Section 3 External Economic Policy

1 Economic Recovery of Industrialized Countries and the Prolonged Problem of Debt Accumulation

The Economic Recovery of Industrialized Countries. In the industrialized countries, the economies that had stagnated in early 1980s finally recovered in the late 1980s. The United States and Japan were the driving force for the economic recovery in the late 1980s. The United States' economy expanded for seven years from 1983 to 1989. In Japan, economic expansion by boosting of domestic demand occurred from 1987 to 1989 as well.

The United States became a debtor country in 1985, and the deficit of its trade balance and current account reached a record high in 1987. The trade imbalance towards Japan was not corrected much although the overall deficit was reduced, so that the economic friction between Japan and U.S. grew fierce. The USTR (United States Trade Representative) specified three articles to be prioritized for negotiation based on Section 301 of the U.S. Trade Act (space satellites, super computers, and wood) in May 1989. Negotiations on these three articles were settled in March and April 1990. From September 1989 to June 1990, the Japan-U.S. Structural Impediments Initiative Talk (SII) was held. The request from the United States to Japan was focused on six articles, including the expansion of public investment, the amendment of the Antimonopoly Law, and the abolition of the Large-Scale Retail Store Law. The talks intended to request that Japan proceed with reform because the trade imbalance had resulted from the systems and business practices of Japan, which was therefore different from a mere trade friction regarding certain articles.

The economic growth of Europe had remained slow since the first Oil Crisis, but the EC's economic integration became a driving force for economic recovery in late 1980s.

The Polarization of Newly Industrializing Countries (NIES). The NIES increased their trade towards the United States and developed their economies, in the rapid yen appreciation after the Plaza Accord. ASEAN countries received direct investment, positively aiming at industrialization for export. This eventually promoted the industrialization of the ASEAN countries, and in particular, export of heavy manufacturing products accounted for over 50% of their entire exports in 1989.

The inflow of short-term funds played an important role in the economic growth of NIES and ASEAN. However, such economic growth depended on the short-term fund, which deteriorated the soundness of financial institutions in ASEAN countries, resulting in the Asian monetary crisis in 1997.

In contrast, Latin America suffered from inflation, fiscal deficit, and the deterioration of the balance of payments after the monetary crisis in 1982.

Summits. The main agenda of the Bonn Summit in May 1985 was to decide the schedule to launch a New Round of negotiations. Most of the Summit countries agreed to start the New Round earlier, but no official consensus was reached at that time. The maintenance of the medium-term economic strategy since the Williamsburg Declaration on Economic Recovery (1983) was also confirmed as a target of the macro policy common to each country, which was contrasted with the economic stimulus measures in the Bonn Summit in 1978.

At the Tokyo Summit in 1986, the Summit countries decided to form a Group of seven Finance Ministers and Deputies of the Summit countries (G7) and to enhance the policy coordination of G7 countries.

In the Venice Summit in 1987, the main agenda was how to firmly execute the Louvre Accord, in February of the same year. The United States requested the creditor countries to expand their domestic demand and reduce their interest rates but Japan refused to reduce its interest rates, by stressing the priority of executing the Emergency Economic Measures. In terms of policy coordination, the United States, insisting on the introduction of elements for automatic operation which could have a strong compulsion power, stood against Japan and West Germany saying that compulsory measures were not preferable.

At the Toronto Summit in 1988, the Summit countries agreed to add commodity-price indicators to the existing indicators for multilateral surveillance activities. The United States requested that Japan and Germany maintain their easy money policy. The main agenda of this Summit was the economic and debt problems of the developing countries. Minister of Finance Kiichi Miyazawa proposed a debtor relief plan using the IMF, but the countries could not achieve the agreement on this proposal.

The Arch Summit in 1989 was held for three days from July 14 in Grand Arch (the new “Arc de Triomphe”) in a suburb of Paris, which coincided with the 200th anniversary of the French Revolution. Regarding the international monetary problem, concerted activities had been conducted after the Plaza and Louvre Accords. It was also confirmed that efforts should be made to solve the trade issues before the completion of the program by the Uruguay Round Negotiations in 1990. The debt and development problems of developing countries were one of the main agenda items of this Summit, so the Summit countries confirmed their intention to welcome the Toronto Scheme for the poorest countries and the “New Debt Strategy” for middle-income countries. Japan announced that it would enhance measures for recycling funds of over $30 billion for three years, as announced in the Venice Summit and execute the measures for recycling funds of over $65 billion in five years including the present three years.

The Houston Summit of July 1990 took place when liberalization and democratization of Eastern European countries was rapidly progressing, as represented by the collapse of Berlin Wall, which was opened up in October 1989, and was focused on political issues. The macro economic issues, which had initially been planned for discussion at the Summit, were raised little, as the economy of the Summit countries continued to expand for the eighth year, in contrast to the issues of Eastern Europe and Soviet Union.

Solutions to the Problem of Debt Accumulation. The United States took the lead in reviewing its debt accumulation policy in the late 1980s. In the IMF and the World Bank Annual Meeting, U.S. Secretary of the Treasury Baker proposed a new plan (the “Baker Plan”) in October in 1985. This plan intended to implement a new lending system for 15 heavily indebted countries, including the unique feature of imposing a conditionality (structural adjustment) to receive the supply. However, this plan was eventually suspended, as the commercial banks of industrialized countries refrained from new lending to the debtor countries, and they even moved to retrieve the debt.

The economic situation of debtor countries remained difficult, as represented by the increase of the debt of Mexico in 1986, and emergency loans by the IMF, rescheduling of the loans of commercial banks and the moratorium on Brazil in February 1987.

At the IMF and the World Bank Annual Meeting in September 1987, Secretary of the Treasury Baker proposed the “Menu Approach” to supplement the “Baker Plan". This proposal was an idea for commercial bank lending to debtor countries to provide more choices (menu) of loans. This included loans for trade and projects, transfer of loans from central banks or governments to private sectors, and debt-equity swapping, etc., which was also aimed at improving incentives for commercial banks.

