Reflation Is Out for Japan

In the fourth quarter of 1976, Japan re-entered the depression which for three years has plagued the land once famed for 10 per cent plus real growth rates. Now that the U.S. and Europe can no longer continue astronomically increasing imports of consumer durables from Japan — the only thing that enabled Japan to survive 1976 — Japan's domestic sales and production have started tumbling. Fourth quarter sales fell 4 per cent from the previous quarter; domestic machinery order in November were the lowest in all of 1976; and overall industrial production has fallen steadily since August except for a one-month upward blip in November. It is widely feared that the first quarter of 1977 will be even worse.

This fact alone makes a mockery of the Carter Administration economic strategy to get Japan, as one of the three "strong economies," to effect a worldwide recovery through increased imports made possible by domestic public works reflation. Japan in 1976 was a weak and fragile country, dependent upon inflationary consumer credit policies in the U.S. and its own ferocious export drive in Europe.

This export drive has been *supplemented* by a fiscal stimulus which was actually quite mild compared to the stimulus Carter wants Japan to impose now as a substitute for exports. Nonetheless, the major business daily *Nihon Keizai Shimbuni(Nikkei)* complained that this stimulus - a 30 per cent budget deficit — had caused major "cracks in the financial structure of Japan." Any attempt to impose the Carter program would wreck Japan's economy by producing an immediate 30 per cent plus inflation. Thus, the business community and major newspapers raised an almost unanimous cry of outrage that has so far prevented Prime Minister Takeo Fukuda from carrying out the Carter line. The industrialists have counterposed to the Carter-Fukuda line a policy of stimulating *exports of capital goods and domestic investment.*

The Fourth Quarter Tumble

At the end of 1975 Japan was heading back into recession due to a drop in exports to the developing countries. This process was arrested only through huge increases in exports of consumer durables to the U.S., and exports of durables plus steel and ships to Europe. By July, the high point, exports to North America and Europe were both 50 per cent higher than they had been in January (also 50 per cent higher than July 1975). As a result, production of consuemr durables rose 23 per cent from November to July, and overall production rose 15 per cent in that period.

Since July the renewed recession in Europe and the end of inflationary consumer credit policies in the U.S. produced stagnation and then a November decline in exports. As a result almost every significant economic indicator tumbled in the final quarter (see *Table I, II, III*).

*** Production hit its peak in July and then fell 2 per cent by October. A one-month blip brought it back to July levels in November but the Ministry of International Trade and Industry predicts another fall for December.

*** Consumer durables, the heart of the "recovery," fell 15 per cent by October (latest available) from its April peak and 11 per cent from July, the economy's peak. Other sectors, such as consumer non-durables, producer goods and capital goods fell approximately 2 per cent in the period.

*** The operating ratio of factories fell from its April peak of 90.6 per cent to 89.1 per cent in July and to 85 per cent by October.

*** Fourth quarter sales fell 3.9 per cent from producers, 4.8 per cent from wholesalers and 3.8 per cent from retailers from the third quarter.

*** Capital investment is predicted to fall 4 per cent in the first quarter of 1977, and steel is predicted to fall 8 per cent in the quarter. The only thing keeping capital goods production from falling precipitously up to now has been the export market. Domestic machinery orders index in November was at the lowest point for all of 1976, while export orders were up 36 per cent from the year before.

Cracks in the Financial Structure

By itself, this sensitivity to the export situation could be taken by some observers — and has by most — to indicate simply a "pause." Many Japanese businessmen are hoping that Carter will repeat the import bailout that ocurred in 1976. And even the most pessimistic major banks are predicting real growth no lower than 4 per cent. But the bailout will not occur. Carter cannot do it. More importantly, Carter's backers — Chase Manhattan Bank et al. — insist that Japan substitute domestic reflation for exports, that Japan deliberately run a current account payments deficit, in order to bail out Third World and weak OECD countries.

This is the crux. What worries the more astute financial observers is not the immediate economic downturn figures, but the more fundamental financial dislocation caused by the 1976 experience. This view is exemplified by the Jan. 4 *Nikkei* column by Sumitomo Bank's Chief Economist Tsutomo Nishimura entitled "Big National Bond Issue Causes Cracks in Financial Structure."

