

What Can Oil-Importing  
Countries do? A Proposal to the  
Toya Summit.

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# Intended Title of the Talk

- “Real Exchange Rate and Lost Decade of Japan” The old title.
- The Japanese economy is now in the impasse between subprime hang-overs and soaring commodity prices.
- Economics can still help understand the nature of problems and suggest the way out of the difficulties.

# Parents from Hokkaido

- “Boys be ambitious!”
- Lakes are beautiful in Hokkaido.
- Strong impressions of the JICA in the trip to Sub-Safari Africa.
- Gratitude to the FASID and to the GRIPS

# Subprime Issues

- The Japanese (or the world) economy sandwiched by the subprime recession and the commodity price hike.
- Real (non monetary) difficulties to provide sufficient finance to low income families.
- Subprime loans, if they function well, serve the public good.
- However, they are costly due to the possibility of default.

# Subprime Issues (2)

- Intrinsic difficulty in lending: The asymmetry of information between lenders and borrowers.
- Fictions created by advanced financial techniques. Loans are tailored into securities that look as if they were safe.
- Hidden poison pills are somewhere. The true solution lies in improvement in monitoring borrowers.
- A systemic crisis can develop if the policy does not rescue the failing institutions. (Adverse effects on the long run.)

# Competitive Devaluation of Currencies

- The interest rate reduction of the Federal Reserve Banks will create negative impacts on the Japanese economic activities. The Beggar-thy neighbor effect by Mundell and Dornbusch.
- The room for monetary policy, interest rate coordination of the Plaza type.

# The Need for Collusion by Oil-Importing Countries

- Before the formation of the OPEC and its effective interventions, the oil market was a monopsony market by “Seven Sisters.”
- Now it is definitely a monopoly market or oligopoly market. Most of the profit or rent goes to the oil producers.
- Profits gained by the producer countries are invested in “sovereign wealth funds (SWF) and allegedly help fueling the oil price speculation. Basic profits in the oil market is, however, the necessary condition for the behavior of the SWF by oil producing countries.

# Monopoly, Monopsony and Bilateral Economy

- The OPEC is definitely a Cartel: monopsony (supply monopoly or collusion).
- The best way is to cope with monopsony is to form a monopoly or demand collusion.
- Then the situation turns into a bilateral economy. It is not the best for the world but it helps to avoid the huge transfer of income from oil consuming countries to oil producing countries. It avoids the situation where all the *aburage* is caught by a *tombi*. (The lion's share belongs to the OPEC.)

# Graphical Presentation Follows

- Monopoly: Marginal MC (MMC)= Price (MU of the oil)
- Monopoly: Marginal Revenue =Marginal of demand curve (MMU)=MC
- Bilateral Monopoly: MMC=MMU
- This will become a threat point (minimum security point.)
- Collaboration is needed among the oil consuming countries. Later, productive negotiation may develop.

# How to Reduce the Oil Demand

- Abolish any subsidies and tax the oil refinery companies and the consumption.
- Tax rebates should be back to low-middle income oil consumers as *lump-sum rebates*.

# Political Difficulties

- (1) Russia and US are among G-8 countries. Producers and refineries like subsidies and less taxes.
- (2) Consumers of course do not like the price hike of oils. But only by making the consumption difficult, the supply price of the oil will decline.
- This proposal would lose the presidency if a candidate adopts.

# Japan's Vulnerability

- “Yudan: the oil embargo.” Taichi Sakaiya
- Diplomacy should be extremely careful.
- Collusion is crucially important with other oil consuming countries.
- Here I just tell the meaning of the economic mechanism.
- This is where political leadership and entrepreneurship should work.
- Then the bubble effect, if any, should be curtailed.

# On the Monetary Policy Coordination

- The ebbs and wanes of international policy coordination in Theory and Practice
- Search for the Real Equilibrium Exchange Rate. Can we define the concept? If so, can you identify by what ground?
- Jorgenson and Nomura (2007) found extremely hard burdens imposed on the Japanese industry in light of the high sector-wise real exchange rate.

# Last Year I Argued

- (1) Monetary policy coordination is useful under the fixed exchange rate but hardly so under the flexible exchange rate. (2) The current account balance is by no means a norm. (3) Japan's real exchange rate was liberated by the Plaza accord toward the direction of appreciation. (4) Until it came down just recently to the level of the pre-Accord level, the Japanese industry had to struggle for being competitive by deflation and making progress in the total productivity.

# The Role of the Terms of Trade

- The real exchange rate: the purchasing power of Japanese products.
- Dollar yen exchange rate (multiplied) by Japanese price (divided by) American Price.
- An automobile of 3 million yen divided by 100yen/dollar divided by \$30,000 = 1.
- The higher the real exchange rate, harder for the Japanese manufacturers for exporting or import competing.
- The matter of the short run adjustment
- International competitiveness for industrial sector worsens with higher real exchange rates.
- Terms of trade: The ratio of the export price index to the import price indexes. I
- Its improvement is a real improvement in the income of Japan.
- See Figure 2.

# The Monetary and International Aspects of Japan's Lost Decade, 1990-2004?

- The real explanation by Real Business Cycle proponents, e.g. Hayashi and Prescott.
- Only the working hours did count.
- Monetary aspects are important since prices are rigid. So is the international aspects.
- The lost decade can as well be attributed to the wrong combination of the exchange rate policy (by the MOF) and the monetary policy (by the BOJ).
- Non Performing Loans were not necessarily the fault of the private sectors.

# What are ahead?

- Unite! The Oil Consuming Countries!
- The subprime issues will wane as exposures continues, but the commodity energy price will still soar.
- How can bubbles be busted?
- The role of diplomacy: not just follow the bosses like the United States or Saudi Arabia. I dare say this in spite of the fact that my academic career would not have existed without the good wills of American people, for example, the Fulbright fellowship. Entrepreneurship is necessary for both diplomacy and monetary policy.

# To Conclude

- The need for independent think tanks.
- In the United States, research institutions were classified by their approximate political affiliation. Brookings Institution and IIE. In Japan by bureaucratic affiliation.
- Justification is too important in Japan: Law department dominance.
- A plea for an establishment of an academic institution like the NBER in Japan.