Japan's dilemma: Depression ahead?

by Our Special Correspondent

During the week of March 15, the Japanese Economic Planning Agency announced that the economic growth rate for the fourth quarter of 1997 was –0.2%. This is the first time since March 1974 that Japan has been faced with a downturn in its physical economy. Unlike 28 years ago, this latest development represents a complete phase-change in the entire political-economic landscape in Japan. Though this is the first public announcement of a negative growth rate, most leading Japanese officials in the government and private sector identified the situation as the "Hesei Depression" long before the official statement. Hesei is the term designating the era of the present Emperor.

As a result of the ongoing crisis, Prime Minister Ryutaro Hashimoto and leaders of the ruling Liberal Democratic Party (LDP) find themselves unable to come up with an appropriate economic package to meet the looming depression. In the latest of a series of proposals, the LDP's chairman of the Policy Research Council, Taku Yamasaki, called for a $77 billion public works and infrastructure building program. Immediately, Finance Minister Hikaru Matsanaga questioned whether Yamasaki's stimulus measures were needed, since the government had already announced a similiar, but smaller package. Finance Minister Matsanaga continues to push a more fiscally driven budget austerity program, in which the deficit targets are more important than an economic stimulus package.

Danger of hyperinflation

Complicating this situation is the fact that the Bank of Japan is pumping massive amounts of liquidity into the stock and money markets, in an attempt to artificially shore up the price of Japanese bank stocks prior to the March 31 close of the fiscal year. Japanese government and private banking officials are striving to keep the Nikkei stock market at the hallmark 17,000 level. All the leading political and financial figures in Japan fear that without foreign funds and Bank of Japan liquidity flowing into the banking sector, Japanese banks could suddenly collapse.

This potential hyperinflationary flood of liquidity comes at a moment when the so-called Asian currency crisis could re-erupt, following the failure of the International Monetary Fund's "rescue packages," especially in Indonesia. At this point, were the offshore hedge funds, led by George Soros's Quantum Fund, to decide to attack the Indonesian rupiah, another massive currency devaluation could ensue, causing a meltdown of the global financial system. Unfortunately, the Japanese calculation in providing this massive liquidity (which over the last two months has increased by 43%), is that liquefying the banking sector will not cause a hyperinflationary spiral, because of the huge losses incurred throughout Asia during last November and December's devaluations.

U.S. concerns are also growing. An article in the March 15 *Washington Post,* entitled "Fears of Deflation Rising in Japan," quoted a U.S. government official saying that "the deepening economic downturn [is] of grave concern, [and we] are deeply worried that Japan's deflationary problems are gaining dangerous momentum and will send the economy spiraling rapidly downward."

New Bretton Woods needed

A Japan with a collapsing physical economy, unmanageable bank debt (some estimate more than $1 trillion), and a weakening yen (about 130 to the dollar) all portend that whatever thinking lies behind the International Monetary Fund's so-called stabilization plan for Southeast Asia, it is bound to fail, because it refuses to recognize the underlying economic cause of the Asian crisis. The U.S. approach is centered on Japan playing the central role in revitalizing the Asian nations' economies. However, the premise that all Japan needs to do is to absorb Asian exports with a "demand stimulus approach," is not only fraught with absurdities concerning the nature of the Japanese economy, but fails to take into account the collapse of most of the manufacturing sector in Asia—the result of the IMF plan.

The only clear alternative is what *EIR*'s Contributing Editor Lyndon LaRouche has proposed: a New Bretton Woods system. Echoing LaRouche's proposal is Japan's Vice Minister for International Financial Policy Eisuke Sakakibara, who not only openly challenged the IMF's approach, but declared that now is the time for establishing a New Bretton Woods. Sakakibara's call, in an interview with the March 1 *Mainichi Shimbun,* came in the middle of the greatest scandal in the Ministry of Finance's history, and at a time when it appeared that the "mandarins" of the budget and tax office of the Ministry of Finance were committed to only a budget austerity package.

With the appointment of a new Bank of Japan governor, Yu Hayami, who, according to Japanese sources, is not hostile to Sakakibara's call for a New Bretton Woods, it is possible that a new political combination can emerge in Japan to lead Asia out of this crisis. Were Hashimoto to push this idea at the upcoming Asian-European Meeting (ASEM) in London in early April, it is believed that other Asian countries would follow Japan. At that point, the Clinton administration would have no choice but to back this option openly.