

Rethinking Capitalism in Era of Global Recession

By Editorial Staff, *Japan SPOTLIGHT*

Introduction

Recent economic indicators show a clear trend toward a slowdown of the global economy. This can be seen in the deceleration of the US GDP growth rate in the second quarter and in the deceleration of mining and industrial production in Europe. In Japan, there are reports of slower GDP growth in the April-June quarter and a worsening of consumer confidence. (Charts 1&2) After the Lehman shock, China, which had led the global economy, has been artificially slowing down its economy by tightening credit to end the housing bubble that occurred because of the loose monetary policy implemented to alleviate the economic crisis.

In spring 2009, the global economy appeared to have suddenly recovered, but this was only a V-shaped recovery – a backlash to the extreme suddenness of the post-Lehman decline – caused by the emergency fiscal action taken after the Lehman debacle. It did not mean any solution to either the chronic lack of demand reflecting the worsening of private-sector companies' balance sheets in various countries sparked by the collapse of the housing bubble in 2007, or the resulting increase in the pressure on companies to repay their debts. Therefore, the global economy is in effect facing the danger of a double dip, and we have to find ways out of this situation.

Private companies in various countries are now moving quickly to repay their loans, and despite low worldwide interest rates, the private sector is in no position to actively increase investment. Some are of the view that as long as lack of demand in the private sector continues, governments cannot reduce the fiscal deficit and must continue to support private demand.

Meanwhile, in view of the danger that accumulated fiscal debts could bring about the collapse of a national economy as exemplified

by the Greek crisis, some think that fiscal action should be rapidly repealed since economic recovery is well under way. Also, as fiscal stimulus measures look set to continue for the long term, a backlash can be seen against so-called “big government” becoming the norm. In the United States, the emergence of the Tea Party, supported by conservatives and separate from the two-party government, is a good example of this.

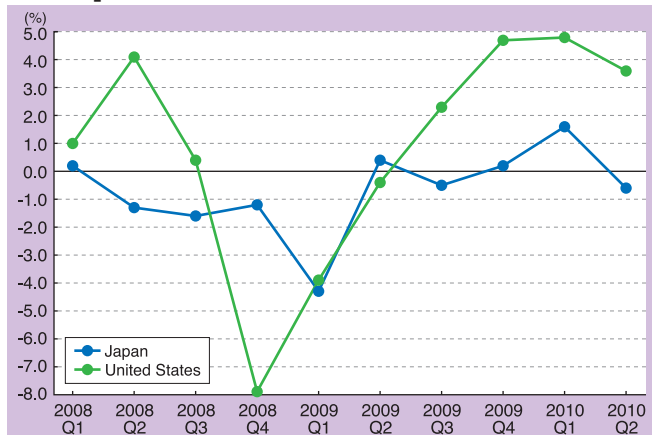
If the structural lack of private demand mentioned earlier is a fact, the state of capitalism, including whether “big government” is inevitable or whether “small government” should be aspired to even in such economic conditions, appears to depend on how one sees a role division between the market and the government.

The Japan Economic Foundation has actively organized symposia and study groups on these issues since the start of 2010, and conducted research on capitalism in the “global economic crisis” era, and on the type and style of contributions Japan should make toward resolving these issues. Below we outline these debates for your perusal.

Since the economic crisis, negative opinions have been appearing throughout the world, including distrust of the “market economy” and the “modern economics” behind it, and even of GNP and economic growth itself. Meanwhile, noneconomic values such as “culture” and “ethics” appear to be being overvalued as well. We feel uneasy about such extreme trends. In contrast to the rapacious capitalism symbolized by the subprime loan frenzy that sparked off the financial crisis, traditional capitalism since the time of Adam Smith emphasizes ethics, based on assumed economic activity.

