US-Japan tensions intensify

Obuchi raises spectre of "war economy"

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22 September 1998

Tensions between the United States and Japan have reached such a point that the Japanese Prime Minister, Keizo Obuchi, has raised the spectre of a military build-up in an attempt to deflect US criticism of his government's handling of Japan's economic and banking crisis.

On the eve of his departure for America, where he is to hold talks with President Clinton, Obuchi told the *Washington Post* that Japan had taken every measure short of organising a 'wartime economy' based on increased military spending to lift the economy out of recession.

According to the report, Obuchi said Japan would never consider that option 'but he raised the subject and discussed it at length' in the hour-long interview. The *Post* concluded that 'Obuchi may have been sending a message to officials in the United States and Asia who have been highly critical of Japan's response to its economic crisis' and noted that the summit meeting to be held today 'comes at a time of great frustration and friction between Tokyo and Washington'.

Signs of friction were seen in a speech delivered last Thursday by US Trade Representative, Charlene Barshefsky, who was in Tokyo to organise the agenda for the Clinton-Obuchi summit talks. Speaking to the National Press Club, she issued what amounted to a series of demands on the government, calling for immediate action on 'fiscal stimulus, financial reform, deregulation and market opening' and attacking the 'inappropriately close relationship between ministries and industries'.

Barshefsky also demanded that the ruling Liberal Democratic Party and the opposition parties, which control the upper house in the Japanese parliament, resolve their differences over the bailout of the Long Term Credit Bank (LTCB) and the government's plan for restructuring the banking system.

Under the LDP plan, public funds would be injected into the LCTB, which would then be merged with Sumitomo Trust and Banking. The opposition parties demanded that the LTCB be liquidated by the government with its bad loans disposed of before the merger, so public funds were not used to prop it up.

Last Friday, on the eve of Obuchi's departure for the US a deal appeared to have been reached. Naoto Kan, the leader of the Democratic Party of Japan, the largest opposition group, claimed the government had accepted opposition proposals 'almost in their entirety'.

According to the opposition, no public funds were to be used to prop up the LTCB. The proposed 13,000 yen ($100 billion) public fund to recapitalise weak banks would be scrapped and the Ministry of Finance would be stripped of some of its powers to determine financial policy. A new body, the Financial Review Committee, would decide the fate of failing banks and financial institutions.

Obuchi did not comment directly on the agreement other than to say his decision had been based on concerns over the impact of further delay on the banking crisis. 'I have decided that, as the world's second-largest economy, Japan should not become the source of a global financial meltdown,' he told reporters.

But less than 48 hours after the deal had been announced it started to fall apart. Obuchi said the government would not let the LTCB collapse and would use public funds for its merger with Sumitomo as originally planned. LDP secretary-general Yoshiro Nori said the government was still looking at policy options not contained in the agreement.

Democratic Party leader Nan told a party seminar on

Sunday it was necessary to 'prepare for the collapse of the agreement'. It would fail 'if the LDO goes about its business with the aim of protecting its vested interests, which are completely different from ours, and concealing its past responsibilities'.

News that the agreement was falling apart sent the Tokyo stock market falling to its lowest level since February 1986, with the Nikkei index dropping 2.8 percent as bank stocks led the fall.

Whatever the final decision on the LCTB, it will have far-reaching implications for the banking system as a whole. At least four banks are regarded as being in a similar position to the LTCB--the Fuji Bank, Yasuda Trust and Banking, Daiwa Bank and Nippon Credit Bank.

The Fuji and Yasuda banks belong to the Fuyo group of companies, which includes heavily debt-burdened and loss- making companies, such as Nissan Motors, Hitachi and Marubeni.

Professor Norio Tamaki, head of banking history at Keio University in Tokyo, told the *Australian Financial Review* that everyone was watching Fuji and its share price. 'If Fuji is attacked, it will cause the beginning of the real financial crisis. This is a much bigger bank crisis than LTCB and, as the main banker to the Fuyo group, its problems will be transmitted to others,' he said.

The government decision not to inject public funds into the banking system means that the banks will have to find the capital necessary to repair their balance sheets. This task is growing every day. The official government estimate of bad loans is around $600 billion, but US officials believe the real figure is closer to $1,000 billion. Last week the credit rating agency Standard & Poor's estimated that the bad loans could total as much as $1121 billion, or 30 percent of gross domestic product.

The stockbroking firm ING Barings estimates that the top 19 banks alone need around 30 trillion yen in new capital ($230 billion) to meet international capital adequacy ratios and clear their bad debts.

The banking crisis is being intensified by the economic recession, the fall in the stock market and the emergence of losses by major industrial companies. According to one estimate, earnings for major companies listed on the Tokyo exchange may drop by as much as 33 percent for the financial year ending next March. The slump is extending across the economy as prices and profits fall.

Steel production is being cut, along with petrochemicals and textiles. Stainless steel exports to Southeast Asia are being priced at 65 percent less than last year as a trade war develops between Japanese, Korean and Taiwanese steel producers.

The electronics industry, one of the mainstays of the Japanese economy, is being hit hard. World prices of memory chips have fallen by 30 percent in recent months, hitting Hitachi, NEC and Toshiba. Hitachi lost $1.8 billion in the financial year to last March, Toshiba expects losses for the half-year of $185 million, and NEC, the world's second-largest chipmaker, expects losses of $74 million.

Plant closures have already started. Hitachi and Matsushita Electric have decided to close semi-conductor factories in the US and Fujitsu is closing a memory-chip plant in Britain. It may not be long before plants begin shutting down in Japan as well.

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