# Bank of Japan appointment sparks new round of criticism

Joe Lopez
3 March 2003

The former deputy governor of the Bank of Japan, Toshihiko Fukui, was appointed last week to head the central bank. This has brought further criticism of Prime Minister Junichiro Koizumi and his government from economists and financial analysts.

Fukui, 67, had worked for the Bank of Japan for over 40 years. At one time he was dubbed the "Prince of the Bank of Japan" and held the post of deputy governor from 1994 to 1998. He was expected to become governor until he resigned from his post when a colleague under his supervision was arrested for leaking information to financial institutions about the contents of sensitive economic surveys. Since 1998 Fukui has worked as the chairman of a private sector think tank, the Fujitsu Research Institute.

Fukui, who will replace outgoing governor Masaru Hayami on March 19, is regarded as a conservative who, like his predecessor, will reject calls for the central bank to set inflation targets and undertake other measures to overcome the deflationary cycle which has gripped the Japanese economy.

In the midst of falling prices and the consequent squeeze on corporate profits, Koizumi indicated he would use the appointment to initiate a fight against deflation. But Fukui's elevation has seen him criticized for buckling under pressure from vested interests to maintain the status quo rather choosing a bank chief prepared to carry out unorthodox policies to address Japan's deepening economic malaise.

An editorial in the *Financial Times* headlined "Koizumi's timidity" voiced the criticisms of international financial interests. It pointed out that, while all of the candidates described themselves as "deflation fighters," from all these battlers the prime minister had chosen "the candidate renowned for the weakest punch."

"Such a lack of courage from Mr. Koizumi," it continued, "is all too reminiscent of many other half-hearted economic reforms under his premiership and bodes ill for the economy."

Describing the appointment as having all the hallmarks of "Japanese stasis", the editorial said the "safe" policies pursued by the Bank of Japan over the past decade had produced economic stagnation, buck passing between various arms of government, years of falling prices, an unsustainable public debt burden that has already reached 40 percent of gross domestic product (GDP), an endless banking crisis and a banking system which supports bankrupt companies.

The editorial repeated calls for a reflationary monetary policy coupled with a fiscal program to rein in government deficits. It also appealed for a banking reform that would identify non-performing loans, nationalise the weakest banks and then sell off their best assets together with "structural reform" to close bankrupt entities that cannot even cover their operating costs.

The "theory" behind this program is that only by ending the policy of propping up bankrupt companies can Japanese banks purge bad loans from their books, restore their balance sheets and begin lending to healthy enterprises. Just how this "shock therapy" is supposed to boost the economy is never made clear. But one thing can be said with certainty: such a program will mean sharp increases in unemployment and cuts in government spending. The bankrupt corporations and banks will be wiped out and their debts repaid by taxpayers.

In an interview with the *Daily Yomuiri*, Allan Metzler, a professor of political economy at Carnegie Mellon University who worked as an honorary advisor to the Bank of Japan from 1986 until earlier this year, maintained that there was no other course but to use public funds to bail out the debt-ridden banks.

"If the deflation stopped, there will be fewer bad loans because a lot of the loans are caused by falling prices, especially real estate prices. That will be a step forward. But in the end, it is only the taxpayers who have to pay for the mistakes made in the banking system. There's no one else."

One of the major problems confronting the Japanese economy is that it is caught in a kind of vicious deflationary circle as falling consumer demand leads to falls in prices, leading to loss of confidence and further cuts in consumer demand. Moreover, the combination of economic uncertainty, the threat of unemployment, an underfunded pension system, rising medical costs and possible increases in the much hated consumption tax and the prospects of taxes and cutbacks to government spending to bail out the banks means that consumer confidence is worsening. This mass psychology has deep roots as many working class families have seen the value of their homes and assets fall dramatically since the collapse of the financial bubble at the beginning of the 1990s.

The unemployment rate provides one indication of the Japanese economic malaise. It reached an average of 5.4 percent for 2002—the worst level since records were started in 1953—and up markedly from the average of 5 percent in 2001. Government figures show that the number of unemployed is 3.59 million. By contrast 1.36 million were looking for work in 1991.

The nationwide core consumer price index was down by 0.7 percent in December 2002 from a year earlier, representing the 39th consecutive month of decline. GDP grew by a minimal 0.5 percent for the October-December quarter mainly due to increases in exports as a result of a weaker yen. However negative growth is being predicted for the coming quarter and the next financial year due to the downturn in the global economy, rising oil prices and the impact of the US led war on Iraq.

In its latest report on the state of the economy, the Bank of Japan commented that activity remained "flat amid substantial uncertainty about the outlook."

According to a report by the Finance Ministry, Japan's trade surplus in January dropped 42.8 per cent from a year earlier, the first fall in 11 months. The decline, it said, was due to an increase in oil imports that exceeded export growth. Japan's trade surplus with the United States also fell 8.9 percent from a year earlier for the first time in five months.

A report released by research firm Teikoku Databank in late January revealed that nearly 20,000 firms went bankrupt in Japan during the 2002 fiscal year, the second highest number of corporate failures since World War II. The record of 20,800 set in 1984 could be exceeded this year as special inspections aimed at investigating the finances of banks find insolvent companies on their books.