The IMF then took a step forward toward the diversification of facilities, in line with these proposals. In the IMF and the World Bank Annual Meeting of September 1987, Managing Director Camdessus appealed to members that it would be necessary for debtor and creditor countries to share responsibilities and cooperate to solve the problem of debt accumulation. The IMF should play a key role in cooperation with the

World Bank and diversify financing facilities, such as by the increase of the Structural Adjustment Facility (SAF), the use of the Extended Fund Facility (EFF) and the inspection of Compensatory Financing of export Fluctuations (CFF). The Enhanced Structural Adjustment Facility (ESAF) was newly established in December 1986 to provide long-term loans on concessional terms to low income countries (the name was changed to the Poverty Reduction and Growth Facility (PRGF) in November 1999). The compensatory financing of export fluctuation was reviewed and the Compensatory & Contingency Financing of export Fluctuations (CCFF) was established in July 1988.

The World Bank also started to address loans for supporting structural adjustment programs and getting financing from private sources by co-financing for the solution of debt problems, in addition to the conventional specific project loans.

However, as these additional measures did not have enough effect, further consultations were made on additional measures for debtor countries, and the “Brady Plan” was released in 1989.

The Miyazawa Plan proposed in the interim committee of the IMF in April 1988 and officially announced in the IMF and World Bank Annual Meeting in September 1988, was the base for “Brady Plan”. The plan proposed to reduce debts through the debt bond swap, etc., of creditor countries and commercial banks, with the warranty for the debt made by the IMF.

U.S. Secretary of the Treasury Brady proposed that commercial banks reduce debts and debt services and that the IMF and World Bank apply public funds to support commercial banks on March 10, 1989. This plan was agreed in G7 in April of that year as the “New Debt Strategy”.

The “Brady Plan” was a strategic change for debtor countries from debt rescheduling or new loans, to the reduction of the burden of debtor countries by lessening debt. The point of this strategy was to convert bad loans to quality loans warranted by the IMF and the World Bank for fluidizing. Actually, Brady Bonds (due after 30 years) were successful in achieving a high standard. In the 1990s, due to these bonds, private funds flowed into Latin American countries, which contributed to the increased capital inflow to developing countries, as supported by the development of derivatives with this. The developing countries’ financial and capital markets, known as “Emerging Markets”, increased their instability due to the rapid capital inflow, and this resulted in Mexican Currency Crisis in 1994 and the East Asian Currency Crisis in 1997.

2 From the Plaza Accord to the Louvre Accord

The Shift to Intervention Policy. The Plaza Accord of September 22, 1985 was the reason that the United States changed its conventional policy of dollar appreciation or nonintervention in foreign exchange markets, and started to correct the dollar appreciation by concerted intervention. The Plaza Accord was implemented at the initiative of the United States.

In the first term of the Reagan Administration, the nonintervention policy for the foreign exchange market was maintained, under supervision of Secretary of the Treasury Regan and Under Secretary for Monetary affairs Sprinkel. However, the dollar rapidly went up from April 1984 to the level of over ¥250/$. Furthermore, the United States' trade balance worsened and the trade deficit exceeded $100 billion in 1984 for the first time in history.

Thus the United States changed its policy to allow market intervention in the second term of the Reagan Administration, after the team changed to Secretary of the Treasury Baker and Deputy Secretary of the Treasury Darman, in February 1985.

Concurrently, the Japanese government started to think it necessity to correct the yen depreciation as the trade friction was worsening. Prime Minister Yasuhiro Nakasone had his private advisors study the conditions and finalized the policy in June, in order to conduct a meeting on currency adjustment between Japan and the United States.

In the G10 meeting held in Tokyo on June 21, the "Report Concerning the Reform of the International Monetary System" was adopted. In the communiqué which was announced after the meeting, there were many conclusions, including the rejection of ideas about target zones as being impractical, but even if the intervention in the exchange market would only be effective to play a limited role, the exchange market should be stabilized by policy coordination and conducting an aggressive concerted intervention when necessary.

Upon the request of the United States, informal talks were held between Vice Minister of Finance for International Affairs Oba and Assistant Secretary Mulford on June 19, just before the G10 meeting, and it was agreed to hold bilateral talks on the policy. This was followed by the talks between Minster of Finance Takeshita and Secretary of the Treasury Baker on June 22. The United States requested that the Japanese government change its fiscal policy, while Japan insisted on the need for concerted intervention in the exchange market. Then, the opinions of the two countries were adjusted in the Japan-U.S. talks in Paris on July 23, and in Hawaii on August 21, as the United States requested Japan to conduct a tax cut as an economic stimulus measure and increase its government expenditures, while Japan stressed the importance of concerted intervention. Upon consultation, the framework of the Plaza Accord was developed including the two principles of policy coordination and market intervention.

The Plaza Accord. The G5 deputies meeting (London) was held on September 15 to study the statement of the Plaza Accord and “Non-Paper” (the document shows a specific program for concerted intervention).

The G5 was then held at the Plaza Hotel in New York on September 22, and the agreement to appreciate the main non-dollar currencies against the dollar (the so-called “Plaza Accord”) was made.

The Agreement stated that, “The Ministers and Governors agreed that the exchange rate should play a role in adjusting the external imbalance”, in order to better reflect the fundamental economic conditions; that “some further orderly appreciation of the main non-dollar currencies against the dollar is desirable,” and that the G5 countries “stand ready to cooperate more closely to encourage this” when it would be helpful to do so.

In the “Non-Paper” stating the specific measures of market intervention, it was agreed to correct the exchange rate by 10-12% for dollar depreciation, that the central banks would sell the dollar for $18 billion in six weeks, and to make a ratchet type intervention to prevent the reaction to dollar appreciation, as well as to limit the currencies for intervention to the U.S dollar, the Japanese yen and the German mark. The fund for intervention was comprised of 30% for the United States and Japan respectively, 25% for West Germany, 10% for France and 5% for the United Kingdom.

