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VIEWPOINT

Japan's Employment Anemia

Here in Japan, this fall has turned into a political season; the House of Representatives has just been dissolved, and the focus is now on the upcoming general election. Meanwhile the economy has taken a turn for the better, at least on the surface. The end of September, which marked the halfway point in the Japanese fiscal year, was greeted calmly, in sharp contrast to the widespread pessimism that prevailed at the end of the previous fiscal year this past March. The stock market is up, and fears about the health of the financial system have receded. The appreciation of the yen is a concern, but overall, economic sentiment is gradually improving. In the Bank of Japan's quarterly *tankan* survey of short-term business sentiment in September, which was released on October 1, the diffusion index for major manufacturers was positive for the first time in almost three years, rising 6 points from the previous survey in June.

Another bit of positive news was the September 30 announcement that the unemployment rate for August declined by 0.2 point from the previous month to 5.1%. But the total number of people employed shrank in August for the first time in four months. The United States is in the midst of what some commentators call a "job-loss recovery," with many people continuing to be thrown out of work even as the economy expands. And the situation in Japan seems somewhat similar, with the upturn in the economy still failing to lead to an increase in the employment rolls. The plight of younger people is especially dire, with unemployment among the under-25 age group running at close to 10%.

On top of the impact of cyclical factors, the labor market has been greatly affected by changes in the business environment, such as the rising waves of corporate restructuring and spinoffs. The share of workers belonging to labor unions has fallen to 20.2%, and Rengo, the Japanese Trade Union Confederation, has targeted improvement of conditions for part-timers and other nonregular employees (most of whom belong to no union) as part of its action program for fiscal 2003.

This year's edition of the government's White Paper on the National Lifestyle addressed the impact of deflation on people's lives, and it devoted one of its three chapters to an analysis of the increasingly harsh employment picture for young people. According to the white paper, the share of part-time and temporary workers (including those placed by temporary staffing agencies) jumped from 15.6% in 1990 to 26.7% in 2001. Though "labor mobility" is a good thing in principle—and though changes in young people's attitudes toward employment are doubtless one factor behind this sharp increase—it hardly seems right that one worker in four is in a nonpermanent job.

ON OTHER PAGES

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One key issue in the upcoming general election is the public pension system. The National Pension scheme is supposed to cover every Japanese from age 20 through 64 (excluding those enrolled in public pension plans for employees), but the flat monthly contribution of ¥13,300 is a heavy burden on those with low incomes. As a result of this and other factors, the share of those failing to pay has been rising steadily; as of the end of fiscal 2002 it stood at an alarmingly high 37%. As this problem exemplifies, the impact of ongoing weakness in the labor market has broad repercussions, extending to tax revenues and even the sustainability of the pension system.

Another issue is the decline in the quality of workers. This is cited as a cause of the serious accidents that have been occurring in plants with distressing frequency recently. It is also a tendency that is liable to affect the international position of Japanese industry, which depends on a high-quality labor force, including a strong contingent of skilled, experienced workers, to support its competitive edge.

In order to maintain a healthy economy and an optimistic society, it is essential that there be an ample supply of jobs for young people reaching adulthood. Candidates in the upcoming election campaign should talk not just about short-term measures to fight unemployment but also about policies to create jobs over the longer haul. The underlying mission of politics is to achieve "the greatest happiness for the greatest number," and employment is fundamental to this endeavor.

■ ***Akio Okawara, October 10, 2003***

REPORT

Print Money to Fight Deflation?

During a visit to Japan in April this year, Professor Joseph Stiglitz of Columbia University, winner of the 2001 Nobel Prize in economics, suggested the issuance of government notes as currency—in other words, a policy of simply printing money—as a way of fighting deflation. In the half year since then, though the possibility that this proposal will be implemented is nil, a number of others have come out with arguments in its favor. This month we will consider whether this approach would actually allow the government to raise revenues through "seignorage" without increasing its deficit.

The currency system in Japan

Before we discuss this proposal, we should confirm our understanding of the difference between Bank of Japan notes and government notes and of the meaning of the term *seignorage*. To do so, let us review the currency system as it now operates in Japan. The Japanese Currency Law defines two types of legal tender, namely, *kahei*, meaning "coins," and *shihei*, meaning "paper money." The former consists of coins issued by the government; the latter consists of notes issued by the Bank of Japan. This sort of division of issuing authority is found in most advanced countries.