In the period of high growth, Japan's exports grew along with world trade as a whole and thus promoted high rates of capital formation. In 1976, Japan's exports grew at the expense of other countries, with Japan taking

TABLE I: INDUSTRIAL PRODUCTION (seasonally adjusted, 100 equals 1970, in breakdown by sector, proportions from 1970)

YEAR/MO	PRODUCTION	CAPITAL GOODS	CONSTRUCTION MATERIALS	DURABLE CONSUMER GOODS	NONDURABLE CONSUMER GOODS	PRODUCER GOODS	OPERATING RATIO
	(100%)	(21)	(10)	(10)	(15)	(42)	
1973	127.3	127.3	131.6	136.1	115.4	128.2	100.6
1974	123.3	128.5	119.7	134.9	116.4	120.9	91.4
1975	109.7	110.6	101.8	129.1	111.9	105.7	81.2
RECESSION LOW	105.7	106.2	101.7	116.8	109.9	96.3	-----
NOV 1975	111.2	106.2	104.7	134.7	110.6	109.9	82.8
JAN 1976	115.7	115.3	103.8	142.2	114.5	113.2	84.3
APR 1976	126.2	129.4	109.6	165.9	120.9	120.7	90.6
JUL 1976	128.2	127.5	113.6	159.2	127.1	124.9	89.1
AUG 1976	126.0	125.1	114.2	155.1	122.5	123.5	86.9
SEPT 1976	125.5	125.7	115.0	147.5	125.4	122.6	87.1
OCT 1976	125.4	127.7	114.4	144.3	124.3	122.8	85.5
NOV 1976	128.5	-----	-----	-----	-----	-----	-----

Note: The recovery of production in early 1976 is clearly based on exports. Export-oriented durable consumer goods show sharpest increase. Recovery of capital goods is based almost entirely on exports. Capital goods kept falling throughout 1975 and hit their low in Nov. '75. Their growth since then has been based on exports, c.f. GNP distribution table which shows no recovery in domestic capital investment.

TABLE II: TRADE AND BALANCE OF PAYMENTS (in billion dollars)

YEAR/MO.	CUSTOM CLEARED*		BALANCE OF PAYMENTS (IMF SERIES, SEASONALLY ADJUSTED)				
	EXP.	IMP.	TRADE	CURRENT ACCOUNT	SHORTTERM CAPITAL	LONGTERM CAPITAL	OVERALL
1973	36.9	38.3	3.7	- .1	2.4	-9.7	-10.0
1974	55.5	62.1	1.4	-4.7	1.7	-3.8	- 6.8
1975	55.9	57.8	5.0	- .7	-1.1	- .3	- 2.6
JAN 11, 1976	59.9	58.8	8.5**	+3.3	-0.08	- .2	+ 3.1
JAN	3.6	4.8	.4	- .09	-0.2	- .03	- .07
FEB	4.8	4.7	.7	+ .3	.3	+ .3	+ .7
MAR	5.9	5.2	1.5	+1.0	- .06	- .09	+ .8
APR	5.3	5.1	.9	+ .4	- .02	+ .09	+ .3
MAY	5.3	5.3	1.3	+ .9	+ .09	+ .05	+ 1.0
JUNE	5.7	5.4	1.0	+ .6	+ .01	- .09	+ .3
JULY	5.9	5.6	.7	+ .1	+ .2	+ .1	+ .45
AUG	5.4	5.5	.4	- .2	+ .08	- .2	- .1
SEPT	6.1	5.6	.7	+ .1	- .01	- .3	- .08
OCT	6.1	5.7	.7	+ .2	- .2	- .48	- .5
NOV	5.6	5.8		+ .06	-------	- .13	+ .3

Note: * On custom clearance, exports and imports cannot be directly compared due to difference in measure of freight and insurance charges; a rule of thumb is to deduct 10% from import. For 1976, please note it only covers through Nov. For year as a whole the increase in exports over '75 will be about 20%.