The concerted intervention was conducted from September 23 and 1 U.S. dollar fell from ¥238.5 before the statement, to the ¥200 level in November.

Therefore, the target for a 10-12% of downward correction of the dollar was achieved in two months. The total amount of funds required for intervention was $10.2 billion, including $3.2 billion from the United States, $3 billion from Japan, $2 billion from Germany, France and the United Kingdom and $2 billion from the other G10 countries.

Agreement for Macro Policy Coordination. The yen’s appreciation rapidly advanced even after the concerted intervention was completed, and exceeded ¥200/$ in February 1986, and reached the ¥150/$ level in July. The Maekawa Commission Report (Report of The Advisory Group on Economic Structural Adjustment for International Harmony) from Prime Minister Nakasone’s private advisory panel, was released. In contrast, the external trade deficit of the United States was not reduced even after the depreciation of dollar, which made the United States into a net debtor in autumn 1985, for the first time in 71 years.

From the G5 deputies meeting (in Paris) held on the November 13, 1985, policy coordination started, mainly on monetary policy. In the G5 meeting (in London) on January 18-19, 1986, monetary policy coordination was not agreed, but coordinated discount rate cuts by Japan, United States and Germany were achieved on March 6 and 7, following the cut of the official discount rate by the Bank of Japan alone on January 30. On April 21, Japan-U.S. coordinated discount rate cuts were made, upon the request of the United States (the third official discount rate cut of the Bank of Japan was from 4% to 3.5%).

The Bank of Japan started reverse-intervention (dollar buying intervention) from March 18, to suppress the rapid yen appreciation. However, the United States repeatedly said they would allow the yen appreciation, at G5 on April 8 and in the Nakasone-Reagan talks on April 12-13.

The United States presented a new plan for policy coordination in the Tokyo Summit in May 1986 (the Baker Proposal). It proposed 1) to form a group of Seven Finance Ministers and Deputies and hold a meeting (G7) at least once a year to conduct surveillance on policy coordination; and 2) to apply indicators (economic indicators) to conduct the surveillance of policies in an objective and severe manner for automatic correction, in the event that economic conditions deviated from the indicator. Although the Summit countries agreed to conduct such surveillance, the Baker Proposal for automatic correction measures was opposed by Japan and West Germany, as it was not desirable to apply the system in a rote and compulsory manner. This opinion became predominant at the Paris G5 on May 29. In the G7 meeting (the first G7) on September 27, the first session on the multilateral surveillance method was conducted. In the meeting, the G7 shared their intent for an agreement to correct the balance of payments disequilibrium and stabilize the exchange rate, by policy coordination on the reduction of the fiscal deficit of the United States and domestic demand expansion by Japan and West Germany.

Minister of Finance Miyazawa and Secretary of the Treasury Baker held talks on September 6 and 26, 1986, and the communiqué of the bilateral talks was released on October 31. In the communiqué, Japan announced that: 1) the Japanese government would submit a supplementary budget draft to the Diet for economic stimulus measures; 2) tax reform would be implemented, including a reduction in the marginal tax rates for both personal and corporate income; and 3) the Bank of Japan would reduce its official discount rate from 3.5% to 3%. The United States should make efforts to reduce the budget deficit, consistent with the Gramm-Rudman-Hollings Budget Law (G-R-H Budget Law, which requires a balanced budget by FY1993). In addition, they stated that they would cooperate to stabilize the foreign exchange rate in the future, as the instability of the foreign exchange rate could jeopardize stable economic growth. The key points were that Japan promised to expand its domestic demand and the United States promised to make efforts to stabilize the foreign exchange rate.

The Louvre Accord. The speculation on the yen and the mark became vigorous at in the beginning of 1987. The yen exceeded ¥150/$ on January 19. Minister of Finance Miyazawa immediately made a visit for talks with Baker. Then, a tacit agreement was made, aiming to stabilize the exchange rate at around the ¥150/$ level. Then Baker suggested holding a G7 meeting. G5 representative meetings were held three times in January and February 1987, for adjustment to set the reference range of the exchange market.

A G6 meeting was held in Paris on February 22, 1987, and an agreement to stabilize the dollar around current levels was announced. This agreement was the so-called Louvre Accord.

The G6 countries confirmed the objectives of the expansion of domestic demand in surplus countries and the reduction of budget deficits in debtor countries, and discussed the method of surveillance, monetary policy coordination and the stability of the exchange rate. As a result, they agreed to use six indicators (growth, inflation, current accounts/trade balances, budget performance, monetary conditions, and exchange rates) for surveillance, and would regularly examine these by using indicators. In terms of the exchange rate, it was clearly confirmed that no further depreciation of the dollar should be expected, but no clear agreement was made for the level and range for stability of the exchange rate. No statement was made regarding monetary policy coordination, either. In the statement of intent of each country, Japan promised 1) a comprehensive tax reform; 2) early implementation of the 1987 budget; 3) preparation of comprehensive economic measures; and 4) reduction of the official discount rate (which was conducted on February 23) from 3.0% to 2.5%.

In spite of the Louvre Accord and the large-scale market intervention, the dollar depreciation and yen appreciation further proceeded to ¥150/$ and ¥140/$, on March 23 and April 24, respectively.

Black Monday. The pace of the policy coordination in each country was not harmonious, even after the Louvre Accord was reconfirmed in the Nakasone-Reagan talks (April 30 to May 1, 1987) and the Venice Summit (June 8 to 10, 1987). The United States insisted on the responsibility of surplus countries, and demanded further reduction of interest rates and the expansion of domestic demand. Therefore, Japan and West Germany strengthened their caution about an excessive easy money policy.

