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JAPAN AS CAPITAL EXPORTER AND THE WORLD ECONOMY

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Sound financial system is considered central to the development of trade either in an economy or internationally. This fact informed the author of this Occasional paper in examining and bringing into focus how Japan became an international creditor i.e. net capital exporter in the world financial system aside from her leading role in world trade. This position was attained through a combination of many factors, some of which were sectoral savings-investment imbalances and the co-existence of high-employment government deficit and the high-employment current account surplus in the 1970s and 1980s. The author thus, traced the historical evolution of Japan's chronic current account surplus vis-a-vis its impact in the international financial systems back to the end of World War II in 1945 when she was an immature debtor country with a regulated financial system. Although it was written in 1985, the paper is still relevant in the light of free market economy and economic liberalisation and the concomitant internationalisation of local economies. The attraction of the paper lies in its exposition on the way Japan moved from a regulated financial market to an open market system which is found useful for countries under-going economic liberalisation. Three phases were identified in the evolution of Japanese balance of payment since 1945 vis: an immature debtor country with current account deficits (1945-64, stage 1); then it became a matured debtor country with current-account surplus, but still with net payment of investment income (1965-1971, stage II); and finally an immature creditor country with current-account income (1972-present, stage III). Apart from the introduction, the paper has seven sections as follows: Section II Evolution of Japan's balance of payments; Section III Co-existence of high-employment government deficit and a high-employment current account surplus; and Section IV Domestic pressure for liberalisation of Japanese financial market. The next three sections were Transition from bank credit control to the open money market paradigm; Internationalisation of the Japanese financial market; and Policy problems facing Japan's future possible position in the international financial system.

The three stages of the Japanese balance of payments position as mentioned above were traced in Section II. Stage 1 i.e. 1945-64, which was regarded as high growth period, was characterised by imposition of import restrictions and foreign exchange controls to protect the emerging local infant industries (ship-building, Iron and Steel and automobiles) and prevent net capital outflows in order for domestic savings to be bottled up for high domestic investment under low interest rate financial policy. However, towards the end of this period, import restrictions were progressively reduced from 59 per cent to 7 per cent of total imports in 1964. Japan thus became an article 8 member of the International Monetary Fund (IMF) and joined Organisation for Economic Co-operation and Development (OECD) in 1964. In stage II, further deregulations of the economy continued in both import and foreign exchange areas, while liberalisation of foreign direct investment into Japan which started in 1967 was completed in 1973. This stage was therefore a transitional period from stage 1 when the economy was fully protected towards stage III where such regulations were decontrolled to the international average levels of advanced countries, although her financial system relied on direct control of bank credit, under which domestic credits were rationed by the Bank of Japan under low interest rate policy. Stage III was a period when her economy was fully liberalised and its financial system internationalised through substantial removal of trade restrictions and the use of floating exchange rate system.

Section III highlighted Japan's persistent current account surplus in spite of the two oil-crises christened Organisation of Petroleum Exporting Countries (OPEC), OPEC I 1974-75 and OPEC II (1979-80). This position hinged on the private sector's (corporate and household) high propensity to save which was in excess of corporate investments relative to GNP, starting from stage II through stage III. Corresponding to the excess of private savings, the government registered deterioration in its I-S balance between 1972 and 1982 while foreign sector deficit i.e. the surplus of Japan's current account also declined slightly due to oil deficits under OPEC II. However, the excess private savings due to decline in the GNP ratio of private expenditure on plant and equipment were more or less offset by the increase in the ratio of government deficit to GNP, without much affecting the GNP ratio of the current account surplus. It is important to note that government deficit increased only to the extent of the excess private savings generated by the lower private investment ratio and not a unilateral creation of new money by government. Another major fundamental factor of this scenario was the existence of extreme difference in the growth rate of exports and imports especially at constant prices. For example, while the export grew by 11.6 per cent per year, imports expanded by only 2.2 per cent per annum, all in real terms between 1972 and 1982. The resultant growth in real external surplus accounted for 32.4 per cent of the expansion in real GNP. Inspite of this marvellous results, Japan, rather than produce for improving living standards at home spent nearly 10 per cent of her real GNP on producing for exports to offset oil deficits in order to arrest a situation of financing higher oil bills on a permanent basis. Japan might have had to borrow if this strategy was not adopted.

Section IV of the paper examined the causes of the co-existence of high-employment government deficit and high-employment current account surplus on which basis she established herself as a capital exporter. In doing this, short-run effects of domestic under-employment, business cycles which caused cyclical budget imbalances, as well as world economic conditions, petroleum price changes and exchange rates were eliminated to get her true current account position at normal or natural levels. After deseasonalising all short term factors both endogenous and exogenous, between 1965 and 1981 and using Economic Planning Agency (EPA) World Economic Model (1984) and Hoop and Tyron Study based on MCM (Multi-Country Model), it was established that the actual external surplus of Japan was influenced by two conflicting factors - the evervalued dollar (i.e. the undervalued yen) and the state of the international business cycle. When the high-employment external surplus was combined with the sectorial I-S balance, the period between 1970 and early 1980s i.e. stage III in the evolution of her balance of payments when she became capital exporter, the newly emerged excess private sector savings were absorbed by the growth of the budget deficits, with little change in the underlying current account surplus.