Coins are produced by the Japan Mint, an independent administrative institution, which supplies them to the Bank of Japan. The government pays the mint for the cost of minting the coins, and the Bank of Japan pays the government the face value of the coins it receives. The difference between what the government pays the mint and what it receives from the BOJ is added to the national treasury as nontax revenue. This profit is traditionally called "seignorage." The BOJ records the freshly minted coins as assets on its balance sheet, and it circulates them by supplying them to commercial banks through money-exchange transactions.

The system for creating paper money (BOJ notes) is different. The notes are produced by the National Printing Bureau, another independent administrative institution, on order from the BOJ, which pays the production costs. When it issues them as currency, it records them as liabilities on its balance sheet. So the creation of paper money produces no direct profits either for the BOJ or for the government. However, the BOJ does earn interest on the government bonds and other assets it receives in return for the notes that it issues, which cost very little to produce. The difference between this income and the production costs may be considered a form of seignorage. Any after-tax profits that the BOJ makes, excluding dividends and increases in reserves, are paid to the national treasury.

According to the BOJ's announced figures, as of the end of September 2003 its liabilities included issued banknotes (BOJ notes) totaling approximately ¥70,060 billion, while its assets included cash (coins) totaling some ¥280 billion; the volume of coins in circulation came to about ¥4,320 billion.

A nineteenth-century parallel

Stiglitz spoke on April 16 to a meeting of the Subcouncil on Foreign Exchange and Other Transactions, a group within the Ministry of Finance's Council on Customs, Tariff, Foreign Exchange, and Other Transactions. While observing that a call to print money may be considered a grievous sin for an economist to commit, he suggested that this is an idea worth considering in a deflationary economy, explaining that issuing government notes in moderation would not lead to hyperinflation. Unlike bonds issued as debt, notes issued as currency do not have to be rolled over. Furthermore, they are not counted as part of the government debt. Stiglitz proposed using funds raised in this way to shore up banks' capital.

The present law does not envisage the issuance of paper money (*shihei*) by the government, but it might be possible to view the issuing of government notes in paper form as an extension of the minting of coins. If this view were taken, the government could earn profits (seignorage) by issuing notes without having to record them as liabilities.

Since Stiglitz offered this proposal, some economists have cited the example of *dajokan-satsu*, the paper money issued by Japan's Meiji-era government in the nineteenth century, arguing that the issuance of government notes might erode confidence in the nation's currency and government bonds. To this, other economists have rebutted that the Meiji government notes are a good model for today's Japan.

Dajokan-satsu were first issued in 1868, the year of the Meiji Restoration. For a number of years after this, Japan had various sorts of government notes and other paper money in circulation. But in 1882 the Bank of Japan was established, and shortly thereafter it became the only institution authorized to issue paper money.

It is true that the issuance of *dajokan-satsu* and other government notes in the early Meiji era was a source of seignorage revenues. But this was a period when the Bank of Japan had not yet been established and the authority to issue paper money had not been consolidated within a single institution. So it seems questionable to cite this as an example when debating the idea of issuing government notes in our own time.

Considering the consequences

Let us consider what might happen if the government undertook to issue its own paper money. Assume that this was limited to a one-off issue of government notes. The BOJ would acquire these notes at face value and put them into circulation through its money-exchange operations. But paper money has a relatively short average circulation life; eventually the notes would be deposited in banks and make their way back to the BOJ. Ultimately they would be retained by the BOJ as assets.

Unlike having the BOJ monetize part of the national debt by directly buying government bonds, this proposal would not involve the assumption of additional debt by the government. The notes, paying no interest and bearing no maturity date, would remain indefinitely on the BOJ's balance sheet, either inflating it or taking the place of government bonds currently held as assets.

In May the UFJ Institute, an affiliate of one of Japan's top banking groups, came out with a report asserting that for practical purposes there is no real difference between having the BOJ buy government bonds and having it buy government notes. To be sure, the government pays interest on its bonds, but as we noted above, it returns the bulk of its profits to the national treasury, so having bonds held by the BOJ rather than by regular investors effectively lightens the government's debt-servicing burden. At the April 16 session, Haruhiko Kuroda, special advisor to the cabinet, explained this point and suggested that this approach—monetization of government debt by the BOJ—is much more realistic than having the government print money.