On October 19, a sharp drop in stock prices, which was worse than the 1929 Great Depression, occurred in the New York Stock Market (Black Monday). The dollar kept declining and fell by up to ¥123/$ at the end of the year, although stock prices recovered at once.

Concerted intervention was found to be effective in 1988, so that the exchange rate regained its stability in the first half of 1988, and reached ¥125-130/$. At the Takeshita-Regan talks on January 23, it was agreed to make a new framework, using SDR to secure sufficient funds for concerted intervention. This resulted in the range of intervention based on the Japan-U.S. swap agreement being enhanced from $5 billion to $15 billion.

Interest Rate Rises and Structural Adjustment. In late 1988 and later, concern shifted to the interest rate rise, for inflation control. As West European countries started a coordinated official discount rate rise, following the rise in the official discount rate of West Germany on July 1, the FRB raised the official discount rate for the first time in 11 months. As the Louvre Accord aimed at a coordinated system, to include interest rate control, the raising of the official discount rates by each country meant the end of the Louvre Accord.

Governor of the Bank of Japan Satoshi Sumita declared that Japan had no intention to change its monetary policy, in the G5 and G7 meetings on September 24, so that Japan decided to maintain a low official discount rate. The BOJ finally raised its official discount rate for the first time in 2 years and 3 months on May 21, 1989.

At the G7 (in Washington) on April 2, 1989, the member countries confirmed that the meeting was mainly for the coordination of macro economic policy. Moreover, an agreement was made to consider the role of structural adjustment (= micro economic policy). Thus, the purpose of international policy coordination shifted from macro economic policy to consultation on structural adjustments.

3 Market Opening and the Internationalization of the Yen

The Trend of the Balance of Payments. For the trade balance, the surplus increased in 1985 and 1986, because of increase in exports and the decrease in the amount of imports due to yen appreciation. The trade balance in 1986 added up to a surplus of $92.8 billion, but the amount of surplus reduced afterwards. The current account surplus similarly shrunk, from $87 billion in 1987 as its peak. It turned out to be $35.7 billion in 1990 (Table 1-3-1). The trade surplus with the United States also reduced temporarily from 1988 to 1990.

A significant outflow of long-term capital continued. Long-term external investment exceeded the trade surplus, but it was because of short-term funding from overseas through the foreign exchange bank. The majority of the external investment was in securities, especially investment in bonds.

The Increase of External Assets. External assets increased by 5.4 times and external liabilities increased by 5.7 times from the year end of 1984, to that of 1990. The net assets increased consistently for the period concerned, by 4.4 times, from $74.3 billion to $328.1 billion (Figure 1-3-2). In terms of assets, the expansion of securities investments and financial accounts were remarkable, as capital management overseas by institutional investors boomed, starting transactions in the Tokyo Offshore Market by foreign exchange banks and much activity in terms of financial transactions with overseas branches.

A Sudden Increase in Exchange Reserves. In 1985, a large amount of dollar selling was conducted by concerted intervention, because the dollar depreciation measures were agreed by the G5. Exchange reserves were almost leveled off (Figure 1-3-1). The intervention operation of dollar buying started from when the yen surged in April 1986, and the exchange reserve increased by $15.7 billion by the end of 1986. A large-scale dollar buying intervention was conducted, based on the agreement for the stabilization of the exchange rate at the ¥140/$ level. Therefore, the exchange reserves increased suddenly, doubling in one year in 1987. They kept increasing until April 1989, and exceeded $100 billion for the first time. The dollar selling intervention continued, to stabilize the exchange rate against the dollar appreciation after May. It decreased to $73 billion in April 1990.

Trends in the Foreign Exchange Market. The U.S. dollar trading volume of the Tokyo Foreign Exchange Market (the total of spot, futures and swap trading) accomplished a rapid expansion from $1.4072 trillion in 1985, to $5.9625 trillion in 1990. This was because due to liberalization measures - including the elimination of the real demand rule in April 1984, the launch of direct dealing, and international broking

(U.S. dollar started from February 1985, others started from July or August 1984) - the market was expanded.

According to an investigation which compared the three large foreign exchange markets (Tokyo, London and New York) in April 1989, the daily average turnover (the total of spot and swap trading), in London was $187 billion, in New York was $128.9 billion and in Tokyo was $115.2 billion. The Tokyo market was comparable with that of New York.

The correction of dollar appreciation started gradually from March 1985. Since the Plaza Accord in September, the rapid yen appreciation had advanced. The yen was appreciated to ¥160/$ by the middle of May 1986, and hit ¥152.55/$ on August 20. In 1987, the dollar kept falling and hit ¥150/$ at the end of January, and then suddenly swung to yen appreciation due to Black Monday in October, and reached ¥120/$ at the end of the year. The G7 statement on December 23 declared its anxiety about the dollar depreciation. Then, the yen-dollar exchange rate started to stabilize at around ¥125/$, after starting from ¥120 in 1988.

U.S. Dollar again reversed in 1989: yen depreciation occurred and reached ¥151/$ by the middle of June. A G7 statement on September 23 decided on correction measure for the dollar appreciation, so that the dollar started to fall again and closed at ¥144 at the end of the year.

The Market Opening Policy and Action Program. Faced with criticism from foreign countries of its "External Economic Measures", the package method which had not been effective in reducing its trade surplus, Japanese government recognized the necessity for an action plan-type external economic policy.

The "Report of the Advisory Committee for External Economic Issues" of April 9, 1985, inquired into the reason why, although previous external economic measures had improved market access, they received a severe criticism from foreign countries. It also presented countermeasures. The report proposed that the government should make an action program for about three years and the program should be voluntary and positive in its contents.

The report, "Outline of the Action Program for Improved Market Access" was prepared in July 1985. The Action Program included tariff cuts of about 1800 items and the relaxation of the standards and certification system.

