Recession hits Japan: What’s behind global “economic schizophrenia”?

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The world economy seems to be afflicted by a severe case of economic schizophrenia. On the one hand the United States, according to official accounts, is enjoying continued economic growth, low inflation, unprecedented wealth creation and falling unemployment. On the other, conditions in Japan, the world’s second largest economic entity, are openly described as similar to the 1930s Depression.

In testimony to the US Congress last week, Federal Reserve Board chairman Alan Greenspan claimed that the US was enjoying a “virtuous circle” in which rising equity values — the stockmarket boom — were providing the impetus for spending and the expansion of output, employment and productivity-enhancing capital investment.

“The current economic performance” he declared, “with its combination of strong growth and low inflation, is as impressive as any I have witnessed in my near half-century of daily observation of the American economy.”

Barely 36 hours after this upbeat assessment, national accounts figures revealed that the Japanese economy had contracted at an annualised rate of 5.3 percent in the first quarter of this year, putting it into an official recession following the 1.3 percent per annum decline in the last quarter of 1997.

What is to account for this divergence? Has the US become a “new economy” in which low inflation combined with technological advances have, to use Greenspan’s phrase, enabled it to move “beyond history” or, is the economic split personality, like schizophrenia, the outward manifestation of a deep disorder in the organism as a whole?

Let us review in more detail the nature of the Japanese slump and its connection to the global economy and the US stockmarket boom.

The release of the Japanese figures sent a shock wave through financial markets as the yen fell to a new seven-year low of 144 to the US dollar, bringing its decline over the past two months to 11 percent, and its decline since April 1995 to 80 percent.

A further decline to 150 to the dollar is expected rapidly, with a drop to at least 170 over the next few months, if not weeks. Some analysts have even predicted that the Japanese currency will fall to 240.

The yen decline, even more than the announcement of recession, brought warnings of a global crisis. The deputy prime minister of Thailand, Supachai Panitchpakdi said excessive falls could lead to a global depression. The major international powers had to ensure that Asia does not “slide in a second Asian crisis ... because a second crisis in Asia will become the first worldwide crisis.”

Speaking to a Stockholm International Peace Research Institute conference last Thursday, international financier George Soros warned of a “breakdown of the entire system” if the crisis in Asia were not resolved. Japan, he said, was already suffering from conditions reminiscent of the 1930s, while the IMF’s programs in Asia had failed to address underlying structural problems caused by the insolvency of the banks.

But even as the latest yen slide began, US Treasury Secretary Robert Rubin made it clear there would be no international intervention, bluntly telling Congress that the “weakness of the yen reflects the economic conditions in Japan, and can only be remedied by restoring economic strength in Japan.”

But that is very much easier said than done.

According to Nobuya Nemota, the senior economist at the Tokyo-based Nomura Research Institute: “We already have most of the necessary conditions for the recession to become a depression. We have a fragile banking system, a credit crunch, falling corporate earnings, companies are pushing wages down, that is dampening demand, and prices are falling — this is the prototype of a depressionary spiral.

“A crash on Wall Street now may be enough to cause the recession to become a depression. The worst of the adjustment may not be behind us; it may be ahead of us.”

In addition to the national accounts figures, other statistics indicate the depth of the Japanese decline. Bankruptcies have increased 37.5 percent over the last year, reaching their highest level in May since the end of World War II. The Ministry of International Trade and Industry has reported that Japanese manufacturers plan to spend 4.4 percent less on plant and equipment in the current fiscal year, the first decline in four years.

The banking crisis is moving from bad to worse. According to Moody’s Investor Services there are at least 13 Japanese banks which may require government assistance. This financial crisis is being exacerbated by the decline of the stockmarket as the Nikkei Index hovers around 15,000 — some 20 percent below the level the government considers necessary. At its peak in late 1989 the index stood at almost 39,000.

The “conventional wisdom” has been that in order to revive the Japanese economy, the government must not only provide a fiscal stimulus through additional spending and reduced taxes but should

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initiate a process of restructuring. However, even bourgeois economists are coming to admit this would worsen the situation.