Speaking to the House of Councillors on April 22, BOJ Governor Toshihiko Fukui noted that modern capitalism has been built on a foundation of sound currency achieved by having the government, while legally retaining the authority to issue money, cede this authority in practice to the central bank. He suggested that Stiglitz's proposal might end up returning us to a much earlier historical stage in terms of macroeconomic policy. This seems like a valid argument.

In essential terms, government notes are a form of government debt backed by the assets of the BOJ, not listed as a government liability but generating seignorage revenues. The arguments in favor of this approach seem to be short of explanations of the ultimate consequences. Some of those who advocate increased purchases of government bonds by the BOJ and other unorthodox monetary policy measures have asserted that there is no need to worry about damaging the BOJ's balance sheet. This is a question that goes beyond the scope of this article, but the idea of issuing government notes is not one that we can properly evaluate without a full accounting of the impact that such a policy would have on the BOJ and the notes it issues.

■ ***Yoshifumi Matsumura***
October 7, 2003

INTERNATIONAL AFFAIRS

This section takes a look at major topics on the international scene, offering an outline of developments together with highlights of media commentary and reports from research institutes.

China under pressure to revalue the yuan

Trade friction between the United States and China has been heating up. Republican and Democratic members of the U.S. Congress have submitted legislation to impose an across-the-board surcharge on all imports of Chinese products if China does not allow the yuan to trade at an exchange rate reflecting its actual strength and keeps it artificially low against the dollar.

During the 1980s and 1990s Japan was the target of U.S. complaints of "unfair trade," and during the administration of President Bill Clinton Washington even pressed Tokyo to accept numerical targets for increasing Japan's imports, a demand that seemed to fly in the face of free-trade principles. China has built up an economic model centering on exports, particularly to the United States; this has served as the basis for rapid growth, but it has also caused the U.S. bilateral trade deficit with China to balloon, leading to American complaints of unfair trade and pressure for currency revaluation. This is a course of developments that is all too familiar to the Japanese from their own experience.

In response to this American pressure, however, some figures both within the United States and in Europe have raised their voices in China's defense. In an August 7 *Financial Times* article, Stephen Roach, chief economist of Morgan Stanley, declared, "China is fast becoming the scapegoat of a weak global economy. . . . The pressure is building for Beijing to change its currency regime. That would be a huge mistake for China, Asia and the global economy." And *Los Angeles Times* columnist James Flanigan on September 3 noted China's severe problems of rural unemployment and overstaffing at state-owned enterprises, writing, "Americans who are increasingly fretting about the loss of jobs to China should know that there is another country out there that is even more worried about the pitiful state of its labor market. That, oddly enough, is China."

By comparison with the stir over the deficit in trade with Japan in the 1980s, the reaction within the United States to the swelling deficit with China has been relatively muted so far. Pointing out this difference, a British think tank has attributed it partly to the fact that China is still a developing country; its industries are competitive mainly in the area of low-priced manufactured goods, and U.S. firms are heavily involved in China's growth through their investments in that country.

In some of their arguments, however, the critics of the pressure on China seem to have gone overboard. For example, in his *Financial Times* article Stephen Roach lashed out at Japan: "If you want an example of an undervalued currency, remember the yen averaged close to 300 to the dollar in the 1970s and about 220 in the 1980s—dramatically cheaper than its current range of ¥115–120. It is hypocritical for Japan to criticise China for emulating a strategy that was central to its own development model." This is a bit unfair; Japan is hardly the only country whose changing circumstances have led to changes in its stated position.

James Flanigan observed, "Areas of rural China, mainly in the western part of the country, are mired with 125 million unemployed." He also noted that "state-owned enterprises . . . are a source of shoddy overproduction and a drag on total output" and that "the state-owned banks financing these dinosaurs are saddled with at least $500 billion of bad loans." One unexpected byproduct of the debate over the yuan exchange rate is that it has highlighted some of the big problems like these that are affecting China even as it continues to record an enviably high economic growth rate.

Agreement and disagreement about Iraq

This year's session of the United Nations General Assembly started on September 23 with addresses from Secretary General Kofi Annan, U.S. President George W. Bush, and France's President Jacques Chirac. On the subject of Iraq, there were no major differences in the basic goals set forth by the three leaders. All three called for the restoration of public order, economic recovery, humanitarian assistance, the rapid construction of a system of democratic governance, and restoration of sovereignty to the Iraqi people as quickly as possible. On the specifics, however, their positions parted, with a deep gap in particular between the United States and France. Once again a political leadership struggle has emerged, one that also involves Britain, Germany, and Russia.