In Section V, attention was focused on domestic pressures for liberalisation of the Japanese Financial market. Two factors accounted for this.First, the deceleration in corporate investment ratio to GNP which resulted in high corporate capital formation (from 33.8 per cent in 1970 to 76.8 per cent in 1984 for all industries) allowing for availability of idle funds to be invested in financial assets. The second reason was, as a fall out from the high-employment government deficit, massive amounts of national bonds were issued every year since 1975 to finance its deficits,and thus quickly accumulated in financial institutions' balance sheets. Besides, for Ministry of Finance and that its macro policy should be expansionary. What should be done was to judge whether the size of the existing surplus is larger or smaller than the high-employment current account surplus and determine the basic causes of the peripheral part of the current account surplus. Trade fictions, the author agreed, could arise as the real exports of a fast growing economy expands more rapidly than the slow growing domestic market of trading partner countries. Its was however, observed that trade barriers imposed by trading partners on one sector of Japan's exports for the purpose of discouraging trade in such sector(s) caused her other export sectors to expand even faster to generate the high-employment current account surplus which corresponded to high-employment savings investment equilibrium. It was also observed that the internationalisation of the Japanese financial market would not significantly complicate the concept of money since yen deposits by non-residents and foreign currency deposits by residents were already included in the money supply. Although, the development of the euro-yen market tended to circumvent a tight monetary policy at home, since higher opportunity cost on commercial bank's reserves will shift bank deposits from domestic to euro-yen markets. In spite of this, money supply management could still be performed through open market operations. In the main it was agreed that the integration of the yen with international capital markets could bring difficulty in influencing domestic real interest rates independently from developments in world or dollar real interest rates.

REMARKS

The book is a good compendium on the evolution of Japanese financial system. The occasional paper made a historical analysis of Japan's financial market from the position of a net capital importer in 1945 to that of a net capital exporter since the 1970s. In doing this, particular attention was given to the development of her financial market from the bank credit-control paradigm where credit was rationed by her central bank alongside trade restrictions and foreign exchange controls to an open money market paradigm where her financial system was not only liberalised but also internationalised. However, during both periods, government financial institutions and long-term credit banks continued to give out long-term loans at low (i.e. below market rate) interest rates for developmental purposes. Moreover, Japan was cautious in its liberalisation efforts by not decontrolling the whole of her economy in one fellswoop as each of the three stages of her balance-of-payments evolution pattern were consciously made to coincide with first, the dynamic development of her comparative advantage goods; second, the liberalisation of import restrictions and foreign exchange controls; and third the gradual transformation of the Japanese financial system from a bank credit-control paradigm towards a market-determining open money market paradigm. This we observe would serve as a lesson for third world countries attempting economic deregulation, to go about it with caution.

It would be observed that Japan was able to develop her financial system to an enviable position, through the existence of a combination of many factors. Chief amongst them included high-employment deficit financing; open market operation; favourable terms of trade through increased investment in the creation of private sector capacity to produce for exports; and financial discipline on the part of government. In other words, emphasis was placed on stimulation of private investment rather than public sector investment. Two of these factors call for special emphasis. First was financial discipline which was all pervading in both the public and private sectors.

(MOF) to redeem and refinance national bonds without disturbing the Capital Market, it had to issue treasury bills below the market rate at first, but later at market rate. At the same time, commercial banks were allowed to raise funds through Gensaki market (a short-term transaction of long-term government bonds with repurchase agreements at market-determined rates); issue Certificates of Deposit (CD); and offer foreign currency deposits since 1978. Other non-bank financial institutions took advantage of this by investing their idle funds in the Gensaki whose interest rates were higher than regulated interest rate on time deposits of the same maturity.

With the above developments, it naturally followed that the Japanese financial market moved from a bank credit-control paradigm to an open money market paradigm. In terms of Modigliani-Papademos (1980) the bank credit paradigm refers to the financial systems in which the non-bank public, mainly the corporate sector, raised its funds almost entirely from the banking system. By contrast, in the open market paradigm, the non-bank public raised its funds in the capital market by relying on marketable instruments held directly by the public or non-bank financial intermediaries. Thus, while the Central Bank controls money supply via a control of bank credit in a bank credit paradigm economy, it does the same through the conduct of open market operations in an open money market paradigm except that government financial institutions and long-term credit banks still provided long-term subsidised loans for development purposes. Since OPEC I, (i.e. 1973-74), macroeconomic forces have facilitated a rapid shift of the Japanese financial system towards an open market type where interest rates were market determined both in the primary and secondary securities markets and maturity of bonds diversified. Above all, the key macroeconomic force pushing her financial system towards an open money market paradigm was the co-existence of high-employment deficit and the high-employment current account surplus, reflecting the emergence of excess savings over investment in the private sector as a whole.

