opinion

The Japan Times

Established 1897

Incorporating The Japan Advertiser 1890-1940
The Japan Chronicle 1868-1940
The Japan Mail 1870-1918
The Japan Times 1865-1870

owned and published daily by
The Japan Times, Ltd.

TOSHIAKI OGASAWARA, *Chairman and Publisher*
YUKIKO OGASAWARA, *Vice Chairman*
TAKEHARU TSUTSUMI, *President*
TAKASHI KITAZUME, *Managing Editor*
AKIRA YAMAZAKI, *Sales Manager*

EDITORIAL

Egypt explodes

The situation in Egypt is going from bad to worse. Islamist leaders are being arrested as former despot Hosni Mubarak has been released from prison and put under house arrest. Attempts to shut down protests have resulted in the worst bloodbaths in the country's modern history.

Not surprisingly, attempts to negotiate a settlement to the country's turmoil have broken down, and both sides appear to be digging in, searching for ways to blame the other for the stalemate and to write a new national narrative.

While the military's removal of a democratically elected government should always be challenged, there was hope that the situation in Egypt would stabilize after the army toppled President Mohammed Morsi. Mr. Morsi had governed with increasing disregard for the views of the substantial minority of people who had opposed him. In the 2012 presidential election, 48.3 percent of the voting public voted for other candidates than Mr. Morsi. A combination of administrative incompetence and authoritarian democracy had alienated many of his supporters and brought millions of people into the streets to protest his rule.

Sensing that it had majority support, the military launched a coup, removing Mr. Morsi and installing a civilian-led administration that would write a new constitution and oversee a transition to a new government.

Mr. Morsi's supporters have not accepted this *fait accompli*. They took to the streets and set up tent camps from which they launched mass protests against the military's usurpation of power. Behind the scenes, however, there were negotiations between the Islamist leadership and the new government to see if they could work out a compromise that would provide some symbolic role for Mr. Morsi while effectively lifting his hand from the day to day operations of the government. The Islamists were said to be ready to accept a deal that would begin with the release of Muslim leaders who had been arrested after the coup. But the military balked.

Instead, the army cracked down on the demonstrators, intervening with force to disperse them from their camp sites. As many as 1,000 people, including 100 soldiers and police, have been killed in the last week following a crackdown on supporters of the former president.

Both sides have blamed the other for the violence. The protesters say the military used indiscriminate violence against peaceful demonstrators. The military insists that there were snipers and other armed individuals who used the protesters as shields. Reports from hospitals show many victims had been shot in the head.

Last week, insult was added to injury with the release of Mr. Mubarak, the man whose overthrow in early 2011 signaled the high water mark of the Arab Spring. After being removed by mass protests, the former president was sentenced to life in prison in 2012 for failing to prevent the killing of protestors, a ruling he is appealing. In a separate case, a court found that he could not be held in connection with corruption charges, eliminating the legal basis for his detention.

While Mr. Mubarak's political life is over, the decision still looks like a deliberate statement to Egyptians and the world that the old order is reasserting itself and that change has very definite limits.

At this point, both sides in this crisis seem more intent on digging in their heels and trying to write a narrative that identifies the other side as the villain than finding a peaceful solution that restores order to the country and responds to the other side's concerns. Martyrs are more valuable than moderation.

Outsiders can't do much to influence this dynamic. Historically the United States has been an important interlocutor with Cairo, providing billions of dollars of military aid. But Washington is worried that it has limited leverage in the current situation.

European Union foreign ministers face a similar situation, but they have even less leverage in Cairo. Moreover, any threats to cut support are neatly neutralized by Saudi Arabia's pledge to make up for any shortfall. The Riyadh government is staunchly opposed to the Muslim Brotherhood and will do what it can to ensure that it makes no inroads into the region.

The deteriorating situation in Egypt is alarming. But even more troubling are the signals that are being sent throughout the region. Autocrats in the region have been reassured that might does equal right. Political institutions are of secondary concern; the rule of law is a flexible concept. More important is the force of arms.

It is a message that echoed in Algiers two decades ago and is heard in Damascus today. It is the wrong message to send to millions of Arabs who will now believe that democracy is not for them. Democratic processes must be protected, laws and constitutions respected.

Outside forces have little direct role to play, but the leaders of countries in the region must be told in unmistakable terms that they cannot rule by fiat. All governments must enjoy democratic legitimacy in form and substance. Authoritarians of whatever stripe will not be tolerated or blindly accepted.