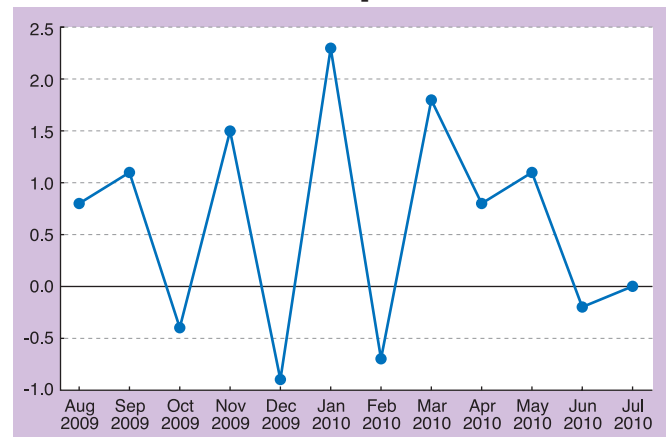
We should not forget that the “market economy” that assumes minimum ethics has brought many benefits to humanity. Through the activation of the market economy, humankind has learned that economic prosperity makes it hard to wage wars. Through economic

CHART 1
Nominal quarterly GDP growth rates of Japan & United States



Source: GDP/Business Activity/Economy SITE

CHART 2
Eurozone industrial production index



Note: % change from previous month
Source: GDP/Business Activity/Economy SITE

globalization, many developing countries have achieved economic development, and poverty is gradually disappearing from the world to some extent. In the post-WW2 development of the Japanese economy, the activation of both market competition and innovation has played a large role. Equal income distribution was also brought about in many cases by the market mechanism. In fact, often the inequality of different incomes for the same ability was the result of nonmarket factors such as regulation and employment practices.

We feel it is important to have a balanced opinion in regard to the market economy, a fundamental element of capitalism. Also, it is inappropriate to make light of economic growth as a materialistic concept or, in an extreme position, to regard the “economy” itself as the enemy. One of our editors recently gave birth to a child, and she simply cannot contemplate bringing that child up in a world without any economic growth.

Below we suggest ways in which Japan can contribute to resolving the crisis in global capitalism and to creating an ideal form of capitalism out of the currently existing many different forms.

What Is “Capitalism with Caring Spirit?”

For the 42 years since 1968, Japan was the world’s second largest economic power after the United States until China overtook it this year. By 2020, India will probably also overtake Japan. Should Japan’s citizens feel despondent about this?

No. The essential point is not quantity, but quality. We should be proud not of the scale of a country’s GDP, but rather of GDP per capita and the amount of happiness per individual.

In the first place, what position has Japan been given in world history? One important point is the historical meaning of Japan’s being the first country to succeed in making a free capitalist economic society in the non-Western world. How was Japan able to do this?

Edward Morse, who came to Japan in 1877, was a professor at the University of Tokyo and is known as the discoverer of the Omori Shell Mounds. In his book *“Japan Day by Day”* on his impressions of Japan at that time, he wrote: “Japanese people are born with a politeness in behavior marked with virtue and character, and sensitivity towards others’ feelings, the burden of moral training, dubbed ‘humanity’.” (Photo 1)

Morse stressed that “not only the well-off ranks but even the poorest people have these same traits.” Many other Westerners who visited Japan around this time were also impressed by the “openness,” “affinity” and “civility” of Japan.

Open to and keenly interested in different kinds of civilization from their own, kind, and well-mannered – this is the vision of Japan that most contemporary foreigners had. Further, the view of many Westerners, as described by Isabella Bird, the Englishwoman who penned *“Unbeaten Tracks in Japan,”* was: “As you can see from their attitude of being neither obsequious nor self-asserting, members of every class in Japan enjoy personal independence and freedom.”

In his *“Bushido: The Soul of Japan”* written in English in the Meiji era (Photo 2), Inazo Nitobe proudly praised Japan’s virtues to the

PHOTO 1

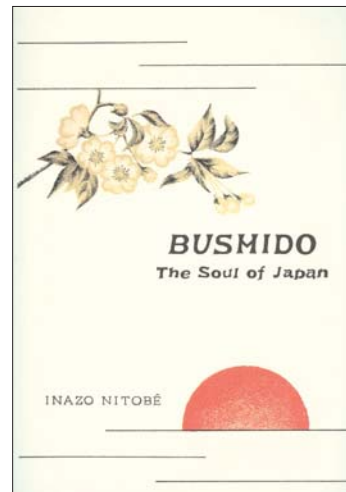
Photo: Yukishi Yo No Omokage By WATANABE Kyoji 2005 Heibonsha Ltd.