**** On balance of payment cumulative figures for 1976 in trade and shortterm capital only cover through Oct.**

TABLE III: REGIONAL BREAKDOWN OF JAPAN's TRADE (in billion dollars)
(for each country, exports from Japan on left, imports on right)
(not seasonally adjusted)

YEAR/MO.	N. AMER.		W. EUROPE		ASIA	
	EXP.	IMP.	EXP.	IMP.	EXP.	IMP.
1973	11.7	11.9	6.5	4.0	8.9	7.9
1974	16.5	16.3	8.5	5.2	12.6	12.4
1975	14.6	14.9	8.1	4.3	12.5	10.5
JULY 1975	1.2	1.4	.68	.42	1.06	.82
OCT 1975	1.1	1.2	.75	.36	1.15	.94
JAN 1976	1.1	1.1	.62	.34	.8	.92
MAR	1.7	1.3	.85	.40	1.23	1.10
JULY	1.8	1.3	.95	.45	1.21	1.18
AUG	1.4	1.2	.82	.43	1.10	1.13
SEPT	1.6	1.2	1.02	.41	1.18	1.23
OCT	1.5	1.2	1.03	.40	1.28	1.17
NOV	1.5	1.2	.97	.46	1.18	1.17

Note: Notice the approximate 50% increase by July 1976 in Japan *exports* to N. America and W. Europe over year before as well as over Jan. 1976 due to stagnation in latter half of 1975. This allows an approximate 50% increase in Japan's *imports* from Asia by July '76 compared to year before or to January. Thus, Japan did not directly act to lift the rest of the world but simply as a transmission belt. Yet, the Rockefellers insist that Japan continue to maintain such an increase in purchases from the developing sector even after it loses its trade surplus with the U.S. and Europe.

much larger chunks of world market than normal in such goods as steel, auto, and electronic appliances. Japan's overall exports grew 12 per cent in *real* terms (20 per cent nominally) much more than world trade. Thus, it could not stimulate genuine recovery, either in capital investment or in consumer spending.

Therefore, the government supplemented the export drive by fiscal measures (a 30 per cent budget deficit) aimed at preventing a drop in consumer spending. As we will show, the actual stimulative effects of the measures were minimal, but the deficit caused severe financial dislocations and severe (though still latent) inflationary pressure. And now it is proposed — by David Rockefeller — to eliminate the exports surplus while pouring on an even bigger budget deficit!

In 1976, the amount of national government bonds issued was $23 billion versus $16 billion in 1975 and $6.4 billion in 1974. The deficit did not result from a big buildup in public works, nor from a tax cut, but simply to avoid the collapse of consumer spending that would have resulted if the deficit had been closed through a tax increase.

The major commercial banks were forced to absorb these low-yield government bonds at almost no profit. The banks were able to buy them only because loans for capital investment plummeted. In the second quarter of 1976 (latest available) private capital investment for and equipment was still 13 per cent below the March 1974 peak and only 5 per cent higher than the recession low. As a portion of GNP, investment dropped from 20 per cent to 13 per cent of GNP (see *Table IV*). Thus the 1976 increase in capital goods production went mainly for exports.

Corporations in turn shifted spare cash into investments with a higher yield than bank deposits, e.g. each others' short-term bonds, stocks, commodities, etc.

Therefore, according to Nishimura, "City (commercial) banks, who have underwritten national bonds but find liquidation virtually impossible...(are forced to) higher reliance — 36 per cent — on marginal means of fundraising such as borrowing more from outside and liquidating bond holdings." And now, with a lowered prime rate, the interest banks pay on some deposits is lower than they receive for loans. A lower deposit rate will further accelerate the shift out of bank deposits. And David Rockefeller wants Japan to increase the bond issue still more?

The industrial corporations are in similar straits. Their current liquidity situation is better than the banks' due to low capital investment, sale of assets, rationalization measures, price increases, and flow of liquidity from export firms to others. However, their basic financial position is tight.

