done in the 1920s in Weimar Germany.

## No credit

Much has been written of the record \$530 billion government bank rescue package with which many de facto insolvent banks were nationalized. The problem with the Japanese economy is directly tied to a banking system which is unable to lend to fuel real economic expansion. When the stock and real estate bubble burst ten years ago, banks kept non-performing loans on their books as "good," through covert new loans at low interest. Only by keeping nominal interest rates below 1%, has the central bank, the Bank of Japan, allowed the banks to keep functioning.

Yet the infusion of new emergency funds to restructure the banking system has solved little long-term, even if it has avoided for the moment new colossal bank failures and financial depositor runs. Reliable data from the government and banks on actual bad loans outstanding are impossible to get in Japan's opaque accounting world, but private estimates are that banks still hold well over \$1-1.5 trillion in bad loans. Moreover, the injections of public funds in the past year must be repaid to the government within three years, making the banks reluctant to take on any new loan risks.

The results of the chronic seizing up of the credit mechanism have been record levels of corporate bankruptcies. In December 1999, corporate bankruptcies jumped 32% year-on-year. This reflected the expiry of government special programs for loans to small and mid-size companies. Most such companies are unable to get traditional bank credit and had been kept alive only via special government credits. As those dried up, bankruptcy was the only option. Such bankruptcies are expected to rise significantly in the first six months of 2000. One reason is that corporate giants such as Nissan Motors are engaged in desperate cost cutting, and the large Japanese trading houses are under pressure to sell off or close unprofitable businesses, directly hitting tens of thousands of smaller companies and adding to a rapidly growing unemployment.

Ironically, this cost reduction process is one of the prime reasons that foreign investors like Soros are buying up cheap Japanese company stocks. As costs are reduced, the profit of the company rises. What is good for George Soros, however, is a disaster for Japan's citizens and the real economy.