A woman prostrates herself as she submits a bill to a customer.

PHOTO 2

Photo: Shokabo



The cover of “Bushido: The Soul of Japan” reproduced in 1994

world. The author saw the virtue and character possessed by the Japanese people as having their source in the Confucian teachings of the “Right Reason” as an absolute command, and “a sympathetic regard for the feelings of others” as an absolute virtue, while personal honor from an ethical viewpoint rather than based on material desires is the driving force behind Japan’s development. He believed these values should be conserved as Japan’s cultural heritage.

“*Representative Men of Japan*,” written in English by Kanzo Uchimura, mentions several enlightened Japanese leaders, including Uesugi Yozan, the strong leader of the Yonezawa clan who implemented fiscal reform in the late 18th century, and Ninomiya Sontoku, who conducted reform to improve production in Japan’s poor agricultural villages.

These figures, along with Adam Smith, share a high esteem for the power of morality and ethics in economic reform and for an independent spirit, as well as a disdain for financial support as a cause of idleness and avarice, and believe that a leader, in his or her parent-like position, should have high ideals; properly manage the people’s independence, mutual assistance between neighbors, and national policies; and let the nation be one where diligence, love and independence rule. This ideal, especially in Uesugi’s case, has something in common with former US President John Kennedy’s famous words, “Ask not what your country can do for you...ask what you can do for your country.”

These kinds of idealistic traditions were background factors in the economic development of Japan, the first non-Western modern country in the 20th century to be based on a free-market economy, in a similar way to how the origin of the philosophical foundation of Western capitalism can be seen as lying in Puritanism.

Nowadays, when a kind of capitalism different from Adam Smith’s, one that can be called unethical and greedy, has broken down through the financial crisis and new forms of capitalism are being sought, showing the world Japan’s original capitalism, based on its national identity, could make an important contribution.

The “openness,” “affinity” and “civility” mentioned by Morse, and the “individual independence and freedom” found by Bird are surely Japan’s model of democracy, built on the basis of the “Right Reason” and “a sympathetic regard for the feelings of others” that Nitobe boasted of and “stressing the power of morality and ethics as elements in economic reform” expressed by Uchimura; that is, a “capitalism with a caring spirit,” so different from the dog-eats-dog-type of capitalism, is Japan’s true identity.

As “a state with a high degree of satisfaction based on people helping one another,” shouldn’t Japan also aim to be “a responsible country overflowing with civility and kindness?” With the govern-



ment and the people both carrying out the responsibility to attain a high degree of happiness, built on the satisfaction of the people, Japan would then be a truly responsible, high-quality country that could help other countries.

This type of “Japan model” of capitalism is actually not so far from the thinking of traditional economics. We have stressed “independence and kindness” as characteristics of the Japan model, but traditional economic theory also has human beings with such features as its core assumption. The Japan model of capitalism can in fact be considered close to Adam Smith’s capitalism.

When discussing the desirable future form of capitalism, how the “roles of the market and the government” should be allotted is a core concern. The “welfare economics,” a research field of traditional economics, holds the following view.

Originally, in the capitalist economy that assumes a market mechanism with individualism and personal responsibility, it was sufficient for the government only to streamline the economic environment such as law and order so the market could function fully while the government itself did not need to conduct economic activities. However, in the actual economy, the market mechanism also has demerits and, in response, welfare economics expects the government to fulfill the following four functions.

First, the government should provide “public goods” such as medical services which, if left entirely to the private sector, will not reach socially desirable levels due to insufficient profits.

Second, if things are left to the market, society is not necessarily able to realize an ideal allotment of income as a whole in the presence of differences in terms of asset ownership from the start. Therefore, the government should redistribute income through taxation.

Third, the government should play the role of stabilizing the business cycle through fiscal and monetary policies from a macroeconomic perspective.

Fourth, in the long term, the government should implement policies that consider benefits for future generations (for example, public infrastructure and the education system).

