

Interview with Kazuhiko Toyama, Partner & CEO, Industrial Growth Platform, Inc.

Rise in Productivity Would Conquer Depopulation in Japan

By Japan SPOTLIGHT

Depopulation is often mentioned as a cause of the stagnant economy in Japan. “Local Abenomics”, the current government’s growth strategy to restore local economies facing the risk of further declines in growth than in the national economy, is trying to stop the trend of depopulation in local Japanese regions. It could be stopped if young people could get good jobs in regional areas and settle there, and get married and have children.

Kazuhiko Toyama, partner and CEO of Industrial Growth Platform Inc., is an expert on the restoration of companies undergoing a management crisis. At the request of the Japanese government, he served as COO of the Industrial Revitalization Corporation of Japan from 2003 to 2007, and has been engaged in planning the restoration and restructuring of a large number of companies in crisis. The holder of an MBA from Stanford University, he has drawn on his experience as a business consultant in publishing his views on the restoration of local Japanese economies and the depopulation issue, and he has been active in many international business and policy discussions.

Japan SPOTLIGHT had the privilege of interviewing Mr. Toyama for our leading article of the cover story in this issue.

Growth Potential of Japanese Economy

JS: Local Abenomics, I believe, is aimed at stopping depopulation by revitalizing local economies in Japan and encouraging young people to work in their home towns and have a family there. If depopulation stops, I think our economy’s growth potential will be enhanced. The Japanese government now has a new growth strategy target of 600 trillion yen in nominal terms for 2020. Would it be possible to achieve this target by this policy? How do you assess Japanese growth potential?

Toyama: Yes, I think the Japanese economy’s growth potential can be still much enhanced. Some of the government’s policies have resulted in much lower labor productivity, not necessarily intentionally but incidentally. In particular, those policies have resulted in extremely low labor productivity in the non-manufacturing sector among developed nations. Therefore, I believe that in spite of depopulation we can enhance the non-manufacturing sector’s labor productivity by



Kazuhiko Toyama, Partner & CEO, Industrial Growth Platform, Inc.

20-30% by eliminating policies that protect inefficient and incompetent companies. The question is whether we can truly eliminate them or not. This will be the key to the success of our growth strategy.

There are many policies that help the least competitive companies with very low productivity to survive. For example, the subsidy for employment adjustment is given to such companies to pay partly for the cost of their employees under suspension of business or for taking training courses when changing job. The credit guarantees of the Credit Guarantee Corporation are provided to the companies when they lend large sums of money for business operations. These policies occasionally help inefficient companies to survive competition and are thus considered as wasteful.

Preferential Tax Treatment for SMEs is also the wrong policy in this regard. Such measures are preventing low-productivity companies from exiting the market.

I believe that before thinking about innovation-encouraging policies, labor market reform, and regulatory reform, all expected to enhance productivity, we should think about eliminating policies that result in the preservation of inefficient companies as soon as possible. This would have an enormous positive

impact upon the growth potential of Japan.

JS: Are those inefficient companies protected by regulations?

Toyama: Yes. There are regulations limiting entries to the market, of course. However, I guess there are more policies serving to support and protect the uncompetitive companies and their negative impact is probably greater than that caused by regulations. In considering labor market reform, we need to strengthen regulations to force companies to observe labor standards or minimum wages before thinking about deregulation. With stronger regulation, we could expel businesses that exploit employees by forcing them to work long hours for very low wages from the market.

Need for Structural Reform Under Labor Shortage

JS: I think there must be many people opposed to the elimination of such policies that help preserve incompetent companies. For example, they might say that you should worry about the negative impact on employment, because if those companies disappear their employees would lose their jobs.

Toyama: I don't think so. I think that is nothing to worry about, because Japan is now seeing an unprecedented structural shortage in its labor force. We do not have to think about any particular policy to absorb such employees who may lose their jobs given these economic circumstances.