In the term ending September 1976 *operating* profits for all businesses increased 60 per cent above the previous six months, on sales incease of 5.3 per cent. However, they were still only 60 per cent of March 1974 peak. Even more important, *total* profits (i.e. counting debt service, capital costs, transfer of assets, etc.) rose only 5 per cent and post-tax profits decreased 5 per cent. Moreover, the increase was concentrated in only six of twenty-one major industrial categories, those related to exports. For the term ending March 1977, *Nikkei* predicts a 20 per cent rise in operating profits but says that 70 per cent of the increase will occur because of price increases in three industries — steel, chemicals, and nonferrous metals. According to the *Mainichi* of Jan. 5, the major banks are beginning a review of their clients with the aim of weeding out firms with bad performance or little prospect of growth. Bankruptcies in 1976 rose to 15,000 from 12,000 in 1975 and in November-December rose to 20,000 annual rate. Wholesale prices rose 6 per cent in 1976 versus 1 per cent in 1975. And David Rockefeller wants to restrict exports and increase the budget deficit still more!

Due to the tight financial situation, corporations

TABLE IV: GNP DISTRIBUTION IN CURRENT BILLION DOLLARS
(Calculated at 300 yen/dollar)
(quarters at annual rate)
(amount and per cent of total)

YEAR/ QTR.	TOTAL	PRIVATE CONSUMPTION		PRIVATE CAPITAL FORMATION: MACH-INERY		INVEN-TORIES		DWELL-INGS		GOVERNMENT EXPENDITURES: CURRENT		CAPITAL	
		Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%
1973	$370b.	$189b.	51%	$71b.	19.1	$12b.	3.1%	$31b.	8.4%	$33b.	9.1%	$34b.	9.1%
1974	441	232	52.7	78	17.8	17	3.8	33	7.5	44	10.0	40	9.2
1975	483	273	56.7	68	14.2	5	1.0	35	7.2	54	11.2	47	9.8
1Q	465	261	56.3	69	14.9	3	0.7	30	6.6	52	11.3	45	9.7
2Q	483	269	56.1	69	14.4	4	0.8	36	7.6	53	11.1	46	9.5
3Q	488	278	57.0	68	14.0	6	1.2	40	7.5	54	11.2	48	9.8
4Q	498	284	57.2	67	13.5	8	1.5	35	7.1	55	11.1	50	10.1
1976													
1Q	511	296	57.3	68	13.1	2	0.3	40	7.6	59	11.4	50	9.6
2Q	538	308	57.3	70	13.0	4	0.7	40	7.5	61	11.3	50	9.2

Note: Notice that even measured in current dollars the fall in capital investment is nothing short of catastrophic both in absolute terms and as a percentage of GNP (the 19% figure of 1973 is typical for the later 60s and early 70s.) Notice also the rise in private consumption as portion of GNP, even though in real terms there was very little increase in consumption on absolute scale. Finally notice that as portion of GNP the real increase in gov't spending came not in public works but in current spending, a process Fukuda is trying to reverse.

limited wage increases to the consumer inflation rate for the third year in a row, only 8 per cent in 1976 against inflation at 10 per cent by the year end. While wages were 13-15 per cent above year-before levels in the first half of 1976, they dropped to 8 per cent increase in the latter half — providing months of steady real wage decreases. A real drag on the economy (*Table V*).

Nonetheless, David Rockefeller sticks the knife in some more. In Tokyo for the Trilateral Commission last week, he met with Prime Minister Fukuda, his longtime protegé. In late August 1975, when Fukuda was Economic Planning Minister in Takeo Miki's cabinet, he had visited Rockefeller in New York City on a secret trip and worked out the policy implemented in 1976 — the "reliance on the U.S. recovery." Last week in Tokyo Rockefeller told newsmen he recommended that Japan revalue the yen, reduce its trade surplus and "increase its share of the defense burden."

Richard Cooper, a leading member of Rockefeller's Trialteral Commission and Carter's appointee for Undersecretary of State for Economic Affairs, told newsmen in Tokyo on Jan. 11 that Japan's trade surplus was "a burden on the rest of the world." Cooper added, "Happily, the three largest economies on the non-communist world, the U.S., Japan and West Germany, don't find themselves in acute financial difficulties...These three countries together should take the lead in expanding the world economy...(and they) should be less concerned about the size of government deficits than they seem to be."

