A Japanese Model Begins to Crumble

Markets Elude Bureaucrats

By James Sterngold
New York Times Service

TOKYO – By engineering Japan's economic recovery after the war, steering the shaken economy deftly through the oil crises of the 1970s and then stablizing the naiton's financial markets quickly after the U.S. stock market collapsed in October 1987, Japan's economic policy markers won a reputation for unparalled management ability.

Hard-earned over 40 years, that international repuatation has been a source of immense confidence here, ever arrogance. But in the last three months, the repuation has begun to unravel. For the first time, market forces are looming larger than the powers of government bureaucrats.

Peristent turmoil has wracked the financial markets this year, sending stock prices down by more than 20%, the yen down more than 5% and interst rates up sharply, despite numerous government attempts to restore order.

As a result, Japan's elite bureaucrats are watching their credibility erode almost daliy.

On Monday, for instance, central bank intervention failed to prevent the dollar from surging 1.33 yen against the Japanese currency to 156.40 yen, its highest level in more than three years. Tokyo stocks also posted their biggest one-day rise, with the Nikkei 225-share index rising 4.83% to 31,840 .49 although traders said much of the gain was due to purchase by institutional investors ahead of the start of the new fiscal year, which begins April 1.

Much of this loss of control stems from measures taken by the bureaucrats themselves.

In recent years, under heavy pressure from the United States, the government initiated a process of financial libralization that made Japan's huge capital markets more open to the world. The markets became vastly larger and more powerful, less subject to bureaucratic control – and far more volatile.

"It is not easy to control the markets as we would like to." a senior Finance Ministry official acknowledged. "But that is a development that we created. If you want to have the benefits of allowing market forces in, you cannot have as much control as there was before."

The liberalization of the financial markets included allowing interest rates to float at market-determined levels, making it easier for Japanese corporations to raise capital abroad, permitting trading in interest-rate and stock-index futures and providing foreign institutions with increased access.

As a result, the government faces not just a technical problem of what steps it can take to stablize stock prices and bolster the battered yen, but how it can rebuild confidence that the system can run efficiently.

The first signs that something fundamental had changed came last fall, when the yen started to weaken against the dollar and defied every attempt by the government to bolster the currency.

A surprise increase in the Bank of Japan's official discount rate in October not only proved ineffectual, but was also followed by an unseemly public row between the central bank and the Finance Ministry over whether another increase was necessary.

There is no simple explanation for the slide in the yen's value. But foreign-exchange experts and economists said that the yen's fall was not due to speculation but rather the belief of Japanse institutions that they can earn returns on investments abroad. In investing overseas, these companies are in effect selling yen to buy dollars or marks or another currency, pushing down the yen's value.

Starting early this year, the yen lost even more ground against the dollar. Yasushi Mieno, the central bank governor, declared that the decline was a speculative trend that would soon reverse. But it did not.

The slide of the yen came even as the Japanese economy was in sound shape: growth was unimpeded for nearly four years; corporate investment in

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way around. We owe the United States for the wellbeing we now enjoy."

Richard Koo, a senior economist at Nomura Research Institute, said: "This has been a particularly difficult time. People are seriously questioning the ability of Japanese government officials to keep the markets on track."

The loss of confidence in the bureaucrats has even started turning into disdain. It is dawning on many people here that Japan has bcome a capital-rich, labour poor country whose vast wealth is dedicated to making Japanese corporations competitive, rather than improving the standard of living.

The huge flow of Japanese capital into the United States and other countries, which was viewed as an emblem of success until recently, is now being regarded in some quarters with resentment

If used at home, that capital could be improving the lives of the Japanese. But there are not enough opportunities to invest profitably in Japan, forcing the outflow.

"The fundamental problem is a lack of investment opportunities here," Mr Koo said. "Japanese realize that they are shipping all their capital overseas and investing in improving living standards outside Japan, while their own living standards are much worse." Investments in Japan are made difficult, he said, by government restricitons and distortions caused by the regulators.

Michiya Matsukawa, a senior adviser to Nikko Securities Co. research and plant and equipment was running at three times the level of the United States on a per-capita basis; inflation, though rising was less than 3%.

Despite these positive factors, interest rates were rocketing upward, threatening the economy; the yen was still falling, threatening to increase inflation; and stock market investors were going from nervousness to panic.

Both the Finance Ministry and Bank of Japan publicly continued to say there was no sound reason for the problems. In private, officials expressed confusion and exasperation with the way the markets failed to respond to their prodding.

Perhaps the worst news came last week, when the Bank of Japan again lifted its discount rate. It was a move that was expected to attract capital back to Japan and strengthen the yen. Instead, the stock market had its scariest and most volatile day on Thursday and the yen remained just as weak.

The loss of confidence this spectacle has engendered has been almost palpable.

Until recently, for instance, the attitude of many Japanese toward American demands that Japan open its markets further was best summed up by the book entitled, "The Japan That Can Say No."

Suddenly, a very different attitude is being expressed. Last week, Shin Kanemaru, one of the most powerful politicians in the ruling Liberal Democratic Party, was quoted as telling his party: "Japan depends on the United States, not the other and a former top official at the Finance Ministry, asserted: "The point is, Japanese are frustrated by the fact that there are better investment opportunities outside Japan."

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