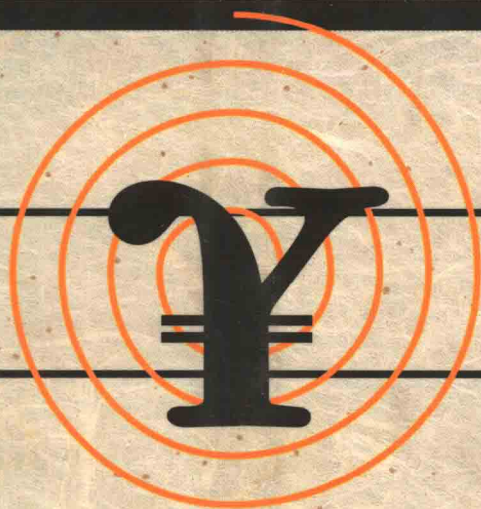


**THE
WEIGHT
OF THE
YEN**



R. TAGGART MURPHY

The Weight of the Yen

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How Denial Imperils
America's Future
and Ruins an Alliance

R. TAGGART MURPHY

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*To my mother and
the memory of my father*

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Preface

LIKE MANY *gaijin* who end up here, I first came to Japan because of an accident. The accident wasn't mine; it happened to my little brother, struck by a glandular infection that nearly killed him. We were ten and eight, living in Laramie, Wyoming, and the doctor told my parents he needed a year in a warm climate to make a complete recovery. In Laramie you walk to school if the temperature climbs above minus fifteen, you wear a windbreaker instead of an overcoat if it gets into the twenties, and two consecutive daily highs of seventy-five qualify as a heat wave. So my father left the University of Wyoming for the University of Hawaii.

In addition to the requisite year-round warm weather, the latter place had strong links with Japan. Visiting Japanese scholars there became interested in my father's work; he was a geographer, and indeed, his system of landform classifications is still used in many Japanese geography textbooks. Thanks partly to the contacts made in Honolulu, an invitation arrived a few years later for him to spend a term teaching at Tohoku University in Sendai. The whole family went over, and my brother and I (we were by then fourteen and sixteen) enrolled in a Japanese high school. My mother said we looked like refugees from the Spanish-American War in our black serge uniforms, complete with gold buttons, celluloid collars, and military hats.

Japan hooked me. We hadn't been there more than a few weeks before I decided that I didn't want to go to any college

where I couldn't major in Asian studies. Japan's appeal to Westerners such as this moody loner of an adolescent has never been fully analyzed, although Donald Richie came the closest to it for me in his haunting travelogue-cum-diary *The Inland Sea*. The physical beauty and sensuality of the country certainly account for part of it; the fundamental humanity and decency of ordinary Japanese people—their sensitivity to the feelings of others—explain even more. Of course, the country has more than its share of arrogant martinets, but anyone who has lived in Japan for any length of time discovers that Japanese people can become extraordinary friends. Short-term visitors often fail to realize this because the Japanese don't make friends easily or casually; they take human relationships very, very seriously and thus can hesitate before making the kind of commitment that to them friendship implies. But real friendship in Japan is the payoff for whatever frustrations may accompany life here; it carries with it the kind of closeness and loyalty that is rarely found in the United States—at least after adolescence—outside the family.

Harvard's reputation in Asian studies lured me to Cambridge in the fall of 1970. Fewer than twenty of us enrolled in first-year Japanese. I can't recall anyone in the class having much interest in business or finance or thinking that by learning Japanese we were making a "smart career move" in the way those words would be used by the M.B.A.'s of the 1980s. Japan didn't seem a very important country at the time. To be sure, every year it posted stunning growth rates and had made a miraculous recovery from the devastation of the Second World War, but wasn't that all due to cheap labor, low defense spending, and help given by the Americans during the occupation? In the late sixties a young person planning a business career—and there weren't that many such folks back then at Harvard to begin with—or a budding intellectual drawn to economics or political science would not have considered wasting time with a minor country like Japan. People who studied Japan were interested in its wonderfully exotic culture, in Zen Buddhism and aikido,

in flower arrangement and tea ceremony, in the Nō theater and the diaries of court ladies who lived a thousand years ago. I was no different; I wanted to read *The Tale of Genji* and Mishima Yukio in the original. At some point during my junior year, however, I realized to my dismay that becoming an academic specialist in Japanese literature meant not so much daily immersion in the far-off melodies and perfumes of the tenth-century Heian court as the unending drudgery of spending most of the next decade memorizing tens of thousands of kanji—the Chinese characters used to write Japanese. I lacked the necessary resolve.