On September 18, *New York Times* columnist Thomas Friedman offered a stinging assessment of

France's intentions: "France wants America to fail in Iraq . . . in the crazy hope that a weakened U.S. will pave the way for France to assume its 'rightful' place as America's equal, if not superior, in shaping world affairs." He goes so far as to declare, "France is becoming our enemy."

As the debating continues in the United Nations and elsewhere, the situation within Iraq remains far from settled. Attacks against U.S. military forces have been increasing from month to month. Writing in the *Washington Post* on September 14, Jim Hoagland did his best to present a hopeful view of the situation: "Iraq has endured a brutal summer" of assassinations and sabotage, but "the country has not plunged into chaos or the bloody civil war that experts have long predicted." He also wrote of the relative calm between the Shiite majority and Sunni minority despite the August 29 bombing of the Shiite central mosque in Najaf, which was seemingly planned to foment sectarian strife. "Iraq still stands," Hoagland declared, citing positive developments in support of his conclusion that "the struggle to rebuild Iraq has certainly not been lost."

Charles Krauthammer, as always, has offered a distinctive angle. In his October 3 column in the *Washington Post* he wrote, "The media cover the sabotage of the oil pipelines. . . . But the undramatic story is that Iraq is producing more than 1.6 million barrels a day, more than three-quarters of 2002 production levels. Last week OPEC unexpectedly cut its production quotas. . . . Why? Because it sees Iraqi oil production coming on line and seriously threatening world prices."

Japan depends on the Middle East for 90% of its supply of oil. A quick recovery in Iraq is also an important Japanese concern. Surely no country would disagree with the assessment by James Baker, former U.S. secretary of state, that the "Lebanonization" of Iraq would be a "geopolitical nightmare." So it behooves all the countries involved to overcome their differences concerning the details and work together to achieve their common goal of getting Iraq back on its own feet as soon as possible.

■ ***Tsuyoshi Ike***
October 9, 2003

INSIDE WASHINGTON

Blackouts and Their Lessons

This summer blackouts were a major topic of discussion in Washington, D.C. In Tokyo, thanks to an unseasonably cool summer, the feared power cuts did not occur. Other parts of the developed world were not so lucky, however. A large swathe of the northeastern United States, including New York City, and parts of eastern Canada experienced the most massive blackout in North American history, with some 50 million people affected. England and Italy also suffered big power cuts.

To make matters worse, on September 18 over 4 million households from North Carolina to Pennsylvania were left without power when Hurricane Isabel assaulted the U.S. east coast. In the Washington area alone more than 1 million households lost power, and it took almost 10 days to restore electricity to some communities.

One reason for the delay was the large number of trees in the Washington area. Hurricane Isabel uprooted many trees or ripped off thick branches, which fell on power lines. Although electricity companies serving the Washington area brought in extra workers from surrounding states, the sheer number of severed lines meant it took considerable time to complete repairs.

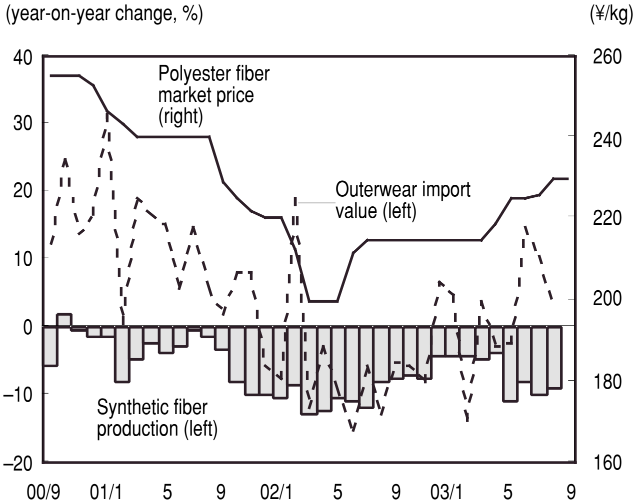
The Hurricane Isabel blackout has refocused attention on the question of burying power lines. Downtown Washington, Georgetown, and other parts of the city where lines are already underground did not lose power. The two major companies supplying electricity to Washington and its environs have a total of 70,000 miles (about 112,000 kilometers) of cable, of which 35,000 miles are already underground. New housing developments are required to bury power lines. But in older neighborhoods conversion has been slow, since it costs about $3 million per mile to switch from overhead to underground lines and when problems occur it is more difficult and time consuming to repair underground cables.