Ivory tower types press for higher inflation fix

Caroline Baum
New York
BLOOMBERG

Folks who have a vivid recollection of the Great Inflation of the 1970s must wonder why anyone would wish even a trace of that upon future generations. Yet some economists seem willing to take that risk.

The idea that the Federal Reserve could "fix" things faster with a bit more inflation keeps popping up in academic circles, which is probably where it should remain.

In December 2008, as the financial crisis started to claim its victims, Harvard University economist Kenneth Rogoff teed up the "inflation option" as one of many to be used by policy makers.

Pretty soon, Harvard colleague Greg Mankiw was advocating higher inflation as a cure for slow growth — and a preferable option to additional fiscal stimulus.

In 2010, Olivier Blanchard, chief economist at the International Monetary Fund, put his imprimatur on the idea. In a paper examining the lessons from the financial crisis, Blanchard and his co-authors suggested that the benefits of a 4 percent inflation target, to minimize the risk of deflation in response to shocks, might outweigh the costs.

Leave aside for the moment the punishing effect higher inflation has on savers, whose investments are paid back in devalued dollars. What of the mechanics of what seems like an unworkable idea? So I posed some questions to Rogoff.

He said in an e-mail that if the Federal Reserve — or any central bank — were to raise its inflation target, that would lift inflation expectations and reduce short- and intermediate-term real rates. (The real rate is the nominal rate minus expected inflation, which nowadays can be inferred from the spread between nominal and inflation-indexed bonds.) In theory, this wouldn't affect real long-term rates, Rogoff said. In practice, I'm not so sure.

Rogoff doesn't like Blanchard's idea of adopting a permanent 4 percent inflation target. He said a "short burst of moderate inflation" — two years of 6 percent inflation — would speed the deleveraging process.

The operative words in that policy recommendation are "short burst" and "moderate inflation." For all its concerted effort — almost five years of zero-percent interest rates, large-scale asset purchases and forward guidance — the Fed can't even hit its 2 percent target from below.

I'm not saying the current 1.3 percent inflation rate is an alarming development that needs to be addressed. I'm just wondering how an institution is going be successful targeting something — inflation — that is determined by today's monetary policy with "long and variable lags" (see Milton Friedman). A "short burst" could be prolonged. "Moderate inflation" might be anything but. And inflation expectations might take on a life of their own.

If a 6 percent inflation target would accelerate the deleveraging process, why stop there? Why not 8 percent? Or 10 percent? Wouldn't that speed the process? You get the point.

Then there's the small matter of central bank credibility. Everything we hear and read about central banking today emphasizes the importance of communicating objectives clearly in order to influence the public's expectations and behavior. Why would central bankers, who have fought hard to earn credibility with financial markets, forgo that trust for short-term gains? And why would we believe anything they ever told us again?

"It's a slippery slope," said Marvin Goodfriend, professor of economics at Carnegie Mellon University and a former research director at the Federal Reserve Bank of Richmond. It introduces the idea that if the central bank were willing "to do something for short-term purposes today, it would do it again for short-run purposes."

Mankiw, also via e-mail, offered a different argument to support the idea: "Think of it as the Fed announcing it will keep future short rates lower, for any given inflation rate, than it otherwise would have.

The long-term rate is the sum of the current and future expected short-term rates. That's an arithmetic calculation. A potential buyer of a 10-year Treasury note, for example, will earn a certain return from rolling over a short-term rate for 10 years. To induce him to lock in for a 10-year period, he would need to earn the expected short-term rate for 10 years plus a term premium, or compensation for accepting the interest-rate risk during that period.

In theory, Mankiw is right. With other things equal and the fallback for all things economic — the longer the Fed is expected to hold the overnight rate at zero, the lower the implied long-term rate.

But other things aren't equal; they never are. In an econometric model, maybe, the central bank can target higher inflation for two years without affecting nominal long-term rates. In the real world, bond investors are going to look at 6 percent inflation and project 8 percent or 10 percent.

Nominal bond yields will rise to incorporate higher inflation expectations. Real yields might not rise, but it's unlikely they would fall. And long-term rates are what matter for capital investment, which is key to increasing the economy's growth potential and raising productivity.

Bad ideas never die. Just last week in a blog post, economist Noah Smith advocated higher inflation — 4 percent or 5 percent — for the next decade. The only downside to higher inflation, he wrote, is the "nuisance cost" of changing prices.

Caroline Baum, author of "Just What I Said," is a Bloomberg View columnist. E-mail: cabaum@bloomberg.net.