I couldn't think of anything to do after I graduated. It was the midst of the 1974–75 recession, and after hanging around on the fringes of Harvard for a few months, I thought I might as well go back to Japan. I taught English for a while, remembered why it was I had fallen in love with the country in the first place, and then, concerned that my life wasn't going anywhere, resolved to get a "real job." I found it working at the Tokyo office of what was then the largest and most profitable bank in the world, Bank of America.

By this time—the late 1970s—Japan had begun to register on the American radar screen. The country had gone from dominating low-value-added, intensive-labor businesses such as textiles to global supremacy in consumer electronics, shipbuilding, and steel. The American television industry had been destroyed. Japanese automakers could clearly produce higher-quality cars more cheaply than their American competitors; Chrysler teetered on the brink of bankruptcy. At the time of the first oil shock of 1973 many had confidently predicted the end of the Japanese economic boom. But by 1976 Japan had briskly recovered. Its trade surpluses swelled while the yen began a long, steady march from 300 to the dollar, where it had been through much of the first half of the decade, to an unbelievable high by mid-1978 of 177 to the dollar.

The standard explanations for Japan's success had worn thin. Labor costs had closed in on Western levels. American aid

during the occupation and procurement during the Korean War were distant memories. The people I worked with in the Tokyo office understood what was happening in Japan and what it could do to “BofA.” In San Francisco, however, anyone suggesting that within ten years Bank of America would lose its premier standing and be going hat in hand to its Japanese counterparts for subordinated debt in order to survive would have been regarded as a lunatic.

At the Harvard Business School, where I matriculated in 1979, much of the faculty had started thinking about Japan. Although the M.B.A.’s golden era had only recently dawned, one could sense the beginnings of defensiveness at HBS—and Japan played a part in that. The school stood accused of sharing the blame for America’s decline by its instrumental role in the creation of a rootless class of “professional managers” who disdained nitty-gritty decades-long involvement in the particulars of specific industries. Even more embarrassing, the school had to confront in Japan the implications of a country bearing the United States *without the benefit of M.B.A.’s*. But to give credit where credit is due—more than can be given, for example, to the typical Anglo-American economics department—the school at least grasped Japan’s importance. First-year students sat through nine case study sessions devoted to modern Japanese economic history as part of the required curriculum.

Even if the Harvard Business School had begun—however uncomfortably—to notice Japan, recruiters for the investment banking industry had not. Like a good half of my classmates, I found this glamorous industry offering a cool \$40,000 a year to newly minted M.B.A.’s awfully attractive. I naïvely assumed that with Japan’s emergence as an economic powerhouse, investment banks would be falling all over themselves to recruit people with some expertise in that country. But when I started talking about Japan to interviewers from Goldman Sachs, Morgan Stanley, and First Boston, I could see in their eyes the pencil crossing off my name. I might as well have spoken of my close study and critical understanding of the operas of Monteverdi.

Within two years things had changed dramatically. Coming out of business school, I had managed to land a spot with an investment bank, albeit a second-tier house partly owned by Europeans. But when the firm got into trouble in 1983, it was quickly abandoned by its European partners, and I found myself back on the street looking for a job. To my surprise, however, I discovered that without really having done anything, I had become a hot property on the job market. Still smarting from the rejections of two years earlier, I hadn't even bothered to approach the famous Wall Street houses again and, anxious to get back to Japan, had accepted a position with Chase Manhattan's operations there. Then suddenly Morgan Stanley, which had been particularly snooty back at Harvard, approached me about joining its Tokyo office. I had already made a commitment to Chase and couldn't take it up, but I was stunned by the change in attitude.

Once I got back to Tokyo in the fall of 1983, I immediately understood why the attitude had changed. As bankers we were sitting in the midst—often as middlemen—of the greatest transfer of wealth in history. Matters had gone far beyond temporary trade surpluses, slowly strengthening currencies, and a few uncompetitive American companies whining about foreign competition. Japanese companies had achieved a superior cost position in almost any key manufacturing industry one cared to mention. Thanks to this position, the companies were inevitably accumulating vast cash hordes, and these cash hordes in turn were swelling the vaults of Japan's banks and insurance companies. But Japan's financial system had not been designed to handle cash in those quantities.

Ronald Reagan provided a solution. Just as the Japanese emerged with large quantities of excess cash, the American government enacted a series of laws that suppressed taxes, did little to control aggregate spending, and made only token gestures to raise the savings rate. The predictable result: a ballooning federal deficit. Doomsayers expected a crash, but the U.S. Treasury found a brand-new source of funds with hundreds of billions of dollars to lend: Japan.

The Treasury was only the first in line. Reagan administration policies unleashed a wave of debt-financed restructuring of American industry. American firms that had long been content to borrow from local banks found the Japanese offering lower rates. American municipalities discovered that Japanese banks charged less for guarantees than American banks. Corporate treasurers began routinely to check conditions in the Japanese market. And owners of corporations quickly learned to offer their companies in Tokyo if they wanted to sell; that's where you got the most money.