Clearly, the “Japan model” of capitalism is the most appropriate for the kind of society this type of welfare economics seeks. All four functions mentioned above are for the public benefit of society as a whole. “Civility and ethics,” the foundation of “caring,” can be seen as playing the greatest role in fostering this public spirit common to the four functions. Meanwhile, what characterizes Japan’s capitalism

is for each member of society to have a “spirit of independence” so that individuals do not overly depend on the welfare policies of a society based on the caring and public spirits.

A “welfare state” by itself often tends to result in moral hazard on the part of people, and may also bring about a lack of innovation, the driving force of the economy. Amid an increasingly aging society, the Japan model is intended to bring about a kind of welfare state that does not have these negative effects.

What Are Public Policies of “Capitalism with Caring Spirit?”

1) The first policy issue is the realization of “advanced welfare,” which relates mainly to the function of providing public goods. It has three aspects.

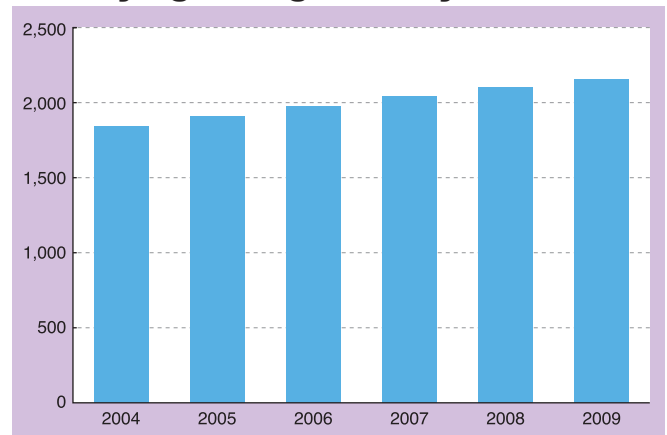
The first aspect is the tackling of aging, now a worldwide phenomenon, in a pioneering manner. Japan, which will experience an aged society first, should provide a world model of social welfare in measures to cope with aging as a nation able to fuse economic strength and ethical kindness.

In doing so, it should be emphasized that these measures are clearly meant to further individual independence. For example, there could be a system where “everyone is independent and can approach old age without worry.” The minimum pension level could be raised to the world’s highest level. Meanwhile, for those with high income, benefits could be reduced in a graduated way. For people able to live alone, local municipalities would provide support for independence while care facilities would be provided for those unable to live alone, thus offering an environment where they could live without worry regardless of personal wealth. We must also further improve the quality of nursing-care insurance. Creating a nondiscriminatory, gender-free, age-free society will increase employment opportunities for the elderly.

Second is a comprehensive response to the trend toward having fewer children. The future of Japan depends on the imagination and ability to act of today’s children. We must expand the child-raising infrastructure (provide just the right number of child-care facilities), (Chart 3) reduce child-raising costs (child benefits plus free education up until high school, but only for households with less than a certain income level), and improve the working environment for

CHART 3

No. of childcare facilities in Tokyo growing steadily



Source: Compiled by JEF from Tokyo Metropolitan Government data

child-rearing people (introduce child-raising leave equally for both men and women, TV conferences for participation from home, etc.).

The third aspect is a broad-ranging response to unemployment, implementing a thorough unemployment safety net and occupational training for those unable to find work. For example, this could mean improving unemployment insurance linked to occupational training, including for temporary employees; strengthening national support for smooth labor transfer utilizing private-sector reemployment support companies; and especially strengthening the fostering of personnel in growth fields such as the environment, tourism, nursing/medical care, and high value-added agriculture.

Exploiting only one of these three factors is not enough. All must be fulfilled, using a balanced approach. For advanced welfare, a certain burden cannot be avoided, but this burden does not necessarily have to be large. While realizing high growth, a taxation system that enables advanced welfare with a medium-sized burden is essential.

In the following public policy issues, the coming generations should be duly considered.

2) The next policy issue after “advanced social welfare” is “maintaining advanced dynamic power.” An aging society does not have to mean reduced dynamic power. Even as aging advances, we should aim to maintain strong industrial competitiveness, thus enabling advanced welfare with a medium-sized burden. There are five relevant points here.

