Transforming Advanced Economies

Toward Increased Business Opportunities

Objectives of Discussion & Position Papers

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Stabilizing the Yen:
The Unattractive Alternatives
to Full Import Liberalization

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Finance Ministers have recently circled the globe trying to stabilize currencies and avoid further dollar declines, particularly a freefall. These are certainly worthy objectives, and Japan has played a major role. Indeed "Endaka" has put pressure on many Japanese industries, creating political and deflationary economic pressures for the government to act. Yet realistically, actions like lowering interest rates, central bank intervention, and liberalizing insurance companies' foreign investment rules, while helpful, are essentially short-term financial fixes.

Letting the current situation drift must inevitably lead to a stronger yen and movement of Japan's export industries overseas. The yen's value is determined by the demand for yen versus dollars. A large trade surplus will thus keep putting upward pressure on the yen's value. In the past this has been partially offset by the outflow of capital, i.e. the demand for foreign, primarily dollar, securities. However, declining interest rate differentials, foreign exchange losses, continued foreign exchange risk, and the reaching of prudential foreign asset levels for some institutional investors, all mitigate against a continuing offset. For these reasons, many investors are hedging their foreign exchange exposures, actually offsetting the dollar demand of continued
securities purchases.

On top of this, their assets are earning revenues that need to be either reinvested or returned to Japan, the latter putting more pressure on the yen. That is, since a continuing strong yen represents unemployment in Japan’s export sector, this compounding build up of foreign assets is like inventorying long-term unemployment in Japan’s advanced industrial sector in order to protect its inefficient producers. Also, to get repaid, Japan will eventually have to import anyway. Recent increased yen demand internationally for investment and transaction purposes only adds to these appreciation pressures. However, this last factor has been somewhat mitigated by borrowers swapping into dollars, not wanting increased yen exposure. In sum, traders logically remain bullish on the yen vis a vis the dollar.

By full liberalization, Japan could effectively lower its trade surplus, offsetting the strengthening yen while making a significant expansionary contribution to world trade. Further, to pass on the benefits of yen appreciation, means allowing imports to come in. Yes, there will be unemployment in the affected sectors. But otherwise there will be unemployment in the export industries due to a strong yen. There is no easy solution.

At the same time, Japan will help its efficient industries to survive rather than protecting its inefficient ones. Real incomes would rise sharply due to lower import prices and thus lower living costs. Then domestic demand for other goods and services can increase. Long-term there should then be higher growth rates as the efficient high value added sectors expand rather than contract. This is the best way to expand domestic demand and demand for imports, while achieving yen stability.
Conversely, with a continually strengthening yen, major Japanese multinationals must shift production abroad to insure their own corporate survival developing a trained labor pool and GNP for foreign countries. Successful companies with more resources are best able to do this, witness autos, electronics, computers, semi-conductors, and biomedical R and D. This production though represents the very jobs and industries Japan wants to keep for the future to move into higher value added products. Moving Japan’s industry into higher value added products and services given an appreciating yen may be difficult. Higher value added products are more impacted by an appreciating yen than lower value added products with a high import content. High cost services, including land rentals, transportation, and telecommunications, act as a drag on any manufacturing sector, particularly in an information intensive competitive environment.

Thus, though Japan appears headed for a headquarters economy as it is easiest for these large international firms to adjust, it will be supported by an internationally high cost infrastructure, agricultural sector, and service economy compared to other multinational competitors. This may put Japanese multinationals and their suppliers at some competitive disadvantage. Anyone who has purchased an airline ticket or made an international telephone call can see this.

Given the overseas plant announcements, the negative earnings impact on export oriented Japanese companies, and the economy’s relative stagnation, liberalization is a medium-term action requirement, probably within the next three years. Longer term the investments will already have been made, the economic structure established, and the yen level set via a major adjustment in the export sector rath-
er than the import sector. Procrastination doesn't now seem to be in Japan's long-term interest since it can't oppose economic forces.

No global currency or trade system can polically or economically withstand major trade imbalances indefinitely. Forces will emerge to correct these imbalances as it did U.S. surpluses in the 1950's and 1960's via overseas investment flows and increased competitiveness of other countries, Japan and Europe particularly. Similarly oil producers' surpluses were reduced via demand and supply adjustments. It is now happening again as currency adjustments lead to more Japanese overseas investments and increased competitiveness of the NICs.

This development will substantially alter Japan's economic structure. The shift in employment to U.S. firms and the LDCs will increase global productive capacity and should lower the U.S. budget and trade deficits. Japan's relative economic stagnation will in turn prevent the kind of synchronized global expansion led by the advanced countries that seems to be necessary to generate a runaway global inflation. Thus, there is no inherent external policy reason for these adjustments not to take place.

Rather than whether an adjustment will take place, the question is more whether Japan will move towards a slow growth internationally high cost headquarters economy or will institute and implement the medium-term policy changes needed to push the economy firmly in the direction of a competitive high value-added advanced post-industrial society. However due to generally high employment levels, there is no overwhelming popular pressure for this policy change.