U.S. Republican's take on immigration reform

Greg Sargent
Washington
THE WASHINGTON POST

U.S. House Judiciary Committee Chairman Robert Goodlatte, a Virginia Republican, has now shown what it would look like if House Republicans seek to kill immigration reform while trying to evade blame for it.

Worse for Democrats, the GOP might not face electoral repercussions for killing reform in next year's midterms.

"The bills that House Republicans support may go nowhere," the Huffington Post's Elise Foley reported Goodlatte as saying at a town hall last week.

"'Will the Senate agree to them? I don't know,' Goodlatte said. 'But I don't think Republicans in the House … should back away from the right way to do things.'

"'Even if it doesn't go all the way through to be signed by this president … it doesn't mean we shouldn't at least show the American people that we are interested in solving this very serious problem.'"

One way to read this: As long as House Republicans pass a few immigration reform measures of their own, they will have demonstrated to the American people that they want to solve the problem, and it won't matter whether their efforts result in a compromise with Democrats.

The notion that Republicans can avoid blame for killing immigration reform seems daft — even Republicans say willingness to discuss reform is more about repairing relations with Latinos than doing something the American people on the whole want. Polls suggest that Latinos would blame Republicans if reform fails.

But Latino communities and the areas where House Republicans are vulnerable don't exactly overlap. There are only 12 GOP-held House districts that Democrats have a good chance of winning in 2014 (though this could change), according to David Wasserman of the nonpartisan Cook Political Report. Only five have large enough Latino populations that turnout could plausibly make a difference next year.

Ultimately the fate of immigration reform rests with the GOP leadership. But the electoral consequences of killing reform won't be felt until after 2014.

Greg Sargent writes The Plum Line blog.

Chinese democracy gets help

Xie Zhihai
Maebashi Gunma Pref.
SPECIAL TO THE JAPAN TIMES

The Internet censorship in China is notorious. Due to the Great Firewall, the state-sponsored censorship system, people can't access some blocked websites like Facebook, Twitter and YouTube. Sensitive words such as some dissidents' names are filtered in the search results.

On Sept. 14, 1987, the first e-mail sent from China to the world said, "Across the Great Wall, we can reach every corner in the world."

Ironically, today people in China have to use some anti-block software to cross the "Great Firewall" for access to the blocked websites. Indeed, the censorship has greatly restricted Internet freedom in China.

Even so, the Internet is a strong force to remold China. Chinese dissident and Nobel Peace Prize laureate Liu Xiaobo famously argued, "The Internet is God's great gift to China — it has provided the Chinese people with the best tool in their efforts to cast off slavery and fight for freedom."

Unlike traditional media, communication via the Internet is inherently bidirectional, decentralized and less easily monitored and censored. This means that it can be used to promote democratic interaction even in an authoritarian country.

China is standing at the crossroads of political transition after successful economic reforms. Demand for political democracy is on the rise as a large middle class has emerged. The Internet has become an effective social medium for people to protest for political rights and freedom under the authoritarian regime.

By the end of 2012, the number of China's Internet users reached 564 million, largest in the world, accounting for 42.1 percent of its total population.

Rapid development of the Internet in China created a dynamic cyber community. Every day there are fierce online discussions and debates, quarreling and fighting. Facing plenty of social problems such as income gap, political corruption and environmental pollution, Chinese people have too much to complain about.

Traditional social media like newspaper, television, radio, and book publication are all under firm control of the authoritarian regime. In contrast, the Internet is much easier for individuals to penetrate and much more difficult for the government to monitor. Consequently, people resort to the Internet for freedom of expression.

The government realizes that the voices of the Internet users must be listened to. For instance, former President Hu Jintao and Premier Wen Jiabao used to conduct same-time online conversations with netizens on the Strong Nation Forum (*qiangguo luntan*), one influential Chinese Web forum.

Special government sectors are set up to collect and analyze opinions and suggestions posted by netizens. Some are adopted by the government in its policy.

One major reason for President Xi Jinping's anti-corruption campaign was that many corruption scandals of governmental officials were disclosed in the cyberspace in recent years. The disclosure has degraded the party's reputation and put its legitimacy at crisis. Here are some typical examples.

In August 2012, some netizens found from Web pictures that one official was always wearing different brands of luxury watches in public. They asserted that he couldn't afford to buy such super expensive watches without bribery. Netizens joked about him as the "watch brother" and strongly requested an investigation on him. Under the online social pressures, the government investigated him. Within one month, the "watch brother" was fired.