The first – and inevitable – point is to strengthen industrial competitiveness. To that end, manufacturing, which earns foreign currency, and the service industry, which absorbs unemployment, should be made the two main industrial pillars. In conjunction, full-time farming should be given gradated support and agriculture with high added-value should be developed as an export industry offering “safety, tastiness and beauty.” For the manufacturing industry, this means building up Japan as an R&D base and positioning Japan as the mother factory while linking the domestic manufacturing process with production networks in East Asia. The manufacturing process should make use of its domestic advantages by focusing on sectors such as those that require rapid, large-scale investment, those featuring intellectual property, those utilizing industrial clusters including partnerships with SMEs, etc.

Most industries remaining in Japan will have to be high-tech and capital-intensive. In this case, we must strengthen competitiveness and maintain the manufacturing industry by lowering the corporate tax to the world’s average level, having countries importing Japanese products abolish customs duties through conclusion of EPAs and reducing service link costs (lowering the cost of using hub harbors and airports, promoting deregulation, etc.).

Now the United States and Europe, regretting the special treatment that was previously given to the service industries centering on finance, are beginning to return to policies favoring the manufacturing industry. However, it may already be too late for some countries.

Reducing the corporate tax is also necessary for the promotion of investment in Japan by foreign companies. Further, for the acceleration of EPA negotiations, abolition of the rice harvest adjustment policy and a system that gives extra support to full-time farming will lead to strengthening agricultural competitive power, although income compensation is effective. This is an urgent issue for manufacturers as well as for farmers because abolishing customs duties on mining and industrial products on the part of importing countries will improve the manufacturing industry’s export environment.

PHOTO 3

Photo: Kyodo News



Tourists listen to a guide explain about the snow-veiled Golden Pavilion in Kyoto.

Industries such as the environment, healthcare and tourism, in both their manufacturing and service aspects, are fields where Japan has an edge. Japan should not spare efforts for bold deregulation in the healthcare sector and initial investment aid for fostering the environment industry. Regarding tourism, Japan is a country specially blessed with four kinds of tourism resources: historical heritage (*Photo 3*), hot springs for healing and relaxation, resorts, and industrial facilities. We need to develop infrastructure friendly to the elderly and foreigners (more barrier-free facilities and more multilingual information).

We welcome the goal of 20 million foreign tourists by 2020 advocated by the Ministry for Land, Infrastructure, Transport and Tourism and anticipate bold measures toward achieving this end, such as eliminating and simplifying visa procedures, rapidly improving multilingual infrastructure, and accomplishing greater convenience, labor saving and cost reduction by use of IT.

The second point is that some sectors need regulation. In finance, appropriate regulation should be introduced to avoid a repeat of the Lehman shock resulting from “failures of the market.” Concerning the influence that neo-liberalism has had on the economy during the past 10 years, the dominant view is that the problem was not the resulting deregulation or competition, but rather the financial sector and its lack of supervision. Powerful supervision of the finance sector is needed.

The environment is another sector where regulation is needed. For example, for the introduction of next-generation eco-cars such as those using solar photovoltaic or electric energy, it is desirable to combine investment promotion under a certain regulatory regime with greater aid to shorten the number of years to recoup invest-

ment. The environment field, expected to be a growth industry amid the acceleration of measures to counter global warming, requires the right combination of goals and regulations with aid measures.

Third is promotion of R&D (Photo 4). To maintain and improve the competitiveness of the manufacturing industry, Japan must continue developing technology of the world's highest level. Many newly developing nations are steadily catching up with Japan's technological level, but Japan's response should not be to stop technical transfer to such nations, but rather to continue its efforts to advance R&D even further. For the purpose of establishing global R&D bases in Asia, a few model footholds of industry-academia-government partnership should be set up while the world's top engineers should be gathered, the research environment streamlined and an international postgraduate school function allied to overseas advanced universities established.