As the economic columnist for the London-based *Financial Times* Martin Wolf put it: "What would happen if greater deregulation, increased competition and greater transparency swept through the economy? Equity and land prices would fall; concealed losses would be revealed; unemployment would soar; pension funds would founder; banks and insurance companies would collapse; and, not least, the desired return on investment would jump.

"What would be the net result? In the short to medium term, uncertainty would increase and much planned investment would be eliminated. The former would lead to higher desired savings than today; the latter would result in a collapse in investment. The result would be slide from stagnation to slump."

The Japanese stagnation is already threatening to set off a "second wave" Asian crisis. Japan has been a major market for East Asia but in the past three months its imports from the region fell by 20 percent. The Japanese banks have been withdrawing from the region and firms are cutting back on investment. Direct investment is expected to decline by 42 percent this year, following a 67 percent increase in 1997.

But the most immediate fears stem from the decline of the yen. In Korea, where major manufacturing firms in shipping, cars and electronics, compete directly with their Japanese counterparts in world markets, the decline of the yen last week precipitated the largest ever single day fall on the Korean stockmarket.

Across the region governments are nervously watching to see whether China will cut the value of the yuan in order to retain its position in the global struggle for export markets. The governor of China's central bank has already warned that the falling yen is affecting China — remarks which have been interpreted as meaning the yuan may be devalued if the yen slide continues.

According to some estimates, the yuan is presently over-valued by 20 percent and the Hong Kong dollar by 50 percent. The fear is that a Chinese devaluation will set off a 1930s-style beggar-thy-neighbour currency war across Asia.

Echoes of 1929

Even this brief review of the nature and extent of the Asian crisis, places the US economic boom in its global context. The present situation has its historical antecedents.

In the latter part of the 1920s world economic conditions, especially commodity prices, had begun to turn down sharply before the sharemarket collapse on Wall Street in October 1929. Well before that, commodity-producing regions such as Australia and Latin America had experienced a decline in prices, and recession was spreading to Central Europe.

The United States, however, continued to enjoy a boom as capital seeking a safe haven and higher rates of return made its way to Wall Street. Eventually, however, economic expansion in the United States ran up against the gathering world recession, resulting in the collapse on Wall Street and the onset of the Great Depression.

Its social and economic consequences were most severe in the United States precisely because, far from freeing itself from the rest of the world, the very dynamism and productivity of the American economy made it more dependent than any other on an expanding world market.

History does not repeat itself but the present situation has parallels with the 1920s. While the US dollar has been surging to new highs on international markets, across the border, the Canadian dollar, along with the currencies of other commodity-producing countries such as Australia and New Zealand, together with the oil-dependent Russian rouble, has undergone a precipitous decline — a clear indication of a gathering world slump.

The record bull run on Wall Street has been financed to a considerable extent by the influx of funds into US Treasury bonds from Japan. With official interest rates kept down, mutual funds — whose finances now rival those of the banks — have invested in Wall Street, pushing the market ever upwards.

As a consequence the Dow Jones index is four times higher than it was six years ago, while the value of assets and stocks has increased by about $12 trillion since the end of 1994 — the largest accumulation of wealth in the history of the United States. But this record accumulation is not matched by real economic expansion. In fact, growth rates throughout the 1990s have been between 2 and 3 cent, below the levels achieved in the years of post-war economic expansion.

This discrepancy has led to the conclusion in some quarters that the United States has become a "new economy" in which the increase in wealth and productivity is greater than that measured by the usual statistics.

Such assertions also have historical precedents. In words which could well have been uttered by Greenspan as he gave his congressional testimony last week, *Forbes* magazine declared in June 1929: "For the last five years we have been in a new industrial era in this country. We are making progress industrially and economically not even by leaps and bounds, but on a perfectly heroic scale."

The unprecedented stock market boom in the United States, the rapid plunge of the Japanese economy into slump and the growing Asian malaise are not separate economic processes, but contradictory expressions of the deepening crisis of the world capitalist economy as a whole.

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