Japan’s New Economy in German Perspective

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Japan is a topic about which there is so much difference in opinion -- even among members of the scientific community. These differences are especially apparent when it comes to the assessment of the strengths and weaknesses of the Japanese economy and Japanese society.

Two important factors giving rise to these differences are found in: one, the special role that Japan plays among the world’s leading economies; and two, Japan’s exceptional historical development.

- Firstly, the world’s leading economic powers largely resemble one another as they are nearly all Western in character. The United States, Canada, Germany, England, France and Italy all share common cultural features and social structure. Not only does Japanese culture and society differ from these, but Japan also ranks second among them in terms of economic activity. Being so important and so different at the same time presents an important challenge to Western observers that is not easily overcome.

- Secondly, Japan did not begin to industrialize until the Meiji Reformation took hold in 1868 -- a time when Europe and the United States were already well along their way toward becoming, modern, industrialized, world powers. In effect, in less than 150 years Japan was able to catapult itself into second place among the worlds most technologically advanced and economically powerful nations. Moreover, this rapid advancement occurred in a nation that did not lie along the world’s traditional trade routes.

In brief, the Japanese economy and Japan’s industrial success has been one of a kind -- one that has been far more puzzling than ever reasonably possible for most Western observers. Thus, few of us living in Japan were very surprized when we read in a 1993 issue of Newsweek magazine, already four years after Japan’s stock market had collapsed, that “The System Has Crashed!” Surely, it was the beginning of a major economic and financial restructuring that would severely impact many people both in Japan and abroad, but the economic ramifications for the majority of Japanese citizens were barely perceptible when compared with was still occurring across Eastern Europe after the fall of Soviet Union. Many Japanese showed concern, but no one that I knew ever contemplated an economic meltdown.

Now, many years later, the world has begun to understand that the problems faced by Japan then and the challenges it faces today, are no different than those that every industrially advanced nation, including Germany, is also facing. Among these chalenges are:

- Epocal change in the national demographic structure
- The resulting need for radical reform in the provision of elderly and national health care
- Insufficient employment opportunity in a mature, modern economy
- Inability to respond satisfactorily to changing market conditions using the tools of classic economic theory
- Dramatic changes in social values and individual lifestyles

Japan's financial crisis did not bring these problems about, but it did provide Japan with the opportunity to become aware of them sooner than other industrially advanced nations -- including Germany; for it was while digging its way out of the rubble of its collapsed financial markets that Japan uncovered these more deeply rooted economic and social problems. The only thing exceptional about Japan in this regard was the bad world press Japan received for having been first to tackle these issues. Japan suffered no "Lost Decade", but it did have a ten years lead in resolving problems that everyone else faces today.

Japan experienced an economic boom during the 80s whose abrupt end mired Japan's banking industry in a large, ever increasing pool of bad debt. The bursting of Japan's Bubble Economy will always be remembered as a dark chapter in Japan's economic history, for what followed were several years of intense, even criminal dissimulation that wreaked havoc throughout the industry. It was the gradual unveiling of this debt that revealed the aforementioned larger structural problems with which the world is now very familiar -- not just in Japan, but across the industrially advanced world.

Japan's Bubble Economy and the havoc that followed in Japan's financial industry were pretty much an all-Japanese, sui generis development unparalleled in contemporary world economic history, but this is where the story ceases to be about a Japanese uniqueness.

Toward the beginning of the 2nd half of the 90s the aforementioned social and economic factors began receiving attention in the Japanese media. As the Japanese financial sector had still not fully recovered, the Japanese public was not well-positioned to become the receiver of more bad news. Paralysis set in. The source of paralysis, though likely influenced by Japan's still reeling financial industry, was no different than that which other industrially advanced countries of the world would soon be confronted with.

This new, socially and economically more widespread crisis began when Japanese consumers, frigthened by reports of impending economic doom, tightend their belts and redirected their income from consumption into savings, Firms still feeling the effects of tightened credit from the first half of the decade now lost all appetite for new investment. As ninety percent of what Japan produces domestically is consumed domestically, increasing overseas exports were also insufficient to compensate for the slowdown in domestic demand.