In November 2012, one journalist put some government official's pink video on the Internet and accused him of accepting sex bribes. The video was striking and attracted many netizens' attention. The government was forced to respond. The official was soon arrested and prosecuted.

There are many similar cases in which the Internet plays a vital role in anti-corruption activities. Cyberspace provided convenience for people to expose corrupt officials, restrict political privileges and pursue social justice. It was under such background that Xi vowed to fight against corruption.

Micro Bog, or Weibo, the Chinese version of Twitter, is the most influential Internet tool in China. Since Facebook and Twitter are blocked, Micro Blog has become the dominant social network website. By the end of June 2012, Micro Blog's penetration rate exceeded 50 percent.

Democracy is deeply rooted in civil society. In contrast to Western democracies, China has an extremely weak civil society due to the authoritarian regime. Micro Blog is developing a vibrant cyber civil society in which netizens get informed, connected, organized and mobilized. Netizens' voices are integrated into public opinions, which have considerable social and political effects. At Micro Blog, netizens can even express harsh criticism on the flawed political system and one-party leadership, which never appear in traditional media.

Micro Blog has also become an inspection agency for checking party rulers, whether corrupt officials or spoiled princelings. In the aforementioned anti-corruption cases, it was through Micro Blog that people managed to disclose the scandals and create social pressures over the government.

The paradox of the Internet in China is evident. Though the government understands that Internet freedom contributes to China's industrial innovation and social development, it still keeps strict censorship for political purposes.

Interestingly, the censorship has also stimulated the development of anti-censorship technology to break through the Great Firewall. The censorship system's function to isolate the Chinese Internet users is limited.

The censorship demonstrates infringement on freedom of expression in China, but it can't stop people from using the Internet to protest for more political freedom. The old Chinese proverb goes, "To block people's mouths is harder than to block the river."

Under increasing domestic and international pressures, the Chinese government will be forced to loosen its control on the Internet in the future.

Thanks to the Internet, the Chinese people are enjoying more freedom of expression. Public opinions expressed in the cyberspace create social pressures on the government and thus impact the real political life. Cyberspace is not an imagined existence anymore, but a tangible community.

As U.S. former Secretary of State Hillary Rodham Clinton pointed out, the Internet helps citizens hold their governments accountable. For China, this is particularly the case, since the political inspection system is flawed and traditional social media are under firm control.

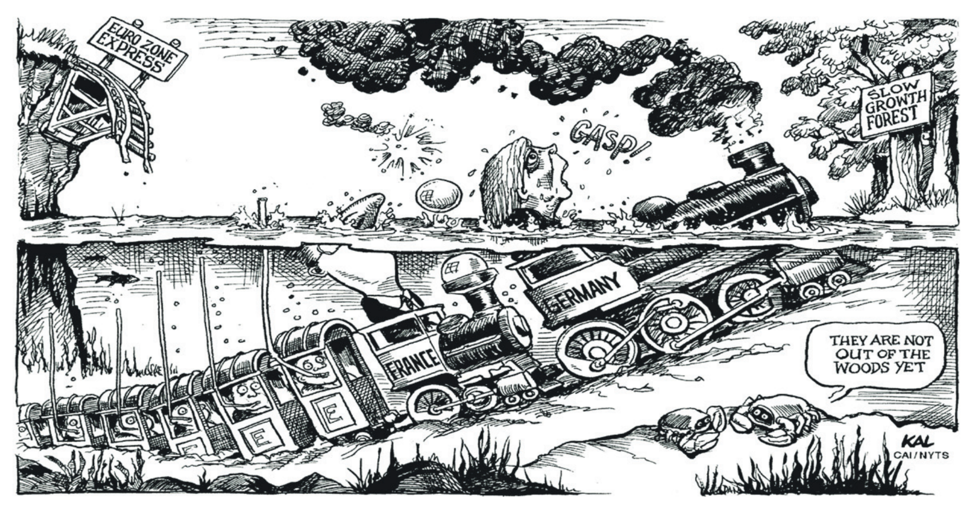
The Internet has already awakened people's democratic consciousness and facilitated a certain level of democratic development in China. Pervasive use of the Internet will make democratization an easier task than it would be otherwise.

As the Internet further develops, people have reason to believe it will help Chinese people to realize more political freedom.

Xie Zhihai, an assistant professor at Maebashi Kyoai Gakuen College in Gunma Prefecture, was a research associate at the Asian Development Bank Institute and a Japan Foundation research fellow. He received his Ph.D. in international relations from Peking University in July 2011.