Americans formed only part of the queue at the Japanese honeypot. Corporations and governments in Southeast Asia, Europe, Canada, and Australia soon realized that the Americans rarely offered the best deals anymore. American banks might still lead-manage many syndicated loans, but the Japanese formed the heart of the syndicate. Traders in the Eurobond market got into the habit of talking to the Japanese first, and Japanese firms muscled their way into the top of the league tables.

My colleagues, competitors, and I had great seats for this game. We knew where to find the Japanese investors, and our institutions were in the business of helping people locate the money they needed. Investment banking had always been a matter of matching investors and borrowers. But from Tokyo the capital moved in only one direction: out. The Japanese authorities tried to control the whole process, but the amount of capital that had to get recirculated was so enormous they really couldn't keep track of all of it. We Americans might have lost our touch at making things, but we could still devise the best legal structures to allow buyers and sellers (or, in this case, non-Japanese borrowers and Japanese lenders) to do what they wanted to do, even if the authorities weren't too happy about it.

As a banker I felt like a child in a candy store. But as someone who cared about Japan I grew uneasy, and as an American, I was really bothered. I loved Japan, but I also loved my own country. I make no apologies for it; love of country is one of

the most natural and, when uncorrupted, decent of emotions. A man who turns on the sights and sounds in which he grew up, rejecting those who nurtured him, is in a fundamental sense inhuman. People are right to regard traitors with instinctive contempt, no matter where they come from.

Like most Americans, I believed the United States had a claim on its citizens beyond that of a natural patriotism. As ethnic and religious hatreds tear the world apart, it is blindingly clear—to me, anyway—that the core American political principles—freedom of speech, press, and religion; equality before the law; accountability of the governors to the governed—are the only principles that hold out any hope for humanity's political future. And I tend to believe, with Lincoln, that the fate of these principles is probably bound up with the fate of the United States.

That is why I became increasingly disturbed as the 1980s proceeded. I had been raised a liberal Democrat. One of my earliest childhood memories is election day, 1956. I couldn't understand why my mother was weeping in front of a television screen that showed bands playing and crowds cheering. I proudly wore Kennedy/Johnson buttons to school in the third grade. I vividly remember the devastation that swept my family and my school when President Kennedy was shot. Nearly as vivid in memory is the exultation we felt over Lyndon Johnson's landslide victory in 1964, which seemed a partial redemption.

But by 1980 my childhood enthusiasm for liberal politics had entirely disappeared. I accepted most of the conservative critique of the liberal hegemony: Heavy government spending and capricious interference in markets had crippled the economy; taxes were too high; welfare, perhaps enacted initially with laudable motives, had ended up destroying neighborhoods and spawning new armies of make-work bureaucrats; and pork barrel spending in Congress had slipped completely out of control. Inflation, deficits, and the energy crisis, far from being inevitable, were the creatures of deceitful and cowardly politicians trying to finance vote-buying programs on the sly by

gunning the money supply and hiding costs from beneficiaries.

With all their “social conservative,” Moral Majority baggage, I couldn’t bring myself to vote for Republicans. I nonetheless quietly rejoiced at Reagan’s 1980 victory—particularly when it became clear the new administration intended to put “social” issues on the back burner and focus on rolling back taxes, inflation, and the government. But as the deadly combination of tax cuts, tight money, soaring defense spending, and no real cuts in entitlements took hold in the years following Reagan’s inauguration, deficits exploded.

Like most responsible Americans, I worried about these deficits. Unlike most Americans, I also knew how and why they were being financed. I didn’t congratulate myself on my special insight; it was obvious every morning when I came into work.

It all came together for me on a business trip to Europe in 1987, when I picked up the British edition of David Stockman’s *The Triumph of Politics*. I had admired Stockman enormously—I still do—seeing him as the real hero of the Reagan administration’s early days. I sat up on the flight back to Tokyo mesmerized by Stockman’s account of how the Reagan administration had almost accidentally implanted annual deficits in the hundreds of billions into the American body politic. But reading Stockman’s book was like reading the first three quarters of a well-designed thriller. Every clue is carefully brought out for the reader’s inspection and put into place. The outlines of the scenario become clear. The pace quickens. You’re all ready for the catastrophic resolution—and then suddenly the book ends.

I was on my way back from closing another garden-variety Japanese deal, a ¥20 billion (\$140 million) insurance company financing with a swap attached for a Spanish government bank. While in Europe, I had also made some dozen calls organized by colleagues at Chase’s offices in London, Paris, and Madrid on borrowers jostling for a place on the gravy train of Japanese finance. Japanese money had transformed the parameters of lending and borrowing; this was no more remarkable to me or any of the people I worked with than the telephone or the