Unemployment reached a record level of 5.6%, and the Bank of Japan set its lendig rate to zero. From quarter to quarter gross domestic product declined steadily, as the number of failed firms increased steadily from month to month for several years. Lower real estate and consumer goods prices, rather than providing amelioratory relief, became indicators of ever worsening economic conditions. Deflation became a buzz word for economic ill health.

The crisis in confidence did not stop at Japan’s shoreline, though. Alarming macroeconomic indicators at home, and a relentess parade of highly distortive news articles circulated by the world press, crippled Japan’s bond and bank ratings. As a result, Japanese banks were often compelled to pay exorbitant risk premia that eventually became known as the Japan Premium.

In an effort to restore growth, slow deflation, and thus rebuild confidence in the domestic economy the Japanese government increased public spending. However, even this classical attempt to push the aggregate demand curve outward failed. The initial spending package was first doubled and then tripled, but the result was the same. The expected restoration of economic growth and the hoped for rebuilding of public confidence did not take place. On the contrary, the enormous increase in public debt merely added fuel to the fire, and the Japanese public’s doubt toward the ability of its own government to perform persisted.

In effect, Japan became the first, large, national economy to demonstrate that the classical fiscal and monetary policy measures are no guarantee against overriding negative public sentiment. What Japan was confronting can be summarized as follows:

- Persistent absence of growth despite massive increases in public spending
- Simultaneous decreases in both prices and consumer demand
- Failure of tax relief to stimulate consumer spending
- Persistent deflation desipte comprehensive, restorative monetary policy measures introduced by the central bank
- Hypertrophic debt accompanied by zero rates of interest

- Failure of large public sector banks to respond to government and public pressure to extend credit

Many of these problems are vey similar to those that Germany faces today.

Increased fiscal spending and monetary policy were not the only measures attempted to restore public confidence and economic growth. In 1998 Prime Minister Hashimoto was driven from office after seeking to introduce a 3 to 5 percent added-value tax as part of his comprehensive reform program known as the Big Bang. Prime Minister Obuchi, Hashimoto's successor, made every effort to push Hashimoto's, now historically famous, financial reform program forward, but died in office. Little in the way of needed change transpired under Prime Minister Mori's leadership, who was compelled to vacate his post as early as April 2001. Only when a little known, political maverick, named Koizumi Junichirô assumed leadership several years later, did Hashimoto's reform program finally take hold, and Japanese consumer confidence began to return. This, now, very popular Prime Minister is receiving credit for the success of Hashimoto's initiative, but only many years after it was first introduced.

Anyone who doubts Japanese readiness and ability to engage in reform should take a careful look at what has transpired in Japan's finance industry during the past 15 years. What was once a constant source of criticism both at home and overseas now looks very different from what it did after Japan's Bubble burst. Japanese banks have been restored and are once again powerful contenders in world financial markets.

In contrast, over 50 percent of Germany`s financial markets are controlled by the state. Even if all major German banks were to pool their resources in an effort to compete better on global markets, still there would be little impact on the domestic front. This overbearing governmanet presence inhibits economic growthe in Germany´s banking sector. So stifling has it become that the sharholders of HVB, Germany`s second largest bank, recently decided to sell the bank to a foreign financial institution. Where are the prominent politicians and business people in Germany with the courage to lead the charge and transfigure Germany`s Middle Age financial landscape?

Japan`s transformation was initiated and implemented by the Japanese government. Much less visible, but just as important, was the relentless effort of the private sector, as large Japanese firms struggled to deal with their own circumstances. Many jobs disappeared and important business alliances were cut. These were not mere cost-reduction measures; rather they included a major overhauling in the way that individual workers were awarded for their performance. Hundreds of thousands of workers lost their jobs, but those who remained were better integrated through improved incentive systems based on individual performance.

Changes in both the private and public sectors were often met with public protest. Nevertheless, drastic and very painful measures similar to those that eventually forced the highly respected Prime Minister Hashimoto out of office, have been met with little resistance under the more popular Prime Minister Koizumi.

