US, Japan interest rate cuts point to global problems

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It is a measure of the rapid slowdown in the world economy that the central banks of the two largest countries are slashing interest rates in an increasingly desperate attempt to boost growth.

On Monday, the Bank of Japan (BOJ) effectively reinstated the zero interest rate policy, which it abandoned last August, in the belief that the economy was showing signs of revival. After an eight-hour meeting, the BOJ said it would continue to pump money into the banking system until the deflationary pressures on the economy had shown clear signs of reversing.

This was followed on Tuesday by the decision of the US Federal Reserve to again cut interest rates by 0.5 percentage points, following two cuts of the same size in January. But in both cases the measures are not expected to bring an economic turnaround.

US financial markets, which had been expecting a larger cut, reacted to the Fed decision with a sharp decline. Following the announcement, Wall Street's Dow Jones Index fell by 2.4 percent while the Nasdaq went down by almost 5 percent.

Announcing its rate cut decision, the Fed referred to "persistent pressures on profit margins" that were restraining investment and the decline in consumption resulting from the fall in equity markets. It said excess productive capacity had emerged which could "continue for some time." Coupled with "the potential for weakness in global economic conditions," this suggested "substantial risks that demand and production could remain soft."

Pointing to the possibility of a further cut before the next scheduled meeting of the Federal Open Market Committee in eight weeks time, the statement continued: "In these circumstances, when the economic situation could be evolving rapidly, the Federal Reserve will need to monitor developments closely."

The official statement from the Bank of Japan was an admission that the policies pursued over the last decade to revive the economy have been a total failure.

Economic recovery, it said, had come to a halt after slowing in late 2000 under the influence of a "sharp downturn of the global economy." Prices were falling and there was concern about further falls due to weak demand. But other longer-term factors were at work as well.

"In retrospect," the statement noted, "both monetary and fiscal policies have taken considerably strong actions during the past decade in Japan. Whereas fiscal policy has repeatedly implemented expansionary measures, the Bank of Japan has adopted a policy of maintaining interest rates at levels unprecedentedly low during the history of central banking at home and abroad. All this notwithstanding, Japan's economy has failed to return to a sustainable growth path, and is now faced again with a threat of deterioration."

In the light of these conditions, the BOJ said, it was necessary to undertake a "drastic" monetary easing. This will take the form of continuous purchases of government bonds, injecting an additional 1 trillion yen (more than $8.2 billion) into the banking system and bringing the overnight interest rate close to zero.

In an editorial comment on the new policy, the *Financial Times* said it was as if BOJ governor Masaru Hayami had taken to the air in a helicopter stuffed with an extra trillion yen "ready to scatter the notes liberally over the banking sector in the hope that this would encourage consumers and businesses to increase their spending and revive the economy."

But there was "considerable risk" that the new policy might be ineffective. "The real problem in much of Japan's economy is not a lack of liquidity but that

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companies and their banks are at the risk of insolvency. Both will remain constrained from expanding their balance sheets, and hence stimulating the economy, in spite of the extra money on offer."

US slowdown

Doubts are also being cast on whether the Federal Reserve Board interest cuts will do anything to halt the slowdown in the US. This is because the downturn has not been caused by previous increases in interest rates aimed at curbing inflation but arises from more basic factors such as falling profit rates and the emergence of excess productive capacity flowing from the rapid expansion of investment over the past decade.

Commenting on the Fed's decision, the *Financial Times* said the US economy was undergoing a "necessary adjustment from an unsustainable path". Rising consumption and investment spending, growing by annual rates of 5 percent and 10 percent respectively, have been increasingly financed by debt. At the end of last year, private sector spending exceeded income by an amount equivalent to 5.5 percent of national income—the largest US private sector financial deficit on record.

It warned that the "necessary adjustments will be painful" and that domestic demand "must fall below the economy's sustainable growth rate until the private sector financial deficit unwinds."

Translated from the language of finance to social reality, such an "unwinding" not only implies further falls in the stock market, but the onset of recession and economic devastation for millions of working people.

The issue of monetary and financial policy in Japan also raises broad social questions with the Bank of Japan again demanding that the government carry out a major "restructuring" of the economy and the financial system.

The return to a zero interest rate policy came after a concerted campaign by the government, which claimed its abandonment last August was harming the prospects for economic recovery. Hayami insisted that the real issue was not the further lowering of interest rates but the elimination of bad debts from the banking system.

Having given way to the government's demands, the BOJ continued to insist that "progress in structural reforms with respect to the financial system ... as well as in the area of economy and industry" is essential.

"Structural reform," it warned, "may be accompanied by painful adjustments. Without such adjustments, however, neither improvement in productivity and sustainable economic growth can be obtained. The Bank of Japan strongly hopes that decisive actions be taken to address fundamental problems both with a clear support of the nation for structural reform and under a strong leadership of the government of Japan."

Here too economic jargon obscures the social reality. According to financial analyst Andrew Smithers, while the proponents of "restructuring" have identified the key problem in Japan as the inadequate return on capital, their "proposed solution, which is to cut costs, is impractical and, if implemented, would be disastrous."

"To achieve a competitive return on capital through cost reduction would require a 40 percent fall in income from employment. Such a fall is neither possible nor desirable."

In other words, restoration of profitable conditions for Japanese capitalism requires nothing less than the wiping out of whole sections of the economy and social misery for millions of working people.

In the decade of the 1990s, the US and Japanese economies seemed to be on divergent paths. On the one hand, the US was held up as the home of the "new economy" where technology and the free market had brought an end to the business cycle and ensured continuous economic growth. Japan, on the other hand, experienced nothing but economic stagnation, following the collapse of the financial bubble of the late 1980s, which defied all attempts to end it.

The way forward for Japan, it was claimed, was to adopt the "American model". How rapidly things have changed. It now seems in many ways that the Japanese experience, rather than being an aberration, may well have been an early pointer to universal tendencies in the world capitalist economy.

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