Another reason the impact of this year's blackouts in the eastern United States was so far reaching is that when power was deregulated in the 1990s and competition intensified, power providers sought to shave costs by reducing the money spent on maintenance of the power grid. Aside from anything else, the need to enhance homeland security to combat terrorism demands a rethink of America's vulnerable electricity infrastructure.

■ ***Kunio Tsurumi, Washington***
October 7, 2003

JAPANESE INDUSTRY

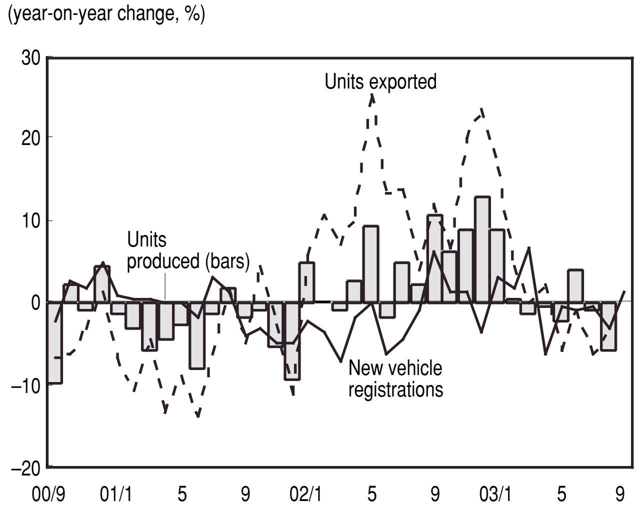
TEXTILES



Sources: Japan Chemical Fibers Association; Ministry of Finance; etc.

Synthetic fiber production sagged 8.9% from a year before in August. With demand for synthetic clothing materials declining, demand for industrial materials for use by automakers is one of the few growth areas. Strong auto sales are powering demand for materials like nylon for air bags and polyester for seat belts and tire cord.

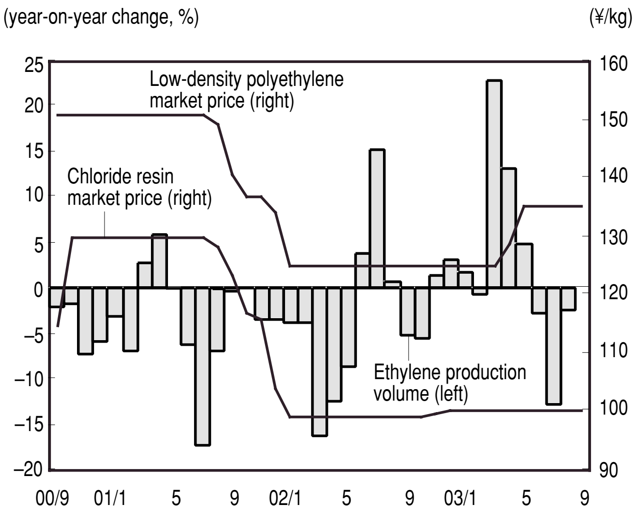
AUTOMOBILES



Sources: Japan Automobile Manufacturers Association; Japan Automobile Dealers Association.

Total new vehicle sales (excluding mini vehicles) rose 4.2% year on year in September, supported by replacement demand for trucks (with regular truck sales up 62.8%) before the start of stricter diesel emission controls in the Tokyo area in October. Exports in August were down by 3.4%, reflecting increased overseas production.

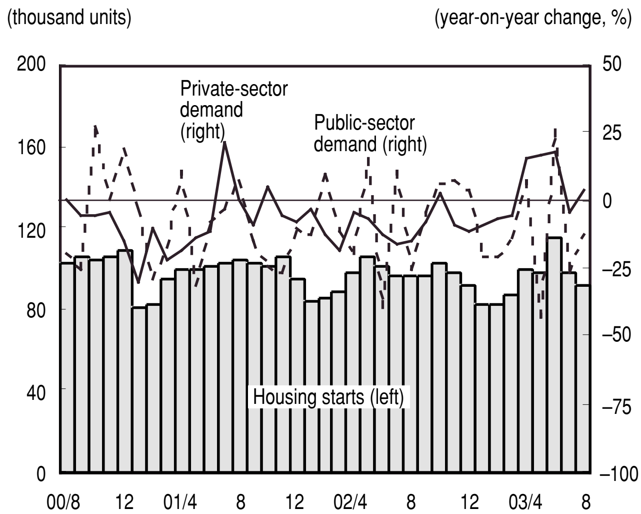
CHEMICALS



Source: Research Institute of Economy, Trade, and Industry.