By the end of the previous decade many of these reform measures were being jointly introduced and implemented. The spirit of cooperation so badly shattered by the numerous cover-ups of the early 90s had returned. The success of this joint effort is visible in the profitable returns now being experienced by major Japanese enterprises and the ebb in the flow of bankruptcies among firms irrespective of their size. Confidence on the part of the general public has also returned, and as evidenced in the Bank of Japan's quarterly report (the TanKan) Japanese firms are regularly looking toward the future with a positive outlook. Difficult, but needed measures that under most circumstance would turn voters aways are no longer avoided by vote-seeking Japanese politicians. Today, Japanese voters realize that bitter medicine is sometimes the only cure, a lecture which politicians and the people in Germany still have to learn.

In effect, Japan has passed an important turning point in its history and is now moving in a very positive direction. The reasons for this succesful turn of events can be summarized as follows:

- In contrast with other large industrial states and also with Germany, not only was the Japanese public awakened earlier to the aforementioned social and economic challenges that all major economies face today, but has already become actively engaged in overcoming them.

- Policy makers prepared a comprehensive reform program before commencing implementation of individual reform measures. In particular, the Big Bang reforms introduced by the government of Prime Minister Hashimoto included -- in addition to measures that targeted the restructuralization of the Japanese financial system -- measures that sought to deregulate the Japanese economy and reduce role of government involvment in many areas of Japanese society. What began under Hashimoto has continued into the present.

- Prime Minister Koizumi risked his own popularity to insure that potentially unpopular, but badly needed reform measures were properly instituted. Not only did he understand what was needed, but he also understood that the Japanese people were prepared to bite the bullet on behalf of a leader whom they could trust. Koizumi's political courage cannot be underestimated as an important factor in the successful implementation of these reform measures.

- None of these reforms took place in a social void. Ideas imported from overseas were carefully sifted through a national filter that sought not to contradict Japanese traditional social values.

This largely successful, combined, public and private reform effort received little recognition overseas and was largely ignored by the large rating firms whose job it is to evaluate overseas investment risk. Even now, the vacuous catch phrase “Lost Decade” is still found in reports about Japan; though it is now clear to every serious Japan observer that nothing of the sort occurred. The 90s were a difficult period of self-reflection, rediscovery, and debate that culminated in a highly aware general public prepared to meet whatever demands placed upon them to overcome their current difficulties. Moreover, Japan is now ready to face whatever challenges the future is still likely to bring. Whatever was sacrificed in economic growth was clearly offset by structural growth and enhanced social cohesion. If we look to Germany we cannot avoid but to feel that we still have a long way to go.

One of the better examples to illustrate Japan’s social resilience and structural flexibility can be found in the restructuring of Japan’s postal system whose final phase of implementation was rated as Japan’s top domestic issue for 2005. An account of this dramatic episode in Japanese history is provided below:

The privatization of Japan’s post office was a plank in Koizumi’s electoral platform already before he came into office in April 2001. The sheer size of such an undertaking made it impossible, however, for just about everyone to give it much thought. The Japanese post office is not only the single largest financial institution in the world, but it employs hundred of thousands Japanese civil servants. It is also an important source of credit to the Japanese government. It was for this reason that even his own party was surprized when Koizumi insisted that his proposal be put into law. Even as Koizumi was overseeing the preparation of appropriate legislation, strong opposition was building in both the opposition party and in Koizumi’s party -- the Liberal Democrats (LPD). Although legislation was finally submitted to the Japanese Diet for passage, Koizumi’s bill barely passed the Lower House and was defeated in the Upper House. Koizumi’s opponents were jubiliant and everyone thought it was the end of Japanese post office reform. Wrong!

LPD party leadership was shocked when Koizumi exercized his parliamentary right to hold new elections, and all of Japan paused to await the final outcome. If this were not enough Koizumi made certain that no one in his own party who had voted against his reform legislation would be allowed to run for office in the new election on his party’s ticket. When these same legislators withdrew their party affiliation and ran as independent candidates, Koizumi ensured their defeat by recruiting media celebrities and prominent business people to fill the vacated electoral LPD party slots. These actions led to acrimonious public condemnations of the Prime Minister from other members of his own party, as well as the opposition. Nevertheless, when the votes were tallied and Koizumi’s party emerged victorious, the leader of the oppposition party resigned in humiliation -- so overwhelming was the defeat.