Fourth is support for entrepreneurs. Entrepreneur education and provision of "soft infrastructure" for such education (building support networks for lawyers, accountants and corporate personnel; expanding venture capital networks, etc.) are the foundation of entrepreneurship, the source of strong dynamism. Entrepreneur education means building up a spirit of being unafraid of failure while transmitting various experiences and the means to overcome difficulties; such education in developing the entrepreneurial spirit of taking on challenges should be started at an early age, while it is also essential to implement lifelong education enabling housewives who have completed child-rearing and post-retirement seniors to start up new businesses.

To realize strong dynamism along with advanced welfare, we need to have healthy older people fully display their talents, so it is important to bolster the environment supporting them. Also, to support bio-ventures, the main pillar of the healthcare industry, Japan should set up university hospital bases that conduct commissioned manufacture, research and personnel education of biomedical goods as well as joint research assistance for bio-ventures and hospitals.

Fifth, conducting half of all university education in English and thus fostering globally active personnel would also be a source of great dynamism. To enable foreigners to enjoy tourism and healthcare in Japan and to improve the international competitiveness of

these formerly domestic-only industries, service providers need linguistic ability.

3) The third public policy issue is to improve the quality of life. This requires us to establish a reputation among foreigners that Japan is a pleasant country to visit, invest in and live in. This encompasses four factors.

The first factor is improved "safety and peace of mind." Although Japan already has a high international reputation in this regard, we should further mitigate product and food safety concerns, enhance the safety of transportation systems, and ensure public security and environmental protection. It is also important to achieve international standardization in Japan's technology, regulations, standards and specifications related to safety and peace of mind in cooperation with other Asian countries. This would also tie in with the establishment of safety and peace of mind in other countries in Asia, a growth center. This would also improve the foundation for economic growth, creating a business environment conducive to Japanese corporations and improving Japan's level of contributions to these countries' development. Japan can especially contribute in fields where it has expertise, including the smart grid, nuclear power generation, fuel cells and electric vehicles from the viewpoint of environmental protection, and high-speed railway and road systems from the perspective of maintaining safety and peace of mind. The safety of food is also a critical issue these days.

The second factor is further improvement in housing quality. Japanese people need homes that they can be pleased to invite foreigners to visit. As well as bringing expansion of domestic demand in Japan, this is vital in order to have foreigners stay here. We need to expand investment in good-quality homes (with space of at least 100 square meters for a family of four and a high level of ecologically friendly equipment) by making use of personal financial assets amounting to 1,400 trillion yen. It is also necessary to spread energy-saving, ecology-minded houses and second homes through such measures as expansion and upgrading of housing finance and taxation, and preferential treatment of inheritance taxes.

The third aspect is to improve barrier-free infrastructure. As aging advances, this is essential for realizing a comfortable society. For example, we should promote barrier-free homes by establishing elderly-friendly homes that are safe to move around in and where falls are prevented, and reduce the burden on caregivers by constructing top-quality homes and promoting renovation.

Making public transport/road systems and tourist spots barrier-free must also not be forgotten. To enable the elderly to live in local areas without worry, it is also important to step up partnership with local networks of providers of medical/nursing care and health-related services, and develop tools to support a home-based lifestyle by using ICT so that elderly residents can easily obtain all necessary services.

Japan should not merely work to further social security for the elderly but also build a barrier-free environment ensuring healthful lifestyles with peace of mind for both

PHOTO 4

Photo: Kyodo News



An ES/iPS cell research lab for iCeMS Gifu University Satellite

Japanese and non-Japanese. As a result, the elderly will become more socially active, new fields of senior-oriented services for life-long learning will be generated, and employment and entrepreneurship opportunities for the elderly will increase.

The fourth factor is to increase support for young people's voluntary activities. For example, all university and technical college students could experience at least three months of volunteer activities, e.g., as an assistant to welfare workers or caregivers in Japan, or helping with overseas ODA activities, and academic credits could be given for these activities. Companies could also take such experiences into consideration when hiring new staff.

What Foreign Policy Can Contribute to “Capitalism with Caring Spirit”?