Ethylene production volume dipped 2.5% year on year in August. Shipments of all four major commodity resins were down, as the cool summer depressed demand for use in drink containers and appliances like air conditioners. PVC makers are facing stiff resistance to price hikes.

CONSTRUCTION



Source: Ministry of Land, Infrastructure, and Transport.

August housing starts were down 5.4% year on year. Drops in rental units and condos pulled down the total. But owner-occupied homes rose 6.7% thanks to strong demand before the hike in housing loan interest rates.

■ ***Kanji Ishitsuka and Etsuko Toyama, October 6, 2003***

WORLD ECONOMY

In its most recent *World Economic Outlook*, the International Monetary Fund upgraded its forecast for growth in Japan and the United States, but it lowered its outlook for European economies, which are feeling the impact of the appreciation of the euro. And it sharply downgraded its 2003 growth forecast for Asia's newly industrialized economies in line with the effects of the outbreak of severe acute respiratory syndrome, or SARS (see the table). However, the IMF's overall forecast for the world economy this year was unchanged from the previous outlook, published in April, and it sees the global recovery accelerating in 2004.

Economic Growth Outlook

(%)

	2001	2002	2003	2004
World	2.4	3.0	3.2	4.1
Japan	0.4	0.2	2.0	1.4
United States	0.3	2.4	2.6	3.9
EU	1.7	1.1	0.8	2.0
Asian NIEs	0.8	4.8	2.3	4.2
Asia	5.8	6.4	6.4	6.5
China	7.5	8.0	7.5	7.5
ASEAN 4	2.9	4.3	4.1	4.4
Middle East	2.0	4.8	5.1	4.6
Latin America	0.7	–0.1	1.1	3.6
Africa	3.7	3.1	3.7	4.8
Russia	5.0	4.3	6.0	5.0

Source: International Monetary Fund, *World Economic Outlook*, September 2003.
Notes: The Asian NIEs, or newly industrialized economies, are Hong Kong, Singapore, South Korea, and Taiwan. The ASEAN 4 (members of the Association of Southeast Asian Nations) are Indonesia, Malaysia, the Philippines, and Thailand.

Japan

In **Japan**, the *tankan* survey of business sentiment (conducted quarterly by the Bank of Japan) registered a positive figure for major manufacturers in September for the first time since December 2000, indicating improvement in economic confidence in the corporate sector and confirming the gradual recovery trend.

Major manufacturers are expecting increased earnings thanks to strong export performance. Sales to other Asian countries, which had been lagging since this spring, have picked up again since July, particularly in such categories as electronic parts, including semiconductors, and chemical products. But exports of automobiles have declined, reflecting increased local production in overseas markets by Japanese automakers.

The job picture has improved slightly. In August the ratio of job offers to job seekers rose by 0.01 from the previous month to 0.63, and the unemployment rate fell by 0.2 point to 5.1%, the lowest level since August 2001.

Americas

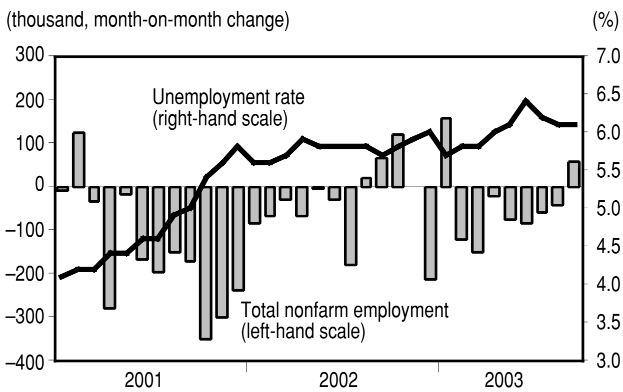
The August figure for consumer spending in the **United States** was up 0.8% from July, reflecting strong demand for durable goods. It was the sixth straight monthly advance. Sales promotion campaigns by manufacturers of autos and computers proved effective. And strong home sales pushed up demand for furniture and other interior goods. But the gains in July and August were at least partly attributable to the tax rebates consumers received this summer, which substantially pushed up disposable incomes, and some observers are concerned about what will happen after this stimulus wears off.