The calling of new elections and the resignation of parliamentary leaders is certainly not something with which German voters are unfamiliar, but has such action yielded in Germany what has already occurred in Japan? Koizumi’s victory provided the green light necessary for Japanese leaders to bring Japan’s social and economic reforms to their successful conclusion. Germany still has a very long road ahead of it.

The final stages of the Japanese reform process were neither routine nor inconsequential. What began as a long arduous process of dissumulation and discovery in the early 90s ended in a dramatic orchestrated climax that now permeates a reform-minded Japanese psyche. What visible effects have these reforms had on Japan’s economy and Japanese society are visible in the following:

- THE CONSUMPTION TAX

Japanese voters are especially wary of tax increases, and when the need for tax increases arises in Japanese society politicians tread very carefully. In 1998 Prime Minister Hashimoto was driven from office when he sought to promote the introduction of a 3 to 5% consumption tax. So deep was his pain felt by other politicians, even tody there is no consumption tax in Japan. For many Germans who consistently pay a 16% added value tax the absence of a similar tax in Japan must appear incredible.

Although the need for a consumption tax is recognized by Prime Minister Koizumi he has been reluctant to introduce one for fear of offending voters. Nevertheless, such a tax is already on the drawing board for the moment that Koizumi vacates his post. In this way Koizumi will be able to keep his electoral promise, but his party can still act with good fiscal responsibility.

The now reform-minded Japanese public will easily understand the need for such a tax and will pay only as much as is required to cover the increased cost of medical and elderly care.

- SOCIAL SECURTIY

As is true for all industrially advance nations our populations are aging and the need for higher expenditure with regard to medical care and social security payments is being experienced everywhere among them. Japan has already addressed both of these issues and is much further ahead than Germany in this regard.

In Japan patients must bear 30% of their medical costs, and monthly payments for elderly care insurance are about € 280. In Germany one pays more than double this amount after retirement due to the higher cost of German health care delivery.

Social security reform legislation was passed in June 2004 under the Koizumi Administration. This legislation left Japan's national pension (kokumin nenkin) system in tact. Monthly payments into the system currently fall just short of €100 per month. These will increase to about €120 by 2017. In addition to Japan's national pension system that applies to everyone, there are also the employee pension and mutual aid pension funds that are paid into by both employees (50%) and employers (50%). By 2017 the current payment rate of 13.6% will rise to 18.3%. Until 2001 Japanese were eligible for retirement pay after the age of 60. By 2017 retirement entitlements will not kick into place until after one has reached his 65th birthday.

Average monthly income received by a pensioned Japanese household comes to about €1,700. After 33 years of work my own expected public pension from the German government will be just over €1,440.

In Japan, where both the desire to work after retirement and the willingness of employers to hire retired workers is stronger than in Germany, many retirees are filling labor shortages typically filled in other industriallly advanced nations by immigrant workers.

- CHANGING SOCIAL VALUES

Changing social values, demographic change and their associated financial challenges go hand-in-hand. Close family and community ties that once determined most human relationships have taken a heavy beating in recent years. Today, our thoughts and behavior are increasingly centered around the individual, and the pronoun "I" now dominates the pronoun "We" in most human communication. This trend is also very apparent in Japan; nevertheless, family, extended family, and community in the workplace remain important and the individual often takes a back seat. In this light Japanese workers are only let go by their employers in times of dire crisis, rather than as a routine cost cutting measure during economic downturns.

Not so long ago Hiroshi Okuda, Chairman of Toyota, the world's largest manufacturer of passenger vehicles, was asked about the reasons for his firm's success. He replied, "The fidelity and permanence of our workers and our investment in research and development". What contemporary German manager would ever attribute his firm's success first and foremost to its employees? In fact, one is quite likely to hear just the opposite. Is it not cost savings through work force reduction that is mentioned first, whereupon stockholders and business analysts clap their hands? The business strategies of German and Japanese firms are not the same, but Japanese firms are nevertheless very successful.

In general, foreign firms resident in Japan find it relatively easy to adjust their labor strategies to those of other Japanese firms, and as a result are very successful in most industries where they are present. Routine surveys made by the German Chamber of Commerce and Industry of German firms resident in Japan regularly produce very positive results that contradict what is often reported in the foreign media.