Japan-U.S. Economic Friction. The trade deficit of the United States with Japan reached $37 billion in 1984. The Reagan Administration was faced with public opinion that requested it to intervene in trade positively. In 1985, many protective bills were presented to the United States Congress, and U.S. government also started to apply Section 301 of the U.S. Trade Act of 1974.

In addition, the Market-Oriented Sector Selective talks (MOSS conference) between Japan and the United States started in January 1985, on four markets including electronics, telecommunication, medical products, medical appliances and forestry products. The talks between Minister of Foreign Affairs Abe and Secretary of State Schultz on January 10, 1986, settled matters on most articles, except semiconductors. In terms of semiconductors, which was the most serious area of trade friction, the "Agreement between the Government of Japan and the Government of the United States of America Concerning Trade in Semiconductor Products" was concluded on July 31, 1986, specifying the monitoring of the export price of Japanese semiconductors and the enhancement of imports of semiconductors to Japan from the United States.

The "Maekawa Commission Report" ("Report of the Advisory Group on Economic Structural Adjustment for International Harmony") was submitted to Prime Minister Nakasone on April 7, 1986. The report proposed the expansion of domestic demand, the change of the industrial structure, and the internationalization of the financial market, aiming at the conversion of the Japanese economic structure into one of international harmony. It stressed the promotion of the liberalization of the financial and capital market, so that Japan could establish a suitable financial and capital market for its economic magnitude in international finance, as well as strengthening the fund management market, in particular. For trading, the complete execution of the Action Program that had been compiled in the previous year and the promotion of imports of manufactured goods, etc., were proposed. Based on this report, the government decided on the "Outline for the Promotion of Economic Structural Adjustment" on May 1, and established the Government-Ruling Parties Joint headquarters for the promotion of Economic Structural adjustment. The "Maekawa Commission Report" materialized as "Policy Recommendation for Structural Adjustment" (the new Maekawa Commission Report) on April 23, 1987.

In May 1987, the government announced its "Emergency Economic Measures" aiming "to make efforts to correct the trade imbalance and to form external economic relations with foreign countries in harmony, as well as to positively promote the economy, by expansion of domestic demand." It included, specifically, the additional import of foreign manufactured goods totaling about $1 billion through government procurement, the enhancement of financing for the import of manufactured goods of the Export-Import Bank of Japan, the improvement of market access for foreign financial institutions to enter the Japanese market, the advanced implementation of the 7-year plan to double ODA in two years and the contribution of untied capital of $20 billion to developing countries (especially debtor countries) for three years, to bring dollars into developing countries.

During this period, the Japanese government promised and implemented domestic demand expansion and the reduction of the interest rate, but the trade surplus towards the United States kept increasing. The current account surplus to GDP started to decline from the peak of 1986 and the trade surplus to the United States finally shrunk, in and after 1988, but it was still not easy to settle the trade friction.

The United States' government proposed the launch of the Japan-U.S. Structural Impediments Initiative (SII) talks, while they recognized Japan as a priority country of Section 301 of the U.S. Trade Act on May 25, 1989. Japan and U.S. agreed to start SII at the Arch Summit on July 14, and the final report was presented on June 28, 1990. The Japanese government proposed: 1) the total amount of public investment for the decade from 1991 would be ¥430 trillion (¥455 trillion including the investment in the three old public corporations such as NTT); 2) the revision of large-sized merchandise shops to improve the distribution system; and 3) the revision of the Antimonopoly Law to exclude exclusionary business practices and transactions through business affiliations. The United States then announced the extension of the Gramm-Rudman-Hollings Budget Law for FY1993 and after, for fiscal deficit reduction.

The Internationalization of Financial and Capital Markets. The Yen-dominated BA (Banker's Acceptance) market was established on June 1, 1985. However, it could not be developed efficiently, as it was not advantageous compared to foreign markets and the procedures were complicated; therefore, there was less incentive for foreign exchange banks and companies to use it.

On December 1, 1986, the Japan Offshore Market (JOM) was launched. The offshore market allowed non-residents of Japan to make capital transactions freely in the market, through special financial and tax measures. In terms of the Tokyo Market, it was established on the model of IBF New York (International Banking Facilities were opened in December 1981) and was separated from the domestic market, which was one of its unique features.

The MOF believed that it would be desirable to promote the internationalization of the financial market in a form separated from the domestic financial market, until the domestic market was liberalized completely. However, after the start of the Yen-Dollar Committee, the idea became more concrete while there had previously been caution about it. The Report of the Committee on Foreign Exchange and Other Transactions (the "Internationalization of the Yen.") also suggested actively studying the offshore market system. Public opinion also encouraged developing the Tokyo Market to be an international financial market center, comparable to London or New York.

181 foreign exchange banks (including 69 foreign banks) joined the Japan Offshore Market, at the time it was established. The market scale rapidly expanded to the level of $607.6 billion by the end of 1989, and its scale became larger than New York, Singapore and Hong Kong, only within a few years after it was established. However, it fell into stagnation with the collapse of the bubble economy.

Participation in the Financial Futures Trading Market and the Foundation of the Tokyo Market. Future trading became very vigorous as a main aspect of risk hedging, with the shift to the floating exchange rate system, and the internationalization of financial transactions. The financial futures exchange was established in the United States in the early 1970s, which was followed in the 1980s by London (1982) and Singapore (1984).

Foreign financial futures transactions by Japanese financial institutions were authorized on May 22, 1987. Restrictions on the self-dealings of the spot option were lifted on March 22, 1988.

The Financial Futures Trading Law and revised Securities and Exchange Law were promulgated on May 31, 1988. The Tokyo International Financial Futures Exchange was established in April 1989 (its services started in June), as Japan's first financial futures exchange.