Emerging nations brace for economic ice age

Uwe Bott
Washington
THE GLOBALIST



After several years of riding high on foreign investment cash and commodity revenue, emerging markets are in for a shock.

The shift is under way. Net capital inflows in emerging markets stood at $3.9 trillion between 2009 and 2012. Between 2004 and 2012, net capital flows in emerging markets stood at a staggering $7 trillion, slightly less than half the size of the U.S. economy. The concern is that the quality of these investments has deteriorated over the last few years, since the low-hanging fruit of earlier years is gone, forcing investors to become more adventurous.

The other major development is that China, itself still an emerging economy, has become a major player in investing in emerging markets. It is estimated that as much as 30 percent of capital inflows in emerging markets in 2012 came from China. If the Chinese slowed down their investments now, that would be a big blow to emerging markets.

China's growing role in investing in other emerging markets in recent years was based on several strategic calculations. Prominent among them is the need to guarantee that China's appetite for commodities would be met and that it would not have to compete for the import of such products with other nations. The best way to secure that is to own a stake in or lend to the commodity-producing companies abroad.

In contrast, U.S. investors invested abroad in search of yield. They were responding to chronically low interest rates and several rounds of quantitative easing that flooded the U.S. economy with liquidity, while lucrative domestic investment opportunities have been scarce for years now. But these incentives for U.S. and Chinese investors may suddenly reverse. Even in a sluggish economic recovery in the United States, ultra-loose monetary policy will come to an end.

The so-called tapering by the U.S. Federal Reserve Bank — the reduction and ultimate termination of its program of buying assets, such as mortgage-backed securities — will lead to an increase in market interest rates in the U.S. That will happen even if the policy rates — the Federal Funds Rate — remains unchanged. This changes the incentive for investors to take home their funds abroad, especially as the risk of their investments there has risen over time.

At the same time, China might not grow at a greater rate than 7 percent per year in the medium term, as it is facing multiple problems. These include challenges to its export-driven growth model, its exponentially greater economic base from which it must grow, sluggish global demand and falling competitiveness with the fastest-aging population mankind has ever seen.

The common mantra that China must switch from an investment-driven growth model to a consumption-based growth model is easier said than done. But this necessary evolution also reduces China's incentive to invest in emerging markets.

China will likely soon start to deploy more of its financial resources at home to recapitalize its banks and bail out highly indebted provinces and municipalities.

As if this double blow of slower investments from the U.S. and China were not bad enough, many of the affected emerging markets will also see the price of commodities — their major export products — slump. This is especially true for oil-exporting countries.

That said, the good news is that virtually all emerging markets have largely strengthened their international reserves to protect themselves against such shocks. Yet, important as these buffers are, panicky investors can quickly lead to a rapid depletion of those reserves. That is a particular danger if such behavior is preceded or accompanied by capital flight (such as domestic investors' withdrawing their money and taking it abroad).

In looking forward to a world of much slower growth, it is important to assess which emerging market among them might be most affected. Three major factors must be considered in that context:

- How dependent is the country on commodity exports, especially oil?
- How large a role have capital inflows played in sustaining economic growth in the emerging market economy?
- How dependent is an emerging market country on such inflows?

The latter two may seem measures of the same thing, but they are not. A country may have a current account surplus and still benefit from large capital inflows leaving it with a strong balance-of-payments position.

By the same token, a country may have a very large current account deficit (also referred to as the savings/investment gap) and hence, depend on foreign savings, meaning large capital inflows.

In assessing vulnerability to a combined "sudden stop" of capital inflows and a commodity price shock, the list of potentially vulnerable countries is large for different reasons. Turkey, Romania, Morocco, South Africa and India stand out as being especially vulnerable. They have all run large current account deficits and hence depend on inflows.

Brazil and much of Latin America are also at greater risk. They are vulnerable because of their dependence on exporting commodities and the fact that they have greatly benefitted from record capital inflows over the last 10 years.

Slow U.S. growth, creeping recession in much of the eurozone and the limits of Abenomics are key markers for decelerated global growth scenarios. This has all played out against aging populations and mountains of debt that residents soon will no longer be able to finance.

The slowdown of the world's second largest economy, China — partly correlated to the malaise in the advanced countries and partly a function of the limits of its own model — is likely to cause a reversal of fortune for many emerging markets. These countries have done well for themselves over more than a decade. What lies ahead need not be catastrophic, but it will require patience and deft policy management.

Uwe Bott is the chief economist of The Globalist Research Center. This article first appeared on The Globalist.