- FOREIGN ACQUISTION

The attitude of the Japanese public towards the acquisition of Japanese firms by foreign investors underwent significant change several years ago, when many Japanese firms overcome by debt and nowhere to turn for credit found their salvation through the invitation of foreign investors interested in obtaining a foothold in Japanese markets. They are no longer shocked to learn that a Japanese firm has become a foreign subsidiary; rather, they wonder with cool indifference. As evidenced last year in the so-called "Heuschreckendebatte" about foreign investment in Germany, German politicians have yet to reach the same level of openmindedness as their Japanese counterparts. Foreign managers are now accepted in Japan in top positions. Certainly the SONY corporation has led the way again by hiring its first foreign CEO, Sir Howard Stringer, a US and British citizen resident in New York City. US companies continue to dominate foreign investment in Japan and are more widespread than their German counterparts. Few Japanese industries are without a US presence.

In the end Japanese markets are a challenge for everyone -- foreign and domestic firms alike. Recent episodes in the corporate histories of both Sony and Vodafon bear witness to this fact. In particular, Vodafon, unable to hold its own, recently sold its Japanese subsidiary to Softbank and fled the Japanese market.

Cool reserve can also be observed in the reverse direction. While many foreign enterprises, such as Volkswagen, have been eager to establish a foothold in China and obtain first advantage in local markets, Japanese firms have hesitated and entered China with a very different strategy in mind. The low cost of labor and the proximity to Japanese markets have played a much larger role in the Japanese decision. In this regard, the quality of Chinese workmanship has often proven substandard for Japanese manufactures, and there have been reported cases of patent infringement. As a results, Japanese firms have retreated in part and now produce their high added-value goods at home.

- KOIZUMI’S DEPARTURE

What will happen after Koizumi leaves office is difficult to say. Surely his departure will have little effect on Japan’s current market upswing or the implementation of further reforms. Koizumi’s potential successors were hand-picked by Koizumi and will surely follow his lead. Whatever happens the astounding fact is that Koizumi , despite his enormous popular backing, is willingly surrendering the reigns of power. Where does such occur but in Japan? Certainly not in Germany, Italy, or England where leaders struggle to hold on to power to the bitter end.

- TWO JAPANS

In 2005 the Japanese media was abundant with discussion about the “New” Japan and the “Old” Japan. In this discussion Old Japan was characterized by Japan’s old guard -- those who, have always straddled firmly between the private and public sector, have yielded enormous power and influence insodoing, and have routinely avoided the political limelight. In short, Old Japan represents the behind-the-scenes political power brokers. The New Japan, in contrast, stands for political transparency, economic efficiency, and individual initiative. These Japanese are typically younger and far more outspoken than their Old Japan forerunners.

By way of closing, consider the following four examples of what New Japan looked like in 2005:

- Despite his ever dwindling fortune Yoshiaki Tsutsumi was still on the Forbes list of the world’s wealthiest people in 2002. He is probably best known among Japanese for his generous support of Japanese athletics. Last year he was charged on suspicion of accounting fraud and has since been convicted, fined and sentenced to prison. Mr. Tsutsumi is part of Japan’s old guard. The conviction and sentencing of such highly placed people rarely occurs in Japan.

- Also last year the Bank of Tokyo Mitsubishi and the Sumitomo Mitsui

Banking Corporation had entered into a bitter, open struggle for the takeover of UFJ, Japan's fourth largest bank. This sensational fight between two of Japan's largest corporations has received broad coverage not only in the international press, but also in the Japanese press. Corporate takeover struggles are not new to Japan, but the public coverage of such conflict is.

- Even more spectacular, but economically less important, has been the acquisition battle between Japan's internet firm Livedoor and Fuji Television for the NBS broadcasting company. Takafumi Horie is 33 years old and the founding president of Livedoor. His acquisition opponent is the 68 year old Hisashi Hieda of Fuji Television. The intense, open struggle between these two individuals personifies the larger social struggle between Japan's new generation and Japan's old guard. This particular struggle culminated with the arrest of Horie.

Finally, it is not everyday that a "gaijin" becomes the CEO of what is probably Japan's most famous multinational corporation -- the SONY Corporation.

I thank yo for your attention.