Report on the "Internationalization of the Yen". With the Yen-Dollar Committee, the move toward the internationalization of the yen progressed. At the Yen-Dollar Committee, the Committee on Foreign Exchange and Other Transactions discussed the matters regarding the internationalization of the yen and submitted its report on the "Internationalization of the Yen" in March 1985, which stated as follows:

"It is valuable and natural for the Japanese economy to promote the internationalization of the yen." Therefore, it is necessary to actively promote policy for improving the efficiency of financial and capital markets, developing the market as an international financial center, and allocating roles in the international market. Although Japan was conservative about using or retaining yen in Euro market, permission for this would be an important step toward internationalization of the yen. It is desirable for both the Euroyen market and the domestic market to develop in a complementary and competitive way, by using their unique features. It is necessary to implement the liberalization of trading by non-Japanese residents or Japanese residents, in line with the liberalization of the domestic market and the internationalization of Tokyo Market, at an early stage. Specifically, the liberalization should be promoted for the Euroyen bond market and medium-term and long-term Euroyen lending.

The Internationalization of the Yen. The Internationalization of the yen was to increase opportunities to use yen in international trading and to raise the yen-dominated ratio in asset holdings. More concretely, it could be understood as being three aspects of internationalization: merchandise trading (yen to be used for dealings in imports and exports), capital transactions (financial assets to be retained in foreign countries as yen), and public exchange reserves (foreign countries to retain yen as a reserve).

The yen-dominated ratio for export advanced particularly since the amendment of the Foreign Exchange Control Law in 1980, and rose up to 35.9% in 1985, from 0.9% in 1945. However, as the majority of exports for the United States were dollar-denominated, yen-denominated trading leveled-off. The yen-dominated ratio for imports was far lower than for exports, and it was only 14.5% in 1990. This is because of the trend that trading for raw materials, such as crude oil or the intermediate commodities, had dollar-denominated prices decided based on the international commodity market.

It is difficult to estimate the amount of yen-denominated capital transactions by using a single indicator, but the yen-dominated ratio for bonds in the Euro market may be shown here, as the major element of funding in the international financial and capital market was corporate bonds. The yen-denominated ratio in all Euro bonds increased up to 13% in 1990, from 5% in 1985 (it turned down again after a peak of 18% in 1994).

For public reserves, the ratio of yen used by foreign currency authorities increased from 2.7 % in 1975, to 8.0% in 1990, but the U.S. dollar was still overwhelming.

Expansion of Euroyen Dealings. As stated above, liberalization advanced rapidly in Euroyen dealings since the launch of the Yen-Dollar Committee.

Euroyen lending was only approved for short-term loans from February 1981, while long-term lending was approved for non-residents from April 1985 and for Japanese residents from May 1989. The balance of Euroyen lending was only ¥550 billion at the end of 1984, but increased to ¥17.18 trillion by the end of 1989 (¥13.24 trillion for Japanese residents and ¥3.95 trillion for non-residents).

The liberalization of Euroyen bond issuance for non-residents progressed from 1984 but the expansion of marketability and the relaxation of issuance guidelines were implemented in June 1985. In April 1986, the unification of qualification standards with rating standards, and the easing of the restrictions on reflow (the period that bonds could not be sold to Japanese investors after issuance was shortened from 180 days to 90 days) was allowed in April 1986. The issue of Euroyen bonds was permitted for foreign banks in June (Table 3-3-1).

The restrictions on Euroyen bond issuance by Japanese residents were lifted in April 1984, and the tax reform in April 1985 also made the conditions for issuing bonds easier. This was also followed by the easing of measures such as qualification standards or redemption standards (qualification standards were abolished in January 1996). However, as the Euroyen bonds for Japanese residents were more disadvantageous than Eurodollar bonds in terms of cost, the amount issued remained low.

The issue of Euroyen CD and Euroyen CP was also begun. It started in December 1984 in Japan. It was only limited to 6-month bonds, but it was extended to 1-year bonds in April 1986 and 2-year bonds in April 1988. Most of the Euroyen CD were issued in London market and the balance reached ¥347.8 billion at the end of 1989, but declined afterwards.

Euroyen CP was approved in October 1987 concurrently with the start of domestic CP issues.

Table3-3-1 Euroyen Bonds and Yen-Dominated Bond Issuance (1972 - 1990)

(100million yen)

Fiscal year	Euroyen bonds for non-residents	Euroyen bonds for residents	Yen-Dominated Bonds
1972	0	0	957
1973	0	0	801
1974	0	0	0
1975	0	0	200
1976	0	0	650
1977	300	0	3,260
1978	150	0	8,270
1979	250	0	4,002
1980	550	100	2,610
1981	800	400	6,125
1982	950	0	8,560
1983	700	0	8,990
1984	2,270	0	11,145
1985	14,457	1,400	12,725
1986	25,515	4,170	7,850
1987	29,939	5,200	4,975
1988	22,130	0	7,972
1989	35,579	120	9,990
1990	49,811	7,470	5,750

Source: Ministry of Finance [Finance and Monetary Monthly Statistics] 476, [Ministry of Finance International Monetary Bureau Annual Statistics] 1991

Okurasho Zaisei Kinyu Tokei Geppo 476, Okurasho Kokusai Kinyu Kyoku Nenpo 1991

Note: 1980 and 1981 are on calendar year [Euroyen bonds for residents]

The Depression of Samurai Bonds. The issue amount of Samurai Bonds once exceeded ¥1 trillion, and played a key role for funding in yen for non-residents, but it was declined in the late 1980s, as the shift to the Euroyen bond occurred, because there were so many restrictions for Samurai Bonds.

However, the issue amount of Samurai Bonds temporarily recovered to $9990 in 1989, because Samurai Bonds with transfer settlement functions in the Euro market (Daimyo Bonds) were started in 1987, and the improvement of the disclosure system was attempted based, on the amendment of the Securities and Exchange Law in 1988.

The Entry to the Japanese Market of Foreign Banks and Securities Companies. Entries of foreign banks continued its gradual expansion until the latter half of the 1980s, when it seemed to be completed. The business environment for the existing branched of foreign banks in Japan showed a tendency to deteriorate due to the advancement of Japanese banks in entering the foreign currency finance market.