Another source of concern with respect to the prospects for consumption has been the lagging job market, but the employment statistics for September were much better than the market had anticipated (Figure 1). Total nonfarm employment (seasonally adjusted) was up for the first time in eight months, advancing by 57,000 over August. Employment in services rose substantially, and the margin of decline in manufacturing payrolls shrank. But the level of unemployment insurance claims, which is a leading indicator of labor market conditions, has remained basically unchanged.

With domestic demand holding firm, the current account balance has continued to register large deficits.

Economic conditions in **Brazil** have been deteriorating. Industrial production for July was down 2.5% year on year, and the unemployment rate rose to 13%

Figure 1. Trends in Employment, U.S.



Source: Department of Labor.

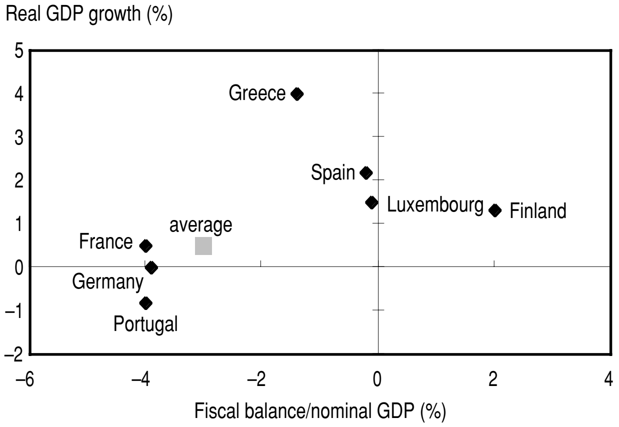
in August. The central bank has lowered its outlook for this year's growth rate from 1.5% to 0.6%. But **Argentina** has been making a comeback; gross domestic product registered a real year-on-year growth rate of 7.6% in the April–June quarter, and industrial production was up 15.5% from a year before in August.

Europe

Though the pace of growth appears to be accelerating in **Britain**, continental economies are continuing to lag, and unemployment in the euro area has remained stuck at a high level.

Governments of countries in the euro area have been considering ways of applying fiscal stimulus, but the countries with the lowest growth rates tend also to have below-average fiscal balances, and they face the difficult task of deciding how to cope with the constraints imposed by the European Union's Stability and Growth Pact (Figure 2).

Figure 2. Real GDP Growth and Fiscal Balance, Euro Area, 2003



Source: International Monetary Fund.

In **Germany** the IFO index of economic sentiment has risen for five straight months. But many observers suggest that these advances are based largely on expectations of future improvement in economic conditions and that the short-term outlook is for only a slow recovery.

The unemployment rate in **France** rose to 9.6% in August, and the number of jobless people was up 5.6% from a year before. The weakness of the employment situation has been taking a toll on consumer confidence. The government is still predicting 0.5% growth this year, but many doubt that this will be achieved.

Asia

The fading of the negative impact of the SARS outbreak and the ongoing recoveries in Japan and the United States have helped improve confidence in economic prospects in Asia.

Industrial production in **South Korea** advanced by only 1.5% from a year before in August. Shipments for export were up 10.5%, but domestic shipments slipped by 3.5%, showing the weakness of domestic demand. In **Taiwan**, meanwhile, industrial production was up 5.3% year on year in August, and exports increased by 11.6%; these positive figures clearly indicate that the economy is recovering from the effects of SARS, which caused a temporary slowdown starting this past spring.

The number of travelers visiting **Hong Kong** topped the year-earlier figure in August for the first time in five months, and retail sales resumed positive growth. The jobless rate fell for the first time in nine months.

In **Singapore**, however, a recovery has been slow to materialize. Industrial production was up 10.3% year on year in August, but the growth was largely limited to the biomedicals sector, which recorded a surge of 68.5%. And July retail sales were weak, except for automobiles; the overall figure was down from a year before.

Thailand's year-on-year growth rate for April–June came in above most expectations at 5.8%. The hotel and restaurant trade registered a double-digit drop as the number of tourists from overseas plunged 40% from the previous year's level, but the overall impact of SARS was limited, with the manufacturing sector growing by 11.0%.

And **China** continues to enjoy a strong expansion; industrial production was up 16.5% year on year in August, and retail sales advanced 9.9%.

■ ***Fumio Oi and Yuko Furukawa, October 7, 2003***