In order to realize the public policies mentioned above, it is essential to develop “capitalism with a caring spirit” which will spring from harmony between Japan-style ethical kindness and the market mechanism. And, for this Japan model of capitalism to contribute to the stability and prosperity of the global economy, the following foreign policies – Japan's “high-level contributions” as a “state with responsibility” – are important. These contributions entail turning around the traditional concept of “world peace and stability, and the economic prosperity that underpins them” to a Japanese style of “supporting economic prosperity and then establishing peace and stability on the basis of that precondition.” There are five elements to this.

The first is expressing leadership in global governance with Japan-style “capitalism with a caring spirit.” (Photo 5) Specifically, as the framework of governance for discussion to resolve urgent global issues evolves from the G-8 to the G-20, Japan should also play the role of a framework manager with abundant conceptual ability so that effective global decision-making can be made by permitting the member countries involved in governance frameworks to change flexibly according to issues such as coping with the global recession, concluding the Doha Round, and developing a post-Kyoto Protocol framework for protecting the global environment.

For the promotion of trade liberalization, for example, Japan should promote FTAs among not only nearby countries (e.g., ASEAN+6 or ASEAN+3) but also major consuming economies (the EU, China, the United States, Brazil, etc.) as a means to supplement consensus formation through the WTO. At the same time, Japan should push ahead with dynamic steps by exerting leadership in regional cooperation such as in APEC and East Asia.

In the development field, the World Bank and the IMF should be improved so that they can offer assistance based on respect for the circumstances of the area in question and, at the same time, they should build supplementary networks with local aid organizations such as the Asian Development Bank (ADB).

Second, Japan must boldly display its inherent technological power and presence in the formation of a governance system and in pioneering activities in “global commons,” the common heritage of all humankind which, like the oceans and space, does not belong to any one country. In particular, Japan has broad-ranging will and ability to play a constructive role in the development and use of outer space. It is a contribution appropriate for Japan, for example, to establish an earth observation satellite network in Asia, serve as a watchdog for the environment and disaster prevention, and ensure the minimum amount of damage in the event a disaster does occur.

PHOTO 5

©UN Photo/Eskinder Debebe



Japanese Prime Minister Naoto Kan (left) meets with UN Secretary General Ban Ki-moon.

Third, Japan can help eradicate global poverty and income disparity through its own style of economic cooperation stressing economic development. Based on the view that economic development brings peace, Japan should contribute to poverty elimination and peace building in low-income countries by not only promoting trade liberalization and low-interest financing aimed at encouraging self-reliant efforts instead of grants but also by streamlining business infrastructure for industrial development, learning from the Asian economic development model. Japan should spread “capitalism with a caring spirit” by taking advantage of its strengths such as unique technologies and products like those associated with the environment, health, agriculture and IT.

The fourth element is actively using Japan's “soft power.” These measures could quickly further Japanese-style humanistic contributions, such as the use of *anime* and other aspects of Japanese culture in promoting peace activities and spreading the philosophy of the futility of war, as well as contributions to human security such as humanitarian and reconstruction assistance and support for peace building.

Finally, the fifth point is somewhat different in quality from the above four elements. It should be stressed that Japan's initiative is critical in reducing nuclear weapons to maintain world peace, a fundamental prerequisite for a stable global economy. Japan is the only country that has experienced atomic bombing, and this horrible calamity remains in the national psyche. Fully utilizing the international momentum for reduction of nuclear arms, Japan should play a leadership role in all related fields such as nuclear arms reduction, nonproliferation and the peaceful use of nuclear power in cooperation with other nonnuclear nations such as South Korea, Australia, Canada and Germany. For example, advancing the banning of preemptive nuclear attacks on NPT-signatory countries would clearly show non-signatory countries the cost of staying outside the treaty.

Finally, comprehensive international networks should be strengthened so that weapons of mass destruction do not get into the hands of terrorists or countries of concern, and leadership must be shown in technological innovation toward disabling such weapons.

During the last decade, there has been criticism of Japan as a “withdrawn” or an “introverted” country. In this time of crisis, it is important for Japan, the world's third largest economic power, to properly listen to such criticisms and, as a “state with responsibility,” to offer this Japanese-style model of capitalism to the world. **JS**