The number of foreign securities companies increased rapidly. However, in most cases, foreign securities companies only had a representative office, so that only 30% of those had shops (branches or overseas subsidiaries).

4 The Increase of the Japanese Presence in Overseas Markets

The Overseas Presence of Japanese Banks and Securities Companies. With the change of policy in 1984, Japanese banks were allowed to establish overseas branches at their discretion, and many regional banks, and member banks of the Second Association of Regional Banks, started establishing their overseas branch offices or representative offices. 23 out of 64 regional banks had overseas branches and 8 regional banks had overseas subsidiaries, at the end of 1990.

The establishment of Japanese securities companies rapidly increased, due to the internationalization of the securities business. The number of their branches increased at a rapid pace of 20 to 40 bases a year, after 1985. In the late 1980s, semi-large and middle-size securities companies started to establish their branches in Hong Kong and Singapore, which were new financial and capital markets. Major securities companies expanded their underwriter services, mainly for the Euro market.

The Increase of the Japanese Presence in Overseas Bond Markets. Funding by Japanese enterprises in the overseas market increased remarkably in the late 1980s. The pace of expansion was remarkable. Japan became the biggest borrower of capital in the overseas bond market at the time. After 1987, the amount of funding exceeded that of the United States, and reached $97.8 billion in 1989 at its peak. Especially, bond issuance in the Eurobond market expanded from $80 billion at the end of 1984, to $210 billion at the end of 1989.

The bond issuance in the overseas market exceeded that in the domestic market in 1984, in terms of the funding of Japanese enterprises. The deregulation of various corporate bonds, such as the introduction of warrant bonds, etc., promoted funding overseas. The real demand rule of the exchange reserve was abolished in April 1984, in particular. As capital could be brought from the foreign markets at low-cost, using the swap, foreign bond issuance increased rapidly.

In terms of foreign bonds, warrant bonds accounted for over 50% in 1987, and 79% in 1989 (Figure 1-3-4). In contrast, the regular corporate bonds showed a sharp decline, in terms of issue and share. In terms of market, 60 to 80% of all foreign bonds were issued in the Euro market.

The Rapid Increase of Outward Investments. Outward securities investments showed a remarkable increase, reaching a peak of about $1.37 trillion in 1986, and then leveling-off.

The reasons for this increase were that Japanese institutional investors conducted short-term trading in U.S. treasury bonds, and general investors such as business corporations, etc., actively invested in U.S. treasury bonds and the stocks of American enterprises. However, securities acquisitions in the U.S. market decreased after Black Monday in October 1987.

Outward direct investment kept increasing at a rapid pace every year from $12.2 billion in FY1985, and reached $67.5 billion in FY1989 (Table 1-3-2). In terms of regions, the amount for North American accounted for 45 to 50%, which was followed by that for Europe.

5 Becoming the World’s Largest Donor Country

The Remarkable Expansion of Japan’s ODA. The Japanese government decided upon its third medium term target for ODA on September 18, 1985, as follows: 1) to make total amount of ODA more than $40 billion for the seven years from 1986 to 1992; and 2) to make ODA in 1992 double that of 1985.

As ODA significantly increased in 1986, the Emergency Economic Measures (decided upon by the Ministerial Conference on Economic Measures) on May 29, 1987 included 1), that is, moving forward the third medium term target by two years, to make the achievement over $7.6 billion in 1990.

Japan’s ODA recorded a remarkable increase of $5.6 billion in 1986 (a 48.4% increase on the previous year) and $7.5 billion in 1987 (a 32.3% increase on previous years). The third medium-term target (to be doubled in seven years and aiming for $7.6 billion) was achieved as soon as within two years (Figure 1-3-5).

In June 1988, the Japanese government announced the fourth medium-term target of ODA, before the Toronto Summit. It aimed at making ODA in the past five years (1983-1987) $25 billion in total, with the actual amount of increase doubled, to more than $50 billion in the upcoming five years (1988-1992). Eventually the target of ODA was almost achieved, at $49.7 billion within the term specified.

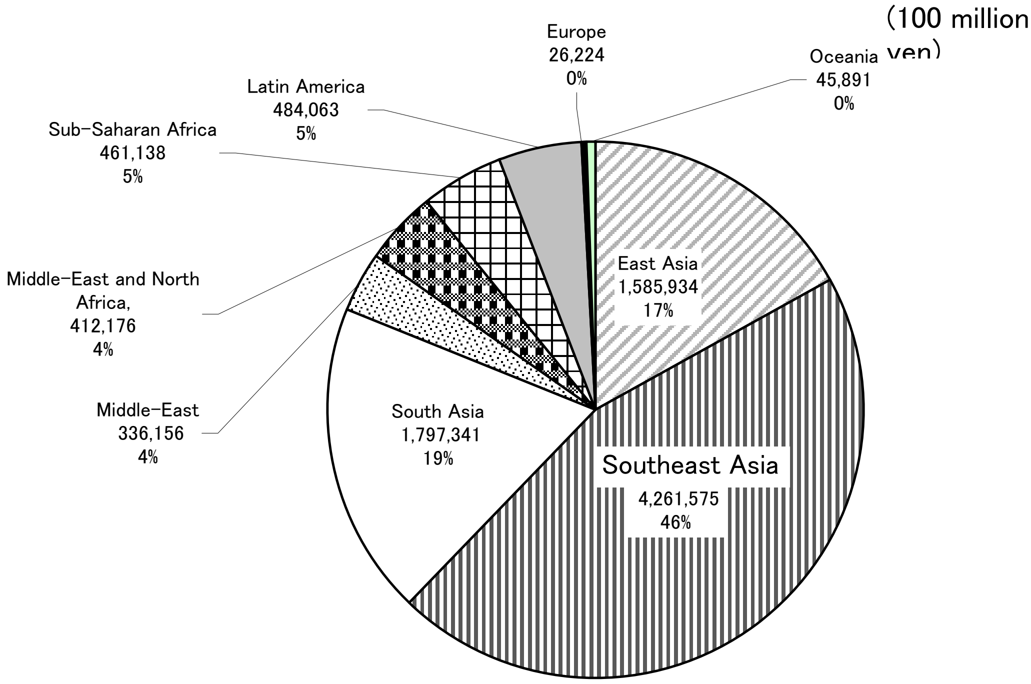
The amount of ODA granted by Japan became the largest in the world in 1989, surpassing the United States. However, in terms of the economic cooperation standard (ratio to the economic scale), it was only 0.33-0.36% of GNP, which was half of the U.S. ratio of 0.7%

