Journal of Commerce
"Japan's actions look and quack like mercantilism"
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Letter to the Editor

Ronald Babula of the U.S. International Trade Commission, in his August 17 letter rejecting the notion of a mercantilist Japanese exchange rate policy, directs his attack at three recent opinion articles in The Journal of Commerce, but does not reference their author. I admit to being the author of all three articles and offer the following rebuttal to Babula's wrong-headed conclusion.

Article IV of the IMF Articles of Agreement states that members shall "avoid manipulating exchange rates…to gain an unfair competitive advantage", and surveillance procedures include "protracted large-scale intervention in one direction in the exchange market" as a development that might indicate such manipulation. This is the starting point for defining the use of exchange rates as a mercantilist instrument of trade policy.

From 1992 to 1996, the Bank of Japan made protracted large scale interventions in currency markets, increasing total reserves from $72 billion to $220 billion, which amounted to 65% of annual imports by 1996. During these same years, Japan had a large and protracted trade surplus and, if anything, the Central Bank should have been selling rather than buying foreign exchange so as to avoid an unfair competitive advantage on trade account.

In 1997-98, the dollar was exceptionally strong as a result of market forces related to the Asian financial crisis and there was a hiatus in Bank of Japan foreign exchange purchases. In 1999, however, there has been a strong resurgence, with $23 billion of reported purchases during June alone (Wall Street Journal, July 21). Japanese officials, moreover, have explicitly acknowledged that these purchases were intended to avoid a strengthening of the yen that would dampen export-led economic recovery. Meanwhile, Japanese trade remains in large surplus.

Since all these facts look and quack like the IMF definition of mercantilism, I conclude that Japanese exchange rate policy has indeed been mercantilist throughout most of the decade.

Babula cites two specific "problems" with my articles, but in both cases he misquotes me. He states that I wrongly "assume" 95% of Japanese "total" reserves are held in dollars, while in fact I have estimated elsewhere, based on knowledgeable sources, that in 1996 95% of Japanese foreign exchange reserves were in dollars. Recently, Japan has probably been buying more European currencies, but dollar holdings still predominate. In any event, my mercantilist conclusion is based on total foreign exchange purchases.

The other cited "problem" with my article is that public and private sector financial data do not support a positive correlation between Japanese official dollar purchases and a weak yen, but I never claimed such a correlation. I simply state that protracted large-scale purchases result in a weaker yen than would otherwise prevail, which is sufficient to draw a currency manipulation conclusion as defined by the IMF.

Finally, there is the relation between Babula's denial of Japanese currency manipulation and official U.S. policy. The Omnibus Trade and Competitiveness Act of 1988 requires semiannual reports by the U.S. Treasury as to whether other nations manipulate exchange rates to gain unfair competitive advantage in international trade. In all consequent Treasury reports, however, Japan has never been mentioned as a possible currency manipulator. On June 30, 1999, during confirmation hearings for Secretary of the Treasury-designate Lawrence Summers, Senator Paul Sarbanes referred to recent reports of currency manipulation for competitive trade advantage, and asked if the U.S. Treasury had identified any trading partners engaged in currency manipulation. Summers responded that he had not received such reports and that no country has been officially identified as a currency manipulator.

Secretary Summers thus concurs with ITC supervisory trade analyst Babula that Japan has never used exchange rates as a mercantilist instrument of trade policy. U.S. policy is evidently consistent but, in analytic terms, it is also deeply flawed.

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