

Foreign Exchange by David Goldman

Japan's 12-month withdrawal scheme

Japanese subsidies of U.S. financial markets cannot go on indefinitely, and Tokyo is preparing for the worst.

The largest, and most disappointed, investors in the Republican Party's shattered electoral effort were not the party contributors who put up \$190 million in campaign funds, but, rather, the Japanese. The stabilization of the U.S. dollar and the rise in securities markets, immediately prior to the elections were the result of a return by Japanese institutional investors to the American markets, with the official encouragement of the Japanese government.

President Reagan did a favor for Japanese Prime Minister Yasuhiro Nakasone last June, well-informed Tokyo sources explain, by easing pressure on the Japanese trade surplus just before the June elections which returned Nakasone with a strong majority. The prime minister, as well as Finance Minister Miyazawa, wanted to return the favor to Reagan, a valued political ally.

On the surface, the favor came in the form of the Oct. 31 agreement to "coordinate economic policies," announced by Miyazawa and U.S. Treasury Secretary James Baker. There is both more and less to this agreement than meets the eye. The government action was the signal for a coordinated move into American markets by Japanese institutions, which had begun to reduce their American presence sharply during the third quarter.

During the third quarter, virtually all the foreign support for the American government-securities market took

the form of support for the dollar. In other words, foreign central banks, mainly the German and Japanese, bought unwanted dollars on the open market, and invested the proceeds in U.S. Treasury securities. Private investors from those countries remained on the sidelines. That created a situation in which various of the leading investment houses speculated that the dollar might fall by an additional 10-25% in the near term. The Nakasone government's encouragement to Japanese private investors was probably the only thing that could have prevented such a collapse.

Apart from the display of Japanese financial muscle, there is no content whatever to the agreement. That much appears obvious to the usual commentators, e.g., the London *Economist*, which dismissed the whole business as "coordinated public relations rather than coordinated economic policy." After an initial sharp rise on the foreign-exchange markets, the dollar fell back through the week of Nov. 10, as this perception spread.

Tokyo policymakers, in informal discussion, formulated the problem as follows: Japan is subsidizing the American economy by shipping a net \$50 billion worth of goods to the United States per year, and investing the proceeds in U.S. securities. The word, "subsidy," would never be used in public, but the fact that America now imports net one-fifth of its total consumption of physical goods bears

no other description.

Tokyo is painfully aware that this cannot last indefinitely. However, policymakers estimate—correctly—that a sudden stop in Japanese financial flows into the United States would produce a shock that would probably bring down the American banking system. The repercussions of this would hurt Japan as well; therefore the Japanese cannot simply cut off the flow.

Neither can they maintain it indefinitely. The objective which Tokyo has set for itself is to gradually reduce the level of net flows to zero over the next 12 months. That implies the same collapse, but at a slower pace. Tokyo sources rationalize the decision as follows: The United States must take action to reduce its trade deficit, while Japan must take action to reduce its trade surplus. If, over the next 12 months, both sides can make substantial progress, then America's demand for foreign funds will be substantially lower.

Already, Tokyo is preparing itself for bitter disappointment. American voters were not impressed with the charade on the financial markets. "Perhaps Americans do not follow the yen/dollar rate as closely as do the Japanese," complained one economist. Nakasone's favor did not help.

The post-election layoffs did not inspire Japanese confidence, either. So-called restructuring at General Motors, Westinghouse, General Electric, Goodyear, etc. amounts to less American industrial capacity, and more imports—precisely the opposite of the supposed American commitment to reduce the trade deficit.

Under these circumstances, how long can the public-relations exercise be expected to stabilize the yen-dollar rate? Tokyo, sources say, is hoping for two months; even that might be wildly optimistic.