Transition of Yen Credit. The accumulative amount of yen credit in FY1985 to 1990 was ¥4.6411 trillion. This accounted for 49.3% of the accumulative amount from 1972 to 1990 in these five years alone.

The largest beneficiary country was Indonesia, which was followed by China, India, the Philippines and Thailand. In the meantime, yen credit to South Korea shrunk, as their economic development was already remarkable, so that it was less necessary to provide economic assistance.

From FY1972 to FY1990, the total amount of yen credits was ¥9.4105 trillion, including ¥4.2615 trillion for South East Asia (46% of total), ¥1.7973 for South Asia (19%) , ¥1.5859 trillion for East Asia (17%) and ¥461.1 billion for sub-Saharan Africa (5%), and ¥484 billion for Latin America (5%) (Figure 3-3-1).

Figure 3-3-1 Regional Amount of Yen Credit (Approval)
(FY1972-1990)



(Source) Japan Bank for International Cooperation Kaigai keizai Kyoryokukikinshi [History of Overseas Economic Cooperation Fund] 2003

6 Trade Friction and the Beginning of the Uruguay Round

The Advance Implementation of Tariff Reductions in the Tokyo Round Agreements.
In the External Economic Measures in April 1984, the advanced implementation of tariff reductions from the Tokyo Round agreements was announced. Regarding these tariff reduction measures, ASEAN countries complained that the measures were specifically for products that the industrialized countries were interested in. The reform of the tariff system in FY1985 was made based upon the consideration of both the industrialized and developing countries.

It was announced in the External Economic Measures that the implementation of tariff reductions on industrial products would to be advanced by 2 years, and those on agricultural products by 1 year, in FY1985. The Japanese government also decided to move forward tariff cuts by two years on the products of developing countries relating to agriculture, forestry, and fishery products, in its External Economic Measure in December.

The target articles for the advanced implementation of tariff reductions were 1205 articles in FY1985, including 33 agricultural and marine products of developing countries, and 40 other agricultural and marine products, and 1132 mining and manufacturing products.

The Action Program. The report of the Advisory Committee for External Economic Issues (the Ōkita Report) was submitted on April 9, 1985, while economic friction between Japan and the United States was still fierce because of the trade imbalance.

The key point of this report was the “Action Program for Improved Market Access”, in order to show Japan’s intention to proceed with the internationalization of Japan.

The most important field of the Action Program was the further improvement of the standards and certification system. The United States was insisting in the Tokyo Round Negotiations that it was effective to improve the standards and certification system, as a measure to abolish non-tariff barriers. In the Action Program, it was aimed to make a comprehensive inspection of the standards and certification system, based on Japanese laws, as well as to make the system comparable to that of other countries, in terms of the openness of the market.

The Government-Ruling Parties Joint Headquarters for the Promotion of External Economic Measures decided upon the “Outline of Access Program for Improved Market Access” on July 30.

Based on the Action Program, the elimination and reduction of tariff rates on 1849 items was implemented from January 1, 1986.

The Liberalization of Agricultural Products and Tariff Reform of Industrial Products. The United States brought its case to GATT for the import liberalization of 12 agricultural products in 1986. As a result of the assessment, the panel report that the import of 10 items other than miscellaneous beans and ground-nuts was unfair, was submitted to the GATT Session in December 1987, and it was adopted by a unanimous approval in February, 1988.

Therefore, Japan and U.S. held bilateral talks on July 21, 1988, to liberalize 8 of the 10 items by FY1990, consecutively, and the Japanese government raised its tariff rates and introduced the tariff allocation system.

Concurrently, although a GATT panel was established in May for beef and citrus fruit, since the agreement between Japan and U.S. expired with the import batch in March 1988, the bilateral talks sought an early solution to this problem. On June 20, Japan and the United States agreed on: 1) the liberalization of imports of beef in

FY1991; 2) the liberalization of imports of fresh orange in FY1991, and orange juice by FY1992; and 3) the liberalization of imports of beef products from October 1988 to FY1990.

To improve market access, because the current account surplus of Japan was still substantial, and to correct the external disequilibrium, a large-scale abolition of tariffs and reduction of tariff rates of industrial products - as many as 1008 items in FY1990 - was implemented. This was equivalent to the scale of the tariff reduction by the Action Program that had been executed in January 1986.

The Beginning of the Uruguay Round. After the end of the Tokyo Round, while protectionism was growing, the Williamsburg Declaration on Economic Recovery in 1983 proposed the start of a new round. Then in the Bon Summit, the agreement for a new round was adopted. In the GATT ministerial meeting held in Punta del Este, in Uruguay, in September 1986, the ministerial declaration for beginning of the new round (Punta del Este Declaration) was adopted. There were 14 articles for negotiation, which included services, trade-related investment measures, and the newly proposed intellectual property rights.

The Uruguay Round was initially planned to end in four years, but actually it took seven years or more. Therefore the agreement was concluded in Marrakesh, in Morocco, on April 15, 1994. At the same time, the “Marrakesh Agreement Establishing the World Trade Organization” was concluded, and the GATT was reestablished as the WTO, on January 1, 1995.