U.S. & JAPANESE ECONOMIES ENTER NEW ERA

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Japanese Financial System at Stake

Japan is facing a financial crisis during the process of its financial reform. The Japanese financial industry has been suffering from bad debt amounting to 600 billion dollars, most of which has accumulated since the collapse of the Japanese bubble economy in early 1990s because the falling prices of real assets decreased the value of collateral the banks were holding. To overcome this crisis, the Japanese government demanded that Japanese banks satisfy the BIS criterion before April 1, 1998 that requires any international banks hold capital equal to least 8% of their risky assets. However, the long stagnation of the Japanese economy made many firms bankrupt. Furthermore, the financial crises of Asian countries are threatening Japanese financial institutions, which invested their funds in Asian countries.

The Japanese financial crisis could cause a world financial crisis because Japan can sell its U.S. bonds to help the Japanese financial institutions reduce their bad debt. In that case, the U.S. would face an unexpected capital outflow and high domestic interest rates, which could result in a depression.

The U.S. is urging Japan to use public funds to stabilize the Japanese financial system, while Japan is hesitant to use expansionary fiscal policies because the fiscal debt has already reached a critical level. The Japanese government is suspect of the effectiveness of fiscal policies, because recent experience has shown that fiscal policy has proven more negative than positive. The Japanese economy is currently relying on the increasing trade surplus after its domestic demand became depressed.

U.S. Economy in a Dilemma

The U.S. economy has been booming from the beginning of the 1990s. One of the main reasons for the boom has been the strong dollar and relatively high interest rates. While the Japanese and European economies were depressed, the strong dollar and high interest rates of the U.S. economy induced foreign capital. Japan owns 300 billion dollars worth of U.S. government bonds, which is more than 10% of total U.S. bonds. About 40% of the U.S. bonds are owned by foreigners. The strong dollar, on the other hand, increased the U.S. trade deficit. Although the U.S. economy is growing, it is built on a contradictory economic system.

To maintain its strong economic growth, the U.S. first has to stabilize the Japanese financial system. To help the Japanese financial system, the U.S. recently decided to help solve the Korean currency crisis. However, both the Japanese and U.S. economies needs new measures to solve their economic problems, the Japanese financial crisis and the U.S. dilemma. The U.S. has two ways of escaping its contradictory system. One is to increase its exports and the other is to increase its foreign direct investment (FDI) by M&As. The U.S. is asking Asian countries including Japan to open their goods and services markets as well as financial markets, especially stock markets. Flexible labor markets in Asia are crucial to U.S. FDI. Japan seems to have no alternatives other than opening its markets to U.S. capital to help its economy recover. VIP