TABLE V: CONSUMPTION AND EMPLOYMENT

YEAR/MO.	NOMINAL WAGES (CHANGE FROM PRECEDING YEAR IN PER CENT)	EMPLOYMENT OF REGULAR WORKERS (1975 equals 100)
1973	121.5	101.8
1974	127.2	102.0
1975	114.8	100.0
RECESSION LOW	106.8	97.4
NOV 1975	114.4	99.6
JAN 1976	113.5	98.3
APR	115.3	99.4
JULY	108.8	98.6
AUG	107.6	98.1
SEPT	108.9	97.9
OCT	112.2	97.8

Note: Regular workers refers to workers hired for life and full time, about half of labor force in Japan. They are almost never laid off since there is a large pool of parttime and temporary workers who are subject to layoffs or reduced hours. It is this system that gives the impression of low unemployment when in fact the real unemployment is quite large.
Note that in first half of 1976 nominal wages were more than 10% above preceding year, i.e. above inflation, a real wage gain though small. In second half, wage gains were below 10% (except for Oct.), a real wage drop.

TABLE VI: INFLATION

YEAR/MO.	WHOLESALE INDEX		CONSUMER INDEX	
	Per cent change from preceding year	Per cent change from preceding month	Per cent change from preceding year	Per cent change from preceding month
1972	0.8		4.5	
1973	15.9		11.7	
1974	31.3		24.5	
1975	3.0		11.8	
NOV 1975	0.8	0.3	8.1	-0.5
JAN 1976	2.4	0.8	8.7	2.0
FEB	3.7	0.7	9.3	0.6
MAR	4.5	0.6	8.6	0.4
APR	4.9	0.6	9.3	2.5
MAY	5.3	0.4	9.2	0.3
JUNE	5.9	0.5	9.5	0.2
JULY	6.8	1.0	9.9	0.5
AUG	6.7	0.5	9.2	-0.8
SEPT	6.8	0.4	9.7	2.7
OCT	6.5	0.1	8.6	0.6
NOV				

India's 1976 Success Based on New World Order in 1977

India has ended 1976 in one of its strongest economic positions ever, as a result of premising its policies on an early realization of a new world economic order. Cultivating its heavy-industry state sector, its trade with the Soviet Union, and high-technology "trilateral" exchanges, the Gandhi government has achieved the first balance of trade surplus the nation has had since the early 1950, and has ended the year with a better foreign reserve position ($3 billion) than any Indian finance ministry official has known since 1948.

These economic achievements have provoked a debate on how to sustain the year's improvements, pitting Mrs. Gandhi's pro-growth faction against the very opposition forces whose World Bank program Mrs. Gandhi largely ignored on the way to the 1976 success. The demand that Mrs. Gandhi reverse her economic approach in favor of a program whose rejection proved fortunate can be credibly raised in India at this time only because landlord-based right-wing interests in the ruling Congress Party are receiving public support for such sleight-of-hand from prominent Carter Administration advisors who are promising an "India tilt" in U.S. policy. Robert McNamara, President of the World Bank, and Orville Freeman, head of Business International and the "zero population growth" Worldwatch Institute, have promoted the Indian controversy by offering generous new aid and preferential market treatment to help India overcome continuing capital and credit limitations — provided that Mrs. Gandhi curtails further high-technology imports, de-emphasizes the state sector, degrades the composition of India's exports toward primary commodities and materials, shifts trade volumes away from the Soviet Union into U.S. dependency, and uses both new loan monies and export earnings to perennially repay what is currently a $17 billion foreign debt.

Mrs. Gandhi and her supporters have had occasion to observe the weakness of the opposition recommendations. While the right-wing and their liberal-counterparts credit speed-up of labor, general wage-controls and good monsoon rains for India's economic advance, the Prime Minister's advisors have publicly emphasized those points of the World Bank program she would *not* tolerate, with these results:

* With grain production over 110 million tons for the year, government take-over of the private grain trade has resulted in a 75 per cent increase in grain stocks in 1975-76 from 10 to 17 million tons.

* Industrial production in state sector industries like iron, steel and coal broke all records, with India becoming a net exporter of steel for the first time.

* India secured contracts valued at $800 million for infrastructural development in the Middle East and Africa, and has skilled technicians exploring for oil on behalf of such important pro-socialist allies as Tanzania and Vietnam. As a result, the nation is excellently situated within the expanding nest of triangular trade agreements of Europe, Arab-OPEC and Comecon partners to ensure a continued high-technology composition