Section VII traced the process of internationalisation of the Japanese financial system to three fundamental factors. These were the near-complete liberalisation of foreign exchange controls whereby both residents and non-residents freely participated in foreign exchange market transactions; the liberalisation of domestic interest rates and related free usage of the euro-yen markets by both residents and non-residents; and the weakening of the barriers between commercial banks and long-term credit banks, security houses, trust banks, etc. Thus by 1980, formal exchange controls were dropped in recognition of the underlying progress of deregulation made in the 1970s. Besides, by 1984, the so-called Japan-US Yen-Dollar Committee completed a report on the liberalisation and internationalisation of the Japanese financial market. Features of the agreement were; free access to the euro-yen bond market for fund raising; liberalisation of both short-term and long-term euro-yen loans; and liberalisation of short-term euro-yen CDs by 1984 under the condition that such euro-yen C.Ds would not be sold to residents. Other agreements reached included the liberalisation of issue rates on short-term government securities or TBs and the establishment of a yen-denominated BA (Bankers Acceptances) market, since the yen will become a key currency as a result of its internationalisation would mean that Japan has to borrow short and lend long.

Concluding, section VIII took a periscopic view of policy implications of Japan becoming a capital exporter. The policy problems were viewed along the areas of macroeconomic policy; trade frictions; and monetary policy. On whether macroeconomic policy should be employed to reduce high-employment current account surplus, the author felt that its existence in Japan does not necessarily imply weak domestic demand

Although financial discipline may be regarded as a foregone conclusion in the private sector, Japan ran budget deficit with due regard to the likely impact of the deficits on the external sector, while maintaining surplus of savings over investment in the private sector. This was unlike what obtains in many third world countries including Nigeria which engage in unilateral creation of money through excessive deficit financing that fuels domestic inflation. The second factor was promotion of private sector investment. The private sector was deliberately encouraged by the national government through the funding of Research and Development (R&D) in many sectors for private sector benefits and availability of long-term cheap credit from government financial institutions and long-term credit banks for the development of certain strategic economic activities. As a concomitant strategy, as soon as private enterprise started maturing between the late 1960s and early 1970s the banking industry and the whole of the financial system was decontrolled through the introduction of the open money market operation and liberalisation of foreign exchange market.

Nigeria has some characteristics similar to Japan especially in their financial systems in their developmental process as they both ran bank credit paradigm economy prior to economic deregulation and liberalisation. Thus, for this reason Nigeria could learn some lessions from the Japanese experience even though she is a developing country. While Japan pursued a bank credit paradigm economy alongside current account deficit and was regarded as a debtor country for about twenty six years (from 1945-1971), in like manners, independent Nigeria also ran a bank credit paradigm although with regimes of current account surpluses and deficits. It should, however, be noted that Nigeria was much more endowed in natural resources. The striking difference in Nigeria's financial and economic management was that before the introduction of the Structural Adjustment Programme (SAP) in 1986, private sector savings could not adequately finance government deficits while at the same time very little of bank credit went to private sector use; there was little or no financial discipline especially in the public sector; private investment was low while propensity to import was very high without a reciprocal effort in the export sub-sector in contrast to what obtained in Japan in the reviewed period.

Even after economic and financial deregulation through the introduction of SAP since 1986, the Nigerian economy is still suffering from lack of financial discipline and demented private sector initiative. The old habit of high government budget deficits even in excess of budgetary estimates which had never been adequately financed by private sector savings continued to be the order of the day. The consequence of this act could be fatal to the economy, as the high government deficit would not only fuel domestic inflation but is also capable of crowding out real private sector investment and thus promote speculative investment and purely merchandising business. Also, with the overhaulingof the 1962 Exchange Control Act and the freedom to export both primary commodities and manufactures through the dissolution of Commodity Boards, the private sector is yet to take the bull by the horn in the export sub-sector. Consequently, non-official foreign exchange earnings had been very low and never kept pace with targeted figures from year to year.

The lessons for Nigeria and other third world countries are that financial discipline should be strictly and vigorously pursued especially at the official level in order to avoid the pitfalls of the past as a necessary condition in her developmental initiative. The sufficient condition for Nigeria to move out of her present position of debt trap; unemployment of resources; and domestic inflation will be to continue to promote private investments in the production process which started in 1986 not only in principle but in practice. In this wise, the sector should be guided through the provision of the right economic climate, to direct all its energies towards the production of goods and services not only to serve domestic needs but principally for export. This way, the nation's foreign exchange earnings would be increased and thus, not only reduce tension on the official sources which are grossly inadequate to meet the country's growing needs but also usher in overall external balance.

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