While the baby boomer generation was in the labor force, it was true that Japan had an excess of workers; but since the retirement of the baby boomers the Japanese economy has fallen into a structural labor shortage. This is being exacerbated by the aging of the population and the decline in the birth rate. We now have many aged people only consuming and not producing, and fewer young people working. This structural labor shortage will not be fixed until at least 20 years after the fertility rate exceeds 2.0 per woman. Assuming that will not happen in the near future, we will continue to have an economy with a structural labor shortage for a while. Thus for the time being, we do not have to worry about any increase in unemployment. The workforces coming from such inefficient companies after they have been eliminated would be easily absorbed into the other companies.

JS: What about the possible impact on income gaps? Would this end up expanding income inequality?

Toyama: With this policy, income inequality would decline. These inefficient companies or those exploiting their employees would be eliminated and the workers, who previously had little negotiating power, could move to more efficient companies that observe labor regulations. Thus, the income gap will shrink. I would say it would be the inefficient companies that maintain the income gap.

It is true that if we were to implement this policy while we had an excess labor supply, it would lead to expanding the income gap, since workers at inefficient companies would either become unemployed or

continue to work for very low wages. But given our current structural labor shortage, strengthening regulations to eliminate such exploitative businesses from the market and raising the minimum wage would work well to reduce the income gap and thus boost economic growth.

Another example of a necessary strengthened labor regulation would be the introduction of pecuniary solutions for undue dismissal, as recommended by the Regulatory Reform Council. Under a labor shortage, workers would be happier if they were given the right to choose whether to receive compensation for undue dismissal or have their job back, as the council has recommended. They could get compensation and move to another job, since there would be many new job opportunities. Without such pecuniary compensation, the workers dismissed would have no option but to take their company to court to seek the restoration of their job, while doing part-time work. This recommendation favors the employees in this regard.

In Japan it would be easy for SMEs to dismiss their employees, but the introduction of pecuniary compensation through this strengthened regulation could empower employees and let the labor market principle win against employers who have exploited their labor force.

This would promote the survival of the fittest in the market as well as labor productivity. In my view, this labor regulation should be strengthened only in favor of companies with good working conditions.

JS: Should the labor market situation be different then between Japan and, say, the United States and Europe?

Toyama: Yes. In the US and Europe, their economies are always under pressure from potential unemployment, which is completely different from Japan. In Japan, raising the minimum wage would lead to a rise in productivity under a labor shortage. The same policy adopted by the Singaporean government in the 1970s was instrumental in promoting reform towards a high value-added industrial structure. I recommend such a policy not to achieve income equality but to encourage structural reform under a labor shortage.

Stopping Depopulation

JS: On a different note, while we need to work on raising productivity, we would also need to stop depopulation and increase the labor force. How can we do this?

Toyama: We would need to strengthen regulations again, instead of deregulation; in this case, it is necessary to prohibit setting a retirement age. A retirement age should be considered as age discrimination and as such should be banned, as it is in the US.

We must also strengthen rules on the same wages for the same jobs. In the case of the manufacturing industry, they have ambiguous job descriptions and workers are expected to do anything, but full lifetime employment is assured. However, in the majority of service sectors this would be meaningless, since their job descriptions must be very clear, as in the case of truck drivers, airline pilots, cabin attendants, etc.

Therefore, at least in the case of such sectors, a rigorous application

of the principle of the same wages for the same jobs would enable more people to join the labor force and thus contribute to economic growth. This should be well understood by Japanese businessmen.

Only 20% of the total labor force work for large enterprises in the manufacturing sector, while 80% of the total working population work in non-manufacturing sectors where they have very clear job descriptions. The principle of the same wages for the same jobs should be adopted for the mainstream of workers. If it is adopted in such sectors, women and older people would find it easier to return to their jobs after temporary leave to give birth or after initial retirement. Doctors and lawyers are typical examples. It should be noted that manufacturing workers whose job descriptions are not clear are now a minority. Our policy discussions must reflect reality for average people so as to avoid a bias towards those with strong influence, such as the senior management of large companies.

JS: What about the question of foreign labor? Foreigners could fill the gap between demand and supply in our labor market, especially given that we will have a bigger labor shortage as demand increases in preparing for the Tokyo Olympics and Paralympics in 2020.

Toyama: My answer is simple. We should not accept cheap foreign labor. We should accept foreign workers only on condition that they work by the same labor standards, such as minimum wages, as Japanese workers. With the introduction of cheap labor, the discipline of management would be lost. We must apply the qualification for a visa or green card to them as strictly as possible. If they are not skilled workers, we must prepare training courses for them. There are a number of such skills-training courses today that are very unsuitable and result only in helping unskilled cheap labor get into Japan. We must stop them as soon as possible, as they will not contribute to economic growth. The introduction of cheap foreign labor will not have any positive consequences but rather negative ones, such as no contribution to growth or negative impressions of Japan among non-skilled workers exploited by businesses through long working hours at cheap rates. We should try to eliminate such businesses from the Japanese market soon.

JS: The effects of structural reform seem unlikely to emerge clearly anytime soon. How can we perceive the merits of structural reform in more tangible terms?

Toyama: In service sectors or SMEs, you would have to recognize the increase in permanent workers or the significant rise in wages for non-permanent workers. This must be perceived as a positive consequence brought about by structural reform.

For example, though the tourism industry is today considered one with the lowest wages, as companies like Disneyland that offer high wages and enjoy high productivity increase their share of the sector, the average wage level in the whole sector will rise as well. Structural reform is, as this shows, raising the share of high-productivity sectors or companies among all businesses and industries, encouraging low-productivity sectors or companies to exit the market, and shifting the

resources of those exiting companies or sectors to the high-productivity ones. We would sense the merits of such structural reform, maybe, by seeing an increase in demand for permanent jobs or jobs with excellent working conditions to attract competent housewives or aged people who truly want to work hard. If we see many incompetent small companies exiting, that would also be a concrete sign of progress in structural reform.

Stimulating Local Economies

JS: If competent young people find good job opportunities in local economies and settle there to have families, would this be a key to stopping depopulation?

Toyama: I think it would be easy to understand this issue by distinguishing local industries from global industries. Local industries like caregiving, retail or wholesale, and restaurants all exist in Tokyo as well and 70% of the employees in Tokyo work for such industries. In Tokyo, the cost of living is very high, so an annual salary of 5-6 million yen would be considered very low relative to living costs. Therefore, people working in such sectors in Tokyo will find it difficult to get married and have children. However, if you go to local regions, the cost of living is much lower and the salaries of workers in the local industries there are even lower than in Tokyo.

But in the case of industries in a local economy, if you can raise salaries slightly, then workers could afford to have children with less expensive living costs.

If you raise their annual salary from 3 million yen to 4 million yen, the feasibility of having children would also be raised. So I believe that how much you can raise the salary relative to living costs would be crucial in terms of stopping depopulation. In a local region in Japan, you can have two kids with a 5 million yen annual salary, while you would need 10 million yen in salary in Tokyo to achieve the same level of living as in a local place with a salary of 6 million yen. Thus it would be easier in a local area to achieve a satisfactory standard of living than in Tokyo.

In addition, there must be much more room for enhancing productivity in a local area, as the existing quality of management is very low and there are still lots of low-hanging fruits. Hotels, bus transportation, and retail businesses in local areas are all covered by my company's restoration planning and in the light of my experience these local companies are overprotected to fill in the gap with Tokyo, and as a result they are poorly managed. It is also true that many competent people have tended to move to Tokyo since the beginning of the modernization of Japan in the second half of the 19th century. Thus, in local areas, there are not so many competent people remaining. This is a salient characteristic of the catching-up process in Japan, a significant degree of centralization having been considered the most efficient way of economic development. But this model will not be effective at all after the catching-up process is over.

JS: But many Japanese still think about moving to Tokyo as a way to achieve success.

Toyama: Yes, they do. But it is not necessary anymore to have so

many competent people in Tokyo, since the economy of Tokyo is already reaching maturity. Many of these people cannot fully utilize their competency in Tokyo. If they were to go to the countryside, they would find many good job opportunities. They could help restore local businesses and enhance the productivity of local economies, and if they could then raise employees' salary by 1 million yen we would be able to resolve the issue of depopulation.

JS: Tourism, medical services and agriculture seem to be considered key sectors for stimulating local economies. Is that right?

Toyama: Yes. You cannot expect a lot of job creation from the manufacturing industry.

Tourism, medical services and agriculture, which is closely linked to tourism through the food business, would be the businesses absorbing most employment, as you said. Competent people whose management skills and potential have not been fully utilized in Tokyo could work well in revitalizing these sectors in local economies.

Thinking about this, we should stop so many young people from coming to Tokyo to work. The large companies in Tokyo are now exposed to serious global competition. There will be fewer people than before who can achieve business success under such competition. Tokyo is not a place to gain business success easily anymore. Young people would have to know it well. Tokyo will be a place of global competition among elites and experts, just like Olympic athletes. You can't expect a new model of the middle class in Tokyo, but you can in local regions. For example, on the occasion of the Tokyo Olympics and Paralympics in 2020 there will be many tourists coming to Japan and it will be the tourism industry, one of the main local industries, that welcomes them.

JS: Could the Tokyo Olympics and Paralympics stimulate the local tourism industry in Japan?

Toyama: Yes. A key question is whether or not the tourism industry in Japan, a typical local industry and poorly managed so far, can become a full-fledged industry supporting the middle class by taking advantage of this occasion.

JS: How can they turn this low-wage industry into one that young people would choose to work in with high expectations?

Toyama: All the low-productivity companies usually run by a family should be gone. In their business model, only the owner family gets very rich and the employees work for the lowest wages. This is what happens in the management of Japanese local inns and hotels. Those firms should be expelled from the market and high-productivity modernized firms should replace them.

JS: Foreign affiliates seem to be active in the tourism business today in Japan. Will they contribute to raising the productivity of the tourism industry here?

Toyama: Yes, indeed. It is true that US and European firms in tourism

are far more efficient and competitive than Japanese ones. In competing against them, Japanese tourist inns and hotels need to provide locally unique but globally appealing services for tourists coming from overseas if they are to survive. They should be more conscious of what their service deserves in terms of price. For example, the average service in a Japanese inn covers two meals per night plus what we call butler service providing the guests with guidance on tourist spots. They price this usually at little more than 10,000 yen, while in Europe the cost would be 30,000 yen at least, maybe even 100,000 yen, for similar service. Such a poor pricing custom should be given up. With Japanese hospitality, they should ask the guests to pay 30,000-40,000 yen per night.

Foreign affiliates would think about business rationally. That is welcome to us. They would expect a high return on investment from areas with low productivity and bad performance, while large Japanese companies would pursue assets that produce high revenues. So large Japanese firms would not invest in local businesses like tourism, since they believe that they cannot gain profits from local businesses with low growth. But from assets with high revenues you earn only low ROI, since investment in those assets comes at a high price. This is how the mindset of large Japanese businesses limits their performance.

Corporate Governance Reform

JS: Will the current reform of corporate governance in Japan by introducing independent directors to encourage boards to evaluate their business performance more objectively, namely by ROI, change Japanese business behaviors?

Toyama: Yes, I hope so. Japanese companies have always pursued growth without profits. However, ROI should be the relevant estimate of investment rather than growth. They tend to believe that the Japanese economy will not grow due to depopulation and they do not invest enough in the domestic market. But this mindset should be corrected. The reform of corporate governance will hopefully change this attitude towards a more efficient use of capital and promote awareness that the growth of productivity will be a source of ROI. With this changed perspective, there would be enormous business opportunities in the Japanese market.

Depopulation does not matter. The scale of the economy will be more largely determined by productivity than by population. The world economy has grown about 40-fold in the past 100 years, while the global population has increased only four-fold and labor productivity has risen by 10 times. Therefore, whether the population decreases or not, areas with low productivity would always provide business opportunities, as the ROI there is very high. Local Japanese economies have low productivity and therefore much room for growth, whether their population declines or not. So it should be noted that Japan's low economic growth rate today has been caused not by a slowdown in population growth but by low growth in productivity. **JS**

Written with the cooperation